G20 Leaders' Communiqué

Antalya Summit, 15-16 November 2015

Introduction

1. We, the Leaders of the G20, met in Antalya on 15-16 November 2015 to determine further collective actions towards achieving strong, sustainable and balanced growth to raise the prosperity of our people. We are firm in our resolve to ensure growth is robust and inclusive, and delivers more and better quality jobs. We recognize that advancing inclusive growth and entrenching confidence require the use of all policy tools and strong engagement with all stakeholders.

2. In pursuing our objectives, we have adopted a comprehensive agenda this year around the three pillars of decisive *implementation* of our past commitments to deliver on our promises, boosting *investments* as a powerful driver of growth and promoting *inclusiveness* in our actions so that the benefits of growth are shared by all. We have also enhanced our dialogue with low income developing countries as part of our implementation of this agenda.

Strengthening the Recovery and Lifting the Potential

3. Global economic growth is uneven and continues to fall short of our expectations, despite the positive outlook in some major economies. Risks and uncertainties in financial markets remain, and geopolitical challenges are increasingly becoming a global concern. In addition, a shortfall in global demand and structural problems continue to weigh on actual and potential growth.

4. We will continue to implement sound macroeconomic policies in a cooperative manner to achieve strong, sustainable and balanced growth. Our monetary authorities will continue to ensure price stability and support economic activity, consistent with their mandates. We reiterate our commitment to implement fiscal policies flexibly to take into account near-term economic conditions, so as to support growth and job creation, while putting debt as a share of GDP on a sustainable path. We will also consider the composition of our budget expenditures and revenues to support productivity, inclusiveness and growth. We remain committed to promote global rebalancing. We will carefully calibrate and clearly communicate our actions, especially against the backdrop of major monetary and other policy decisions, to mitigate uncertainty, minimize negative spillovers and promote transparency. Against the background of risks arising from large and volatile capital flows, we will promote financial stability through appropriate frameworks, including by ensuring an adequate global financial safety net, while reaping the benefits of financial globalization. We reaffirm our previous exchange rate commitments and will resist all forms of protectionism.

5. We remain committed to achieving our ambition to lift collective G20 GDP by an additional 2 percent by 2018 as announced in Brisbane last year. Our top priority is timely and effective implementation of our growth strategies that include measures to support demand and structural reforms to lift actual and potential growth, create jobs, promote inclusiveness and reduce inequalities. We have made significant progress towards fulfilling our commitments since last year, implementing half of our multi-year commitments. Analysis by the IMF, OECD and World Bank Group indicates that our implementation so far represents more than one third of our collective growth ambition. Yet we also acknowledge that more needs to be done. We will strive more and take prompt action to expedite implementation of our remaining commitments. Going forward, we will continue to closely monitor the implementation of our commitments through the robust framework we developed this year. We will also continue reviewing and adjusting our growth strategies to ensure that they remain relevant to evolving economic conditions, policy priorities and structural challenges, in particular slow productivity growth, and that they remain consistent with our collective growth ambition. The Antalya Action Plan, comprising our adjusted growth strategies and implementation schedules for key commitments, reflects our determination to overcome global economic challenges.

6. We are committed to ensure that growth is inclusive, job-rich and benefits all segments of our societies. Rising inequalities in many countries may pose risks to social cohesion and the well-

being of our citizens and can also have negative economic impact and hinder our objective to lift growth. A comprehensive and balanced set of economic, financial, labour, education and social policies will contribute to reducing inequalities. We endorse the Declaration of our Labour and Employment Ministers and commit to implementing its priorities to make labour markets more inclusive as outlined by the G20 Policy Priorities on Labour Income Share and Inequalities. We ask our Finance, and Labour and Employment Ministers to review our growth strategies and employment plans to strengthen our action against inequality and in support of inclusive growth. Recognizing that social dialogue is essential to advance our goals, we welcome the B20 and L20 joint statement on jobs, growth and decent work.

7. Unemployment, underemployment and informal jobs are significant sources of inequality in many countries and can undermine the future growth prospects of our economies. We are focused on promoting more and better quality jobs in line with our G20 Framework on Promoting Quality Jobs and on improving and investing in skills through our G20 Skills Strategy. We are determined to support the better integration of our young people into the labour market including through the promotion of entrepreneurship. Building on our previous commitments and taking into account our national circumstances, we agree to the G20 goal of reducing the share of young people who are most at risk of being permanently left behind in the labour market by 15% by 2025 in G20 countries. We ask the OECD and the ILO to assist us in monitoring progress in achieving this goal. We will continue monitoring the implementation of our Employment Plans as well as our goals to reduce gender participation gap and to foster safer and healthier workplaces also within sustainable global supply chains.

8. We will address current opportunities and challenges brought into the labour markets through such issues as international labour mobility and the ageing of populations. Domestic labour mobility is an important labour market issue in some G20 countries. We recognize and will further explore the potential of a flourishing silver economy. We further ask our Labour and Employment Ministers to report to us on progress made in 2016.

9. To provide a strong impetus to boost investment, particularly through private sector participation, we have developed ambitious country-specific investment strategies, which bring together concrete policies and actions to improve the investment ecosystem, foster efficient and quality infrastructure, including by the public sector, support small and medium sized enterprises (SMEs), and enhance knowledge sharing. Analysis by the OECD indicates that these strategies would contribute to lifting the aggregate G20 investment to GDP ratio, by an estimated 1 percentage point by 2018.

10. To improve our investment preparation, prioritization and execution processes, we have developed guidelines and best practices for public-private-partnership (PPP) models. We also considered alternative financing structures, including asset-based financing, and simple and transparent securitization to facilitate better intermediation for SMEs and infrastructure investment. Going forward, we call on our Ministers to continue their work to improve the investment ecosystem, promote long-term financing, foster institutional investors' involvement, support the development of alternative capital market instruments and asset-based financing models, and encourage Multilateral Development Banks (MDBs) to mobilize their resources, optimize their balance sheets, and catalyze private sector funding. We are advancing efforts and developing toolkits to unlock the ways and means for countries to better prepare, prioritize and finance infrastructure projects. We expect the Global Infrastructure Hub to make a significant contribution towards these endeavors. To help ensure a strong corporate governance framework that will support private investment, we endorse the G20/OECD Principles of Corporate Governance. We have placed a special focus on promoting long-term financing for SMEs, and we welcome the Joint Action Plan on SME Financing, the G20/OECD High-Level Principles on SME Financing as guidance, and the establishment of the private sector-led World SME Forum, a new initiative that will serve as a global body to facilitate the contributions of SMEs to growth and employment.

11. Global trade and investment continue to be important engines of economic growth and development, generating employment and contributing to welfare and inclusive growth. We note

that global trade growth remains below pre-crisis levels. This is a result of both cyclical and structural factors. We therefore reaffirm our strong commitment to better coordinate our efforts to reinforce trade and investment, including through our Adjusted Growth Strategies. Inclusive Global Value Chains (GVCs) are important drivers of world trade. We support policies that allow firms of all sizes, particularly SMEs, in countries at all levels of economic development to participate in and take full advantage of GVCs and encourage greater participation and value addition by developing countries. We further reaffirm our longstanding commitment to standstill and rollback on protectionist measures and will remain vigilant by monitoring our progress. For this, we ask the WTO, OECD and UNCTAD to continue their reporting on trade and investment restrictive measures. We ask our Trade Ministers to meet on a regular basis and we agree on a supporting working group.

12.The WTO is the backbone of the multilateral trading system and should continue to play a central role in promoting economic growth and development. We remain committed to a strong and efficient multilateral trading system and we reiterate our determination to work together to improve its functioning. We are committed to working together for a successful Nairobi Ministerial Meeting that has a balanced set of outcomes, including on the Doha Development Agenda, and provides clear guidance to post-Nairobi work. We will also need to increase our efforts to implement all the elements of the Bali Package, including those on agriculture, development, public stock holding as well as the prompt ratification and implementation of the Trade Facilitation Agreement. We will continue our efforts to ensure that our bilateral, regional and plurilateral trade agreements complement one another, are transparent and inclusive, are consistent with and contribute to a stronger multilateral trade system under WTO rules. We emphasize the important role of trade in global development efforts and will continue to support mechanisms such as aid for trade in developing countries in need of capacity building assistance.

Enhancing resilience

13. Strengthening the resilience of financial institutions and enhancing stability of the financial system are crucial to sustaining growth and development. To enhance the resilience of the global financial system, we have completed further core elements of the financial reform agenda. In particular, as a key step towards ending too-big-to-fail, we have finalized the common international standard on total-loss-absorbing-capacity (TLAC) for global systemically important banks. We also agreed to the first version of higher loss absorbency requirements for global systemically important insurers.

14. Critical work remains to build a stronger and more resilient financial system. In particular, we look forward to further work on central counterparty resilience, recovery planning and resolvability and ask the FSB to report back to us by our next meeting. We will continue to monitor and, if necessary, address emerging risks and vulnerabilities in the financial system, many of which may arise outside the banking sector. In this regard, we will further strengthen oversight and regulation of shadow banking to ensure resilience of market-based finance, in a manner appropriate to the systemic risks posed. We look forward to further progress in assessing and addressing, as appropriate, the decline in correspondent banking services. We will expedite our efforts to make further progress in implementing the over-the-counter (OTC) derivatives' reforms, including by encouraging jurisdictions to defer to each other, when it is justified in line with the St. Petersburg Declaration. Going forward, we are committed to full and consistent implementation of the global financial regulatory framework in line with the agreed timelines, and will continue to monitor and address uneven implementation across jurisdictions. We welcome the FSB's first annual report on the implementation of reforms and their effects. We will continue to review the robustness of the global regulatory framework and to monitor and assess the implementation and effects of reforms and their continued consistency with our overall objectives, including by addressing any material unintended consequences, particularly for emerging markets and developing economies (EMDEs).

15. To reach a globally fair and modern international tax system, we endorse the package of measures developed under the ambitious G20/OECD Base Erosion and Profit Shifting (BEPS) project. Widespread and consistent implementation will be critical in the effectiveness of the project, in particular as regards the exchange of information on cross-border tax rulings. We,

therefore, strongly urge the timely implementation of the project and encourage all countries and jurisdictions, including developing ones, to participate. To monitor the implementation of the BEPS project globally, we call on the OECD to develop an inclusive framework by early 2016 with the involvement of interested non-G20 countries and jurisdictions which commit to implement the BEPS project, including developing economies, on an equal footing. We welcome the efforts by the IMF, OECD, UN and WBG to provide appropriate technical assistance to interested developing economies in tackling the domestic resource mobilization challenges they face, including from BEPS. We acknowledge that interested non-G20 developing countries' timing of implementation may differ from other countries and expect the OECD and other international organizations to ensure that their circumstances are appropriately addressed in the framework. We are progressing towards enhancing the transparency of our tax systems and we reaffirm our previous commitments to information exchange on-request as well as to automatic exchange of information by 2017 or end-2018. We invite other jurisdictions to join us. We support the efforts for strengthening developing economies' engagement in the international tax agenda.

16. In support of our growth and resilience agenda, we remain committed to building a global culture of intolerance towards corruption through effectively implementing the 2015-2016 G20 Anti-Corruption Action Plan. We endorse the G20 High-Level Principles on Integrity and Transparency in the Private Sector which will help our companies comply with global standards on ethics and anti-corruption. Ensuring the integrity and transparency of our public sectors is essential. In this regard, we endorse the G20 Anti-Corruption Open Data Principles and the G20 Principles for Promoting Integrity in Public Procurement, and we welcome the ongoing work on asset disclosure frameworks. We will further work to strengthen international cooperation, including where appropriate and consistent with domestic legal systems, on civil and administrative procedures, as an important tool to effectively combat bribery and to support asset recovery and the denial of safe haven to corrupt officials and those who corrupt them. We welcome the publication of our Implementation Plans on beneficial ownership transparency and will continue our efforts in this regard.

17. We remain deeply disappointed with the continued delay in implementing the IMF quota and governance reforms agreed in 2010. The 2010 reforms remain our highest priority for the IMF and we urge the United States to ratify these reforms as soon as possible. Mindful of the aims of the 2010 reforms, we ask the IMF to complete its work on an interim solution that will meaningfully converge quota shares as soon as and to the extent possible to the levels agreed under the 14th General Review of Quotas. The 14th Review should be used as a basis for work on the 15th Review, including a new quota formula. We reaffirm our commitment to maintaining a strong, quota-based and adequately resourced IMF. We reaffirm our agreement that the heads and senior leadership of all international financial institutions should be appointed through an open, transparent and merit-based process and we reiterate the importance of enhancing staff diversity in these organizations. We reaffirm that the Special Drawing Rights (SDR) basket composition should continue to reflect the role of currencies in the global trading and financial system and look forward to the completion of the review of the method of valuation of the SDR.

18. We welcome the progress achieved on the implementation of strengthened collective action and *pari passu* clauses in international sovereign bond contracts, which will contribute to the orderliness and predictability of sovereign debt restructuring processes. We ask the IMF, in consultation with other parties, to continue promoting the use of such clauses and to further explore market-based ways to speed up their incorporation in the outstanding stock of international sovereign debt. We look forward to the upcoming review of the IMF-WB Debt Sustainability Framework for Low-Income Countries. We acknowledge the existing initiatives aimed at improving sustainable financing practices, as stressed in the Addis Ababa Action Agenda. We also take note of the Paris Forum initiative, which contributes to further the inclusiveness by fostering dialogue between sovereign debtors and creditors.

<u>Buttressing Sustainability</u>

19. 2015 is a crucial year for sustainable development and we remain committed to ensuring our actions contribute to inclusive and sustainable growth, including in low income developing

countries. The 2030 Agenda, including the Sustainable Development Goals (SDGs) and the Addis Ababa Action Agenda, sets a transformative, universal and ambitious framework for global development efforts. We are strongly committed to implementing its outcomes to ensure that no-one is left behind in our efforts to eradicate poverty and build an inclusive and sustainable future for all. We adopt the G20 and Low Income Developing Countries Framework to strengthen our dialogue and engagement on development. We will develop an action plan in 2016 to further align our work with the 2030 Agenda.

20. Our work this year supports key areas for sustainable development such as energy access, food security and nutrition, human resource development, quality infrastructure, financial inclusion and domestic resource mobilization. We endorse the G20 Action Plan on Food Security and Sustainable Food Systems, which underlines our commitment to improve global food security and nutrition and ensure the way we produce, consume and sell food is economically, socially and environmentally sustainable. We remain focused on promoting responsible investment in agriculture and food systems, improving market transparency, increasing incomes and quality jobs, and fostering sustainable productivity growth. We will pay particular attention to the needs of smallholder and family farmers, rural women and youth. We also commit to reducing food loss and waste globally. We welcome Expo Milano with the theme “Feeding the Planet – Energy for Life”. We also welcome our Agriculture Ministers´ decision to establish a new platform to improve the way we and other countries can measure and reduce food loss and waste.

21. The private sector has a strong role to play in development and poverty eradication. Through our G20 Call on Inclusive Business we stress the need of all stakeholders to work together in order to promote opportunities for low income people and communities to participate in markets as buyers, suppliers and consumers. Our G20 National Remittance Plans developed this year include concrete actions towards our commitment to reduce the global average cost of transferring remittances to five percent with a view to align with the SDGs and Addis Ababa Action Agenda. We are promoting financial inclusion by helping to open up access to payments, savings, credit and other services. We welcome the continued work on financial inclusion within the Global Partnership for Financial Inclusion (GPFI).

22. We remain focused on the G20 Principles on Energy Collaboration and welcome our Energy Ministers´ first meeting ever. Recognizing that globally over 1.1 billion people lack access to electricity and 2.9 billion rely on the traditional use of biomass for cooking, we endorse the G20 Energy Access Action Plan: Voluntary Collaboration on Energy Access, the first phase of which focuses on enhancing electricity access in Sub-Saharan Africa where the problem is most acute. The Plan aims to strengthen G20 coordination and establishes a long-term voluntary cooperation framework that can be applied to other regions over time, recognising that energy access is a critical factor to foster development. In this first phase, we will cooperate and collaborate with African countries and relevant regional and international organizations on policy and regulatory environments, technology development and deployment, investment and finance, capacity building, regional integration and cooperation, taking into consideration national needs and contexts.

23. We recognize that actions on energy, including improving energy efficiency, increasing investments in clean energy technologies and supporting related research and development activities will be important in tackling climate change and its effects. We endorse the G20 Toolkit of Voluntary Options for Renewable Energy Deployment. We also highlight the progress made this year by participating countries in taking forward our collaboration on energy efficiency and agree to further support on a voluntary basis the 2015 outcomes of existing work streams on efficiency and emissions performance of vehicles, particularly heavy duty vehicles, networked devices, buildings, industrial processes and electricity generation, as well as financing for energy efficiency. We will continue to promote transparent, competitive and well-functioning energy markets, including gas markets. We stress the importance of diversification of energy sources and continued investments for increased energy security. We reaffirm our commitment to rationalise and phase-out inefficient fossil fuel subsidies that encourage wasteful consumption, over the medium term, recognising the need to support the poor. We will endeavour to make enhanced progress in moving

forward this commitment. We ask our Energy Ministers to report back on energy collaboration again in 2016 on the continued implementation of the G20 Principles on Energy Collaboration.

24. Climate change is one of the greatest challenges of our time. We recognize that 2015 is a critical year that requires effective, strong and collective action on climate change and its effects. We reaffirm the below 2°C goal as stated in the Lima Call for Action. We affirm our determination to adopt a protocol, another legal instrument or an agreed outcome with legal force under the UNFCCC that is applicable to all Parties. Our actions will support growth and sustainable development. We affirm that the Paris agreement should be fair, balanced, ambitious, durable and dynamic. We underscore our commitment to reaching an ambitious agreement in Paris that reflects the principle of common but differentiated responsibilities and respective capabilities, in light of different national circumstances. We reaffirm that UNFCCC is the primary international intergovernmental body for negotiating climate change. We welcome that over 160 Parties including all G20 countries have submitted their Intended Nationally Determined Contributions (INDCs) to the UNFCCC, and encourage others to do so in advance of the Paris Conference. We are prepared to implement our INDCs. We will instruct our negotiators to engage constructively and flexibly in the coming days to discuss key issues, among other things, mitigation, adaptation, finance, technology development and transfer and transparency in order to arrive at Paris with a way forward. We commit to work together for a successful outcome of the COP21.

25. The scale of the ongoing refugee crisis is a global concern with major humanitarian, political, social and economic consequences. There is a need for a coordinated and comprehensive response to tackle this crisis, as well as its long term consequences. We commit to continue further strengthening our support for all efforts to provide protection and assistance and to find durable solutions for the unprecedented numbers of refugees and internally displaced persons in various parts of the world. We call upon all states to contribute to responding to this crisis, and share in the burdens associated with it, including through refugee resettlement, other forms of humanitarian admission, humanitarian aid and efforts to ensure that refugees can access services, education and livelihood opportunities. We underline the need to address the root causes of displacement. We highlight, in this regard, the importance of political solutions to conflicts and increased cooperation for development. We also recognize the importance of creating conditions to enable refugees and internally displaced persons to safely and voluntarily return to their homes. We will work with other states to strengthen our long term preparedness and capacity to manage migration and refugee flows. We invite all states according to their individual capacities to scale up their assistance to relevant international organizations in order to enhance their capabilities to assist affected countries in dealing with this crisis. We encourage the private sector and individuals to also join in the international efforts to respond to the refugee crisis.

26. We are living in an age of Internet economy that brings both opportunities and challenges to global growth. We acknowledge that threats to the security of and in the use of ICTs, risk undermining our collective ability to use the Internet to bolster economic growth and development around the world. We commit ourselves to bridge the digital divide. In the ICT environment, just as elsewhere, states have a special responsibility to promote security, stability, and economic ties with other nations. In support of that objective, we affirm that no country should conduct or support ICT-enabled theft of intellectual property, including trade secrets or other confidential business information, with the intent of providing competitive advantages to companies or commercial sectors. All states in ensuring the secure use of ICTs, should respect and protect the principles of freedom from unlawful and arbitrary interference of privacy, including in the context of digital communications. We also note the key role played by the United Nations in developing norms and in this context we welcome the 2015 report of the UN Group of Governmental Experts in the Field of Information and Telecommunications in the Context of International Security, affirm that international law, and in particular the UN Charter, is applicable to state conduct in the use of ICTs and commit ourselves to the view that all states should abide by norms of responsible state behaviour in the use of ICTs in accordance with UN resolution A/C.1/70/L.45. We are committed to help ensure an environment in which all actors are able to enjoy the benefits of secure use of ICTs.

Conclusion

27. We remain resolute to continue our collective action to lift actual and potential growth of our economies, support job creation, strengthen resilience, promote development and enhance inclusiveness of our policies. We thank Turkey for its G20 Presidency and hosting a successful Antalya Summit this year. We look forward to our next meeting in Hangzhou in September 2016 under the Chinese Presidency. We also look forward to meeting in Germany in 2017.

Annex

Agreed Documents

- Antalya Action Plan, November 2015
- Accountability Assessment Report
- G20 Investment Strategies and G20/OECD Report on G20 Investment Strategies
- Multilateral Development Banks Action Plan to Optimize Balance Sheets
- G20/OECD Principles of Corporate Governance
- G20/OECD High-Level Principles on SME Financing
- G20 Joint Action Plan on SME Financing
- The Common International Standard on Total-Loss-Absorbing-Capacity for Global Systemically Important Banks, the FSB
- Higher Loss Absorbency Requirements for Global Systemically Important Insurers, the IAIS
- G20 and Low Income Developing Countries Framework
- G20 Action Plan on Food Security and Sustainable Food Systems
- High-Level Statement on Remittances
- G20 Leaders' Call on Inclusive Business
- G20 Energy Access Action Plan: Voluntary Collaboration on Energy Access
- G20 Toolkit of Voluntary Options for Renewable Energy Deployment
- G20 Skills Strategy
- G20 Policy Priorities on Labour Income Share and Inequalities
- G20 Policy Principles for Promoting Better Youth Employment Outcomes
- G20 Framework on Promoting Quality Jobs
- G20 High-Level Principles on Private Sector Transparency and Integrity
- G20 Principles for Promoting Integrity in Public Procurement
- G20 Anti-Corruption Open Data Principles

Ministerial Statements

- Communiqué, Meeting of G20 Finance Ministers and Central Bank Governors, Istanbul, 9-10 February 2015
- Communiqué, Meeting of G20 Finance Ministers and Central Bank Governors, Washington DC, 16-17 April 2015
- Communiqué, Meeting of G20 Agriculture Ministers, Istanbul, 7-8 May 2015
- Declaration, Meeting of G20 Labour and Employment Ministers, Ankara, 3-4 September 2015
- Chairs' Statement, Joint Meeting of G20 Finance and Labour Ministers, Ankara, 4 September 2015
- Communiqué, Meeting of G20 Finance Ministers and Central Bank Governors, Ankara, 4-5 September 2015
- Declaration, Meeting of G20 Tourism Ministers, Antalya, 30 September 2015
- Communiqué, Meeting of G20 Energy Ministers, Istanbul, 2 October 2015
- Chairman's Summary, Meeting of G20 Trade Ministers, Istanbul, 6 October 2015

Working Group Documents

Framework Working Group

- Quantifying the Implementation of G-20 Members' Growth Strategies- (IMF-OECD Note)

Anti-Corruption Working Group (ACWG)

- Accountability Report for 2015
- Written Implementation Plan on Beneficial Ownership

Development Working Group (DWG)

- Inclusive Growth and Development: 2015 Antalya Development Roadmap
- DWG 2015 Annual Progress Report
- Implementation Plan of the G20 Food Security and Nutrition Framework
- G20 National Remittance Plans
- G20 Inclusive Business Framework
- Annexes of the G20 Inclusive Business Framework
- Concept Note on the G20 Global Platform on Inclusive Business
- Call to Action for Strengthening Tax Capacity in Developing Countries
- Multi-Year Framework for Policy Coherence and Coordination on Human Resource Development (HRD) between the G20 Development Working Group (DWG) and the Employment Working Group (EWG)

Employment Working Group (EWG)

- G20 Principles for Effective Public Employment Services
- G20 Principles on Silver Economy and Active Ageing
- Terms of Reference for G20 Employment Working Group
- Terms of Reference for G20 Network on Safe and Healthy Workplaces
- Terms of Reference for G20 Employment Working Group Sub-Group on Labour Income Shares and Inequalities
- Country Self-reporting Template on Implementation of G20 Employment Plans

Global Partnership for Financial Inclusion (GPFI)

- GPFI Private Sector Engagement Strategy
- GPFI 2015 Progress Report
- Digital Financial Solutions to Advance Women's Economic Participation
- Synthesis Report on Innovations in Agricultural Finance
- OECD/INFE Core Competencies Framework on Financial Literacy for Youth
- OECD/ INFE Policy Handbook on the Implementation of National Strategies for Financial Education
- Financial Education for Migrants and Their Families: OECD/INFE Policy Analysis and Practical Tools
- OECD/INFE Progress Report on Financial Education for MSMEs and Potential Entrepreneurs
- Consultation Document for Second Edition of GPFI White Paper on Standard-Setting Bodies and Financial Inclusion
- G20 Survey on De-risking Activities in the Remittance Market
- The Use of Remittances and Financial Inclusion
- Innovative Digital Payment Mechanisms Supporting Financial Inclusion Stocktaking Report
- Report on SME Finance Compact Workshop

Climate Finance Study Group (CFSG)

- Toolkit to Enhance Access to Adaptation Finance for Developing Countries that are Vulnerable to the Adverse Effects of Climate Change Including LIDCs, Small Island Developing States and African States, OECD in Collaboration with the Global Environment Facility
- Climate Funds Inventory, OECD
- G20 Climate Finance Study Group Annual Report 2015

Supporting Documents

IMF Surveillance Note, November 2015

IMF Sustainability Updates, October 2015

OECD Secretary-General Report to the G20 Leaders

Effective Approaches to Support Implementation of the G20/OECD High-Level Principles on Long Term Financing by Institutional Investors, OECD Report, November 2015

Report on the Implementation and Effects of Reforms, FSB's Report to the G20 Leaders, November 2015.
Paper on MDB Common Approaches to Supporting Infrastructure Development
World Bank Group (WBG) Working Paper on Prioritization of Infrastructure Projects: A Decision Support Framework
MDB Presentation on Evaluating Readiness and Capacity for Infrastructure Public Private Partnerships
Report on Stock-Taking of Selected Policy Indicators on the Enabling Environment for Infrastructure Investment
Report on Risk and Return Characteristics of Infrastructure Investment in Low Income Countries
Report on Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment
Concept Note on the Report on Issues Arising from the Indirect Transfer of Assets to Identify Policy Options to Tackle Abusive Cases, with particular reference to Developing Countries
FSB Chair's Letter to the G20 Leaders, "Financial Reforms – Achieving and Sustaining Resilience for All"
FSB Report to the G20 on Actions Taken to Assess and Address the Decline in Correspondent Banking
FSB Report to the G20 on Progress in Resolution – Removing Remaining Obstacles to Resolvability
BCBS Report to G20 Leaders – Finalizing Post-Crisis Reforms
FSB Report on Progress in Transforming Shadow Banking into Resilient Market-Based Finance
OECD Secretary-General Report to G20 Finance Ministers with Its Annexes ("Reports on Possible Tougher Incentives for the Countries that Fail to Comply with the Global Forum Standards on Exchange of Information on Request" and "SMEs and Taxation")
Scoping Paper for a Practical Toolkit to Assist Developing Countries to Address Difficulties in Accessing Comparables Data and Use Approaches to Apply Internationally Accepted Principles in the Absence of Comparables
Report on the Terrorist Financing, FATF's Report to the G20 Leaders
SMEs Anti-Corruption Education Toolkit
Progress Report on the G20 Self-Assessment on Combating the Bribery of Foreign Public Official
Asset Recovery Country Profile
Company Ownership Guide
Asset Disclosure Country Profile
Targeted Approaches to Addressing Corruption in the Extractives Sector
Report on the G20 Energy Efficiency Action Plan: Voluntary Collaboration on Energy Efficiency 2015 Outcomes of Work Streams
Voluntary Energy Efficiency Investment Principles for G20 Participating Countries
Report on G20 Deployment of Renewable Energy
Update on Recent Progress in Reform of Inefficient Fossil Fuel Subsidies that Encourage Wasteful Consumption
Summary of Progress Reports on the Commitment to Rationalize and Phase Out Inefficient Fossil Fuel Subsidies
The Joint IEA-IEF-OPEC Market Impact Report of the IOSCO Oil Price Reporting Agencies Principles
The Second Oil PRA Review Report regarding the Implementation of the Principles for Oil Price Reporting Agencies
Prospects for Global Trade

Reports on G20 Trade and Investment Measures (Mid-October 2014 to Mid-May 2015)
Summary of the Stocktaking Seminar on Small and Medium Enterprises and Low Income Developing Countries in the International Market Place
Advancing The Multilateral Trading System, Discussion Paper for the G20
Regional Trade Agreements and The Multilateral Trading System, Discussion Paper for the G20
Report on "Inclusive Global Value Chains-Policy Options in Trade and Complementary Areas for GVC Integration by Small and Medium Enterprises and Low-Income Developing Countries"
G20 Labour Markets in 2015: Strengthening the Link between Growth and Employment
Income Inequality and Labour Income Share in G20 Countries: Trends, Impacts and Causes
The Contribution of Labour Mobility to Economic Growth
The Labour Share in G20 Economies
Enhancing Policy Coherence between the G20 Growth Strategies and Employment Plans
Achieving Better Youth Employment Outcomes: Monitoring Policies and Progress in G20 Economies
G20 National Employment Plans: Proposed Self-Reporting Template
Monitoring Progress in Reducing the Gender Gap in Labour Force Participation
Options for G20 Activities to Promote Safe and Healthy Workplaces for All
Strengthening Public Employment Services
The Effects of Technology on Employment and Implications for Public Employment Services
The G20 Skills Strategy for Developing and Using Skills for the 21st Century
Inequality in G20 Countries: Causes, Impacts and Policy Responses
Setting Objectives for Achieving Better Youth Employment Outcomes
Synthesis Paper of Self-Reports on the Implementation of G20 Country Employment Plans

Issues for Further Action

We look forward to further work on investment, including with a follow-up by the OECD and other relevant international organizations on our investment strategies under our broad framework.

We expect the Global Infrastructure Hub to present its report on knowledge sharing to G20 Finance Ministers and Central Bank Governors by April 2016.

We look forward to further work on issues concerning optimization of the balance sheets of MDBs.

Recognizing the potential role of corporates' liability structure in financial stability, we call on the FSB to continue to explore any systemic risks and consider policy options in this regard.

We ask the FSB to continue to engage with public- and private- sector participants on how the financial sector can take account of climate change risks.

Building on its findings presented in its last report to the G20, we call on the Financial Action Task Force (FATF) to report back to our Finance Ministers and Central Bank Governors by their first meeting in 2016 on the steps countries are taking to address the weaknesses identified to cut off terrorism-related financial flows.

A stable and resilient international financial architecture is a key element to foster strong, sustainable and balanced growth as well as financial stability. We ask our Finance Ministers and Central Bank Governors to work and report back to us by our next meeting on this issue.

We agree that attention should be given to global health risks, such as antimicrobial resistance, infectious disease threats and weak health systems. These can significantly impact growth and stability. Building on the Brisbane Statement, we underscore the importance of a coordinated international response and reiterate our resolve to tackle these issues to fight the adverse impacts on the global economy and will discuss the terms of reference to deal with this issue in the G20 next year.

Acknowledgements

We thank international organisations, including the UN, IMF, World Bank Group, OECD, WTO, ILO, FSB, FATF and BIS, for their valuable inputs to the G20 process. We also thank the G20 engagement groups, namely Business 20, Civil Society 20, Labour 20, Think 20 and Youth 20 for their important contributions this year. We welcome the establishment of the Women20 and look forward to its active contributions going forward.

Final

G20 Leaders' Communique

Hangzhou Summit

4-5 September 2016

1. We, the Leaders of the G20, met in Hangzhou, China on 4-5 September 2016.

2. We met at a time when the global economic recovery is progressing, resilience is improved in some economies and new sources for growth are emerging. But growth is still weaker than desirable. Downside risks remain due to potential volatility in the financial markets, fluctuations of commodity prices, sluggish trade and investment, and slow productivity and employment growth in some countries. Challenges originating from geopolitical developments, increased refugee flows as well as terrorism and conflicts also complicate the global economic outlook.

3. We also met at a time of continued shifts and profound transformations in the configuration of the global economic landscape and dynamics for growth. With these transformations come challenges and uncertainties as well as opportunities. The choices we make together will determine the effectiveness of our response to the challenges of today and help to shape the world economy of the future.

4. We believe that closer partnership and joint action by G20 members will boost confidence in, foster driving forces for and intensify cooperation on global economic growth, contributing to shared prosperity and better well-being of the world.

5. We are determined to foster an innovative, invigorated, interconnected and inclusive world economy to usher in a new era of global growth and sustainable development, taking into account the 2030 Agenda for Sustainable Development, the Addis Ababa Action Agenda and the Paris Agreement.

6. In this context, we, the G20, as the premier forum for international economic cooperation, forge a comprehensive and integrated narrative for strong, sustainable, balanced and inclusive growth, and thereby adopt the attached package of policies and actions - the Hangzhou Consensus - based on the following:

----Vision. We will strengthen the G20 growth agenda to catalyze new drivers of growth, open up new horizons for development, lead the way in transforming our economies in a more innovative and sustainable manner and better reflect shared interests of both present and coming generations.

----Integration. We will pursue innovative growth concepts and policies by forging synergy among fiscal, monetary and structural policies, enhancing coherence between economic, labor, employment and social policies as well as combining demand management with supply side reforms, short-term with mid- to long-term policies, economic growth with social development and environmental protection.

----Openness. We will work harder to build an open world economy, reject protectionism, promote global trade and investment, including through further strengthening the multilateral trading system, and ensure broad-based opportunities through and public support for expanded growth in a globalized economy.

----Inclusiveness. We will work to ensure that our economic growth serves the needs of everyone and benefits all countries and all people including in particular women, youth and disadvantaged groups, generating more quality jobs, addressing inequalities and eradicating poverty so that no one is left behind.

Strengthening Policy Coordination

7. Our growth must be shored up by well-designed and coordinated policies. We are determined to use all policy tools - monetary, fiscal and structural - individually and collectively to achieve our goal of strong, sustainable, balanced and inclusive growth. Monetary policy will continue to support economic activity and ensure price stability, consistent with central banks' mandates, but monetary policy alone cannot lead to balanced growth. Underscoring the essential role of structural reforms, we emphasize that our fiscal strategies are equally important to supporting our common growth objectives. We are using fiscal policy flexibly and making tax policy and public expenditure more growth-friendly,

including by prioritizing high-quality investment, while enhancing resilience and ensuring debt as a share of GDP is on a sustainable path. Furthermore, we will continue to explore policy options, tailored to country circumstances, that the G20 countries may undertake as necessary to support growth and respond to potential risks including balance sheet vulnerability. We reiterate that excess volatility and disorderly movements in exchange rates can have adverse implications for economic and financial stability. Our relevant authorities will consult closely on exchange markets. We reaffirm our previous exchange rate commitments, including that we will refrain from competitive devaluations and we will not target our exchange rates for competitive purposes. We will carefully calibrate and clearly communicate our macroeconomic and structural policy actions to reduce policy uncertainty, minimize negative spillovers and promote transparency.

8. We are making further progress towards the implementation of our growth strategies, but much more needs to be done. Swift and full implementation of the growth strategies remains key to supporting economic growth and the collective growth ambition set by the Brisbane Summit, and we are prioritizing our implementation efforts. In the light of this, we launch the Hangzhou Action Plan and have updated our growth strategies, including new and adjusted macroeconomic and structural policy measures that can provide mutually-supportive benefits to growth. We will also strive to reduce excessive imbalances, promote greater inclusiveness and reduce inequality in our pursuit of economic growth.

Breaking a New Path for Growth

9. Our growth, to be dynamic and create more jobs, must be powered by new driving forces. While reaffirming the importance of addressing shortfalls in global demand to support short-term growth, we believe it is also imperative to address supply side constraints so as to raise productivity sustainably, expand the frontier of production and unleash mid- to long-term growth potential.

10. We recognize that in the long run, innovation is a key driver of growth for both individual countries and the global economy as a whole. We are committed to tackling one of the root causes of weak growth by taking innovation as a key element of our effort to identify new growth engines for individual countries and the world economy, which will also contribute to creating new and better jobs, building a cleaner environment, increasing productivity, addressing global challenges, improving people’s lives and building dynamic, cooperative and inclusive innovation ecosystems. We thus endorse the G20 Blueprint on Innovative Growth as a new agenda encompassing policies and measures in and across the areas of innovation, the new industrial revolution and the digital economy. In this context, we recognize the importance of structural reforms. We will act on the recommendations of the Blueprint in accordance with our national circumstances and in line with our vision for leadership, partnership, openness, inclusiveness, creativity, synergy and flexibility.

11. We commit to important cross-cutting actions related to multi-dimensional partnerships, supporting developing countries and improving skills and human capital. We will set up a G20 Task Force supported by the OECD and other relevant international organizations to take forward the G20 agenda on innovation, new industrial revolution and digital economy, subject to the priorities of the respective future G20 presidencies, ensuring continuity and consistency with the results so far, and promoting synergies with other G20 workstreams.

12. To achieve innovation-driven growth and the creation of innovative ecosystems, we support dialogue and cooperation on innovation, which covers a wide range of domains with science and technology innovation at its core. We deliver the G20 2016 Innovation Action Plan. We commit to pursue pro-innovation strategies and policies, support investment in science, technology and innovation (STI), and support skills training for STI - including support for the entry of more women into these fields - and mobility of STI human resources. We support effort to promote voluntary knowledge diffusion and technology transfer on mutually agreed terms and conditions. Consistent with this approach, we support appropriate efforts to promote open science and facilitate appropriate access to publicly funded research results on findable, accessible, interoperable and reusable (FAIR) principles. In furtherance of the above, we emphasize the importance of open trade and investment regimes to facilitate innovation through intellectual property rights (IPR) protection, and improving public communication in science and technology. We are committed to foster exchange of knowledge and experience by supporting an online G20 Community of Practice within the existing Innovation Policy Platform and the release of the 2016 G20 Innovation Report.

13. To seize the opportunity that the new industrial revolution (NIR) presents for industry, particularly manufacturing and related services, we deliver the G20 New Industrial Revolution Action Plan. We commit to strengthen communication, cooperation and relevant research on the NIR, facilitate small and medium-sized enterprises (SMEs) to

leverage benefits from the NIR, address employment and workforce skill challenges, encourage more cooperation on standards, adequate and effective IPR protection in line with existing multilateral treaties to which they are parties, new industrial infrastructure, and support industrialization, as committed in the action plan. We also support industrialization in developing countries, especially those in Africa and Least Developed Countries (LDCs). We are committed to supporting our workforces throughout this transition and to ensuring that the benefits of the NIR extend to all, including women, youth and disadvantaged groups. We call for cooperation to maximize the benefits and mitigate the negative impact of the expected technological and industrial changes. In all these initiatives, the G20 will take into consideration the different opportunities and challenges for developing and developed countries.

14. To unleash the potential of digital economy, we deliver the G20 Digital Economy Development and Cooperation Initiative, which builds on our work begun in Antalya. We aim to foster favorable conditions for its development and to address digital divide, including through expanded and better and affordable broadband access, flow of information for economic growth, trust and security, while ensuring respect for privacy and personal data protection, investment in the ICT sector, entrepreneurship, digital transformation, e-commerce cooperation, enhanced digital inclusion and development of micro, small and medium-sized enterprises (MSMEs). We reaffirm paragraph 26 in the Antalya Communique, commit to offer policy support for an open and secure environment and recognize the key role of adequate and effective IPR protection and enforcement to the development of the digital economy. We welcome the efforts made by the OECD, IMF, national and other international organizations on the measurement of the digital economy, and recognize that further relevant research and exchange are needed.

15. We reiterate the essential role of structural reforms in boosting productivity and potential output, as well as promoting innovative growth in G20 countries. We deliver the Enhanced Structural Reform Agenda, noting that the choice and design of structural reforms are consistent with countries' specific economic conditions. We endorse the nine priority areas of structural reforms and a set of guiding principles identified in the Agenda to provide high-level and useful guidance to members, while allowing them to account for their specific national circumstances. We also support the quantitative framework consisting of a set of indicators, which will be improved over time, to help monitor and assess our efforts and progress with structural reforms and challenges. We are putting in place an integrated strategy for growth with short, medium and long-term measures. We will ensure that the Enhanced Structural Reform Agenda and the relevant elements of the Blueprint on Innovative Growth are well articulated.

More Effective and Efficient Global Economic and Financial Governance

16. Our growth, to be resilient, must be underpinned by effective and efficient global economic and financial architecture. We will continue our work in this regard.

17. We endorse the G20 Agenda Towards A More Stable and Resilient International Financial Architecture. We will continue to improve the analysis and monitoring of capital flows and management of risks stemming from excessive capital flow volatility. We look forward to the IMF's review of country experiences and emerging issues in handling capital flows by year-end. We note the ongoing work on the review of the OECD Code of Liberalization of Capital Movements. We support work to further strengthen the Global Financial Safety Net (GFSN), with a strong, quota-based and adequately resourced IMF at its center, equipped with a more effective toolkit, and with more effective cooperation between the IMF and regional financing arrangements (RFAs), respecting their mandates. In this respect, we welcome the upcoming CMIM-IMF joint test run. We support maintaining access to bilateral and multilateral borrowing agreements between members and the IMF, in line with the objective of preserving the IMF's current lending capacity, and call for broad participation of the IMF membership, including through new agreements. We welcome the entry into effect of the 2010 IMF quota and governance reform and are working towards the completion of the 15th General Review of Quotas, including a new quota formula, by the 2017 Annual Meetings. We reaffirm that any realignment under the 15th review in quota shares is expected to result in increased shares for dynamic economies in line with their relative positions in the world economy, and hence likely in the share of emerging market and developing countries as a whole. We are committed to protecting the voice and representation of the poorest members. We support the World Bank Group to implement its shareholding review according to the agreed roadmap, timeframe and principles, with the objective of achieving equitable voting power over time. We underline the importance of promoting sound and sustainable financing practices and will continue to improve debt restructuring processes. We support the continued effort to incorporate the enhanced contractual clauses into sovereign bonds. We support the Paris Club's discussion of a range of sovereign debt issues, and the ongoing work of the Paris Club, as the principal international forum for restructuring official bilateral debt, towards the broader inclusion of emerging creditors. We welcome the admission of the Republic of Korea and the decision of Brazil to join the Paris Club. We welcome China's continued regular participation in Paris Club meetings and intention to play a more constructive role, including further discussions on

potential membership. Following the IMF's decision, we welcome the inclusion of the RMB into the Special Drawing Right (SDR) currency basket on October 1st. We support the ongoing examination of the broader use of the SDR, such as broader reporting in the SDR and the issuance of SDR-denominated bonds, as a way to enhance resilience. In this context, we take note of the recent issuance of SDR bonds by the World Bank in China's interbank market. We welcome further work by the international organizations to support the development of local currency bond markets, including intensifying efforts to support low-income countries.

18. Building an open and resilient financial system is crucial to supporting sustainable growth and development. To this end, we remain committed to finalizing remaining critical elements of the regulatory framework and to the timely, full and consistent implementation of the agreed financial sector reform agenda, including Basel III and the total-loss-absorbing-capacity (TLAC) standard as well as effective cross-border resolution regimes. We reiterate our support for the work by the Basel Committee on Banking Supervision (BCBS) to finalize the Basel III framework by the end of 2016, without further significantly increasing overall capital requirements across the banking sector, while promoting a level playing field. We welcome the second annual report of the Financial Stability Board (FSB) on implementation and effects of reforms, and will continue to enhance the monitoring of implementation and effects of reforms to ensure their consistency with our overall objectives, including by addressing any material unintended consequences. We will continue to address the issue of systemic risk within the insurance sector. We welcome the work towards the development of an Insurance Capital Standard (ICS) for internationally active insurers. We are committed to full and timely implementation of the agreed over-the-counter (OTC) derivatives reform agenda, and we will remove legal and regulatory barriers to the reporting of OTC derivatives to trade repositories and to authorities' appropriate access to data. We encourage members to close the gap in the implementation of the Principles for Financial Market Infrastructures and welcome the reports by the Committee on Payments and Market Infrastructures, International Organization of Securities Commissions and FSB on enhancing central counterparty resilience, recovery planning and resolvability. Recognizing the importance of effective macroprudential policies in limiting systemic risks, we welcome the joint work by the IMF, FSB and Bank for International Settlements (BIS) to take stock of international experiences with macroprudential frameworks and tools and to help promote effective macroprudential policies. We welcome the FSB consultation on proposed policy recommendations to address structural vulnerabilities from asset management activities. We will continue to closely monitor, and if necessary, address emerging risks and vulnerabilities in the financial system, including those associated with shadow banking, asset management and other market-based finance. We will continue to address, through the FSB-coordinated action plan, the decline in correspondent banking services so as to support remittances, financial inclusion, trade and openness. We look forward to further efforts to clarify regulatory expectations, as appropriate, including through the review in October by the Financial Action Task Force (FATF) of the guidance on correspondent banking. We call on G20 members, the IMF and WBG to intensify their support for domestic capacity building to help countries improve their compliance with global anti-money laundering and countering the financing of terrorism (AML/CFT) and prudential standards. We endorse the G20 High-level Principles for Digital Financial Inclusion, the updated version of the G20 Financial Inclusion Indicators and the Implementation Framework of the G20 Action Plan on SME Financing. We encourage countries to consider these principles in devising their broader financial inclusion plans, particularly in the area of digital financial inclusion, and to take concrete actions to accelerate progress on all people's access to finance.

19. We will continue our support for international tax cooperation to achieve a globally fair and modern international tax system and to foster growth, including advancing on-going cooperation on base erosion and profits shifting (BEPS), exchange of tax information, tax capacity-building of developing countries and tax policies to promote growth and tax certainty. We welcome the establishment of the G20/OECD Inclusive Framework on BEPS, and its first meeting in Kyoto. We support a timely, consistent and widespread implementation of the BEPS package and call upon all relevant and interested countries and jurisdictions that have not yet committed to the BEPS package to do so and join the framework on an equal footing. We also welcome the progress made on effective and widespread implementation of the internationally agreed standards on tax transparency and reiterate our call on all relevant countries including all financial centers and jurisdictions, which have not yet done so to commit without delay to implementing the standard of automatic exchange of information by 2018 at the latest and to sign and ratify the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. We endorse the proposals made by the OECD working with G20 members on the objective criteria to identify non-cooperative jurisdictions with respect to tax transparency. We ask the OECD to report back to the finance ministers and central bank governors by June 2017 on the progress made by jurisdictions on tax transparency, and on how the Global Forum will manage the country review process in response to supplementary review requests of countries, with a view for the OECD to prepare a list by the July 2017 G20 Leaders' Summit of those jurisdictions that have not yet sufficiently progressed toward a satisfactory level of implementation of the agreed international standards on tax transparency. Defensive measures will be considered against listed jurisdictions. We encourage countries and international organizations to assist developing economies in building their tax capacity and

acknowledge the establishment of the new Platform for Collaboration on Taxation by the IMF, OECD, UN and WBG. We support the principles of the Addis Tax Initiative. We recognize the significant negative impact of illicit financial flows on our economies and we will advance the work of the G20 on this theme. We emphasize the effectiveness of tax policy tools in supply-side structural reform for promoting innovation-driven, inclusive growth, as well as the benefits of tax certainty to promote investment and trade and ask the OECD and IMF to continue working on the issues of pro-growth tax policies and tax certainty. In this connection, China would make its own contribution by establishing an international tax policy research center for international tax policy design and research.

20. Financial transparency and effective implementation of the standards on transparency by all, in particular with regard to the beneficial ownership of legal persons and legal arrangements, is vital to protecting the integrity of the international financial system, and to preventing misuse of these entities and arrangements for corruption, tax evasion, terrorist financing and money laundering. We call on the FATF and the Global Forum to make initial proposals by the Finance Ministers and Central Bank Governors Meeting in October on ways to improve the implementation of the international standards on transparency, including on the availability of beneficial ownership information of legal persons and legal arrangements, and its international exchange.

21. We recognize that, in order to support environmentally sustainable growth globally, it is necessary to scale up green financing. The development of green finance faces a number of challenges, including, among others, difficulties in internalizing environmental externalities, maturity mismatch, lack of clarity in green definitions, information asymmetry and inadequate analytical capacity, but many of these challenges can be addressed by options developed in collaboration with the private sector. We welcome the G20 Green Finance Synthesis Report submitted by the Green Finance Study Group (GFSG) and the voluntary options developed by the GFSG to enhance the ability of the financial system to mobilize private capital for green investment. We believe efforts could be made to provide clear strategic policy signals and frameworks, promote voluntary principles for green finance, expand learning networks for capacity building, support the development of local green bond markets, promote international collaboration to facilitate cross-border investment in green bonds, encourage and facilitate knowledge sharing on environmental and financial risks, and improve the measurement of green finance activities and their impacts.

22. Recognizing the detrimental effects of corruption and illicit finance flows on equitable allocation of public resources, sustainable economic growth, the integrity of the global financial system and the rule of law, we will reinforce the G20's efforts to enhance international cooperation against corruption, while fully respecting international law, human rights and the rule of law as well as the sovereignty of each country. We endorse the G20 High Level Principles on Cooperation on Persons Sought for Corruption and Asset Recovery and welcome Chinese initiative to establish in China a Research Center on International Cooperation Regarding Persons Sought for Corruption and Asset Recovery in G20 Member States, which will be operated in line with international norms. We commit to continue the G20 Denial of Entry Experts Network. Consistent with our national legal systems, we will work on cross-border cooperation and information sharing between law enforcement and anti-corruption agencies and judicial authorities. We call for ratification by all the G20 members of the United Nations Convention Against Corruption and welcome the launch of the second cycle of its review mechanism. We will endeavor to apply effectively the extradition, mutual legal assistance and asset recovery provisions of the above Convention and other applicable international conventions. We endorse the 2017-2018 G20 Anti-Corruption Action Plan to improve public and private sector transparency and integrity, implementing our stance of zero tolerance against corruption, zero loopholes in our institutions and zero barriers in our actions. We ask the Anti-Corruption Working Group to develop an implementation plan before the end of 2016 as a flexible framework to carry this work forward with renewed high-level attention and urgency. We also welcome outcomes of the London Anti-Corruption Summit in May 2016 and the OECD Ministerial Meeting in March 2016.

23. In line with the G20 Principles on Energy Collaboration, we reaffirm our commitment to building well-functioning, open, competitive, efficient, stable and transparent energy markets, fostering more effective and inclusive global energy architecture to better reflect the changing realities of the world's energy landscape, and shaping an affordable, reliable, sustainable and low greenhouse gas (GHG) emissions energy future while utilizing energy sources and technologies. We stress that continued investment in energy projects and better regional interconnection, particularly in sustainable energy projects, remains critically important to ensuring future energy security and preventing economically destabilizing price spikes. We endeavor to work with Sub-Saharan and Asia-Pacific countries to improve universal access to affordable, reliable, clean, sustainable and modern energy services, particularly by addressing barriers to electricity access. We encourage members to significantly improve energy efficiency based on the specific needs and national circumstances of each member and promote energy conservation through appropriate lifestyle changes. We will explore innovative collaborative arrangements for international cooperation on energy efficiency. We endorse the

G20 Voluntary Collaboration Action Plan on Energy Access, the G20 Voluntary Action Plan on Renewable Energy and the G20 Energy Efficiency Leading Programme issued by the G20 energy ministers and ask them to meet regularly to follow up on the implementation of these plans.

24. We reaffirm the importance of energy collaboration towards a cleaner energy future and sustainable energy security with a view to fostering economic growth. We welcome the progress on the voluntary international collaboration on energy efficiency in six key areas, taking into consideration the policies outlined in the Energy Efficiency Leading Programme and in line with national circumstances, including in heavy duty vehicles, and improving the efficiency of these vehicles. We also reaffirm our commitment to rationalize and phase-out inefficient fossil fuel subsidies that encourage wasteful consumption over the medium term, recognizing the need to support the poor. We welcome G20 countries' progress on their commitments and look forward to further progress in the future. Further, we encourage G20 countries to consider participating in the voluntary peer review process. Given that natural gas is a less emission-intensive fossil fuel, we will enhance collaboration on solutions that promote natural gas extraction, transportation, and processing in a manner that minimizes environmental impacts. We stress the importance of diversification of energy sources and routes.

Robust International Trade and Investment

25. Our growth, to be strong, must be reinforced by inclusive, robust and sustainable trade and investment growth. We note with concern the slow growth in trade and investment globally and commit to enhance an open world economy by working towards trade and investment facilitation and liberalization. We recognize the importance of economic diversification and industrial upgrading in developing countries to benefit from more open global markets. We endorse the outcome of the G20 Trade Ministers Meeting held in Shanghai on 9-10 July, and welcome the establishment of the G20 Trade and Investment Working Group (TIWG). We commit to further strengthen G20 trade and investment cooperation.

26. We reaffirm our determination to ensure a rules-based, transparent, non-discriminatory, open and inclusive multilateral trading system with the World Trade Organization playing the central role in today's global trade. We reiterate our commitment to shape the post-Nairobi work with development at its center and commit to advancing negotiations on the remaining DDA issues as a matter of priority, including all three pillars of agriculture (i.e. market access, domestic support and export competition), non-agricultural market access, services, development, Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) and rules. We also note that a range of issues may be of common interest and importance to today's economy, and thus may be legitimate issues for discussions in the WTO, including those addressed in regional trade arrangements (RTAs) and by the B20. We will work together with all WTO members with a sense of urgency and solidarity and with a view to achieving positive outcomes of the MC11 and beyond and we will work together to further strengthen the WTO.

27. We commit to ratify the Trade Facilitation Agreement by the end of 2016 and call on other WTO members to do the same. We note the important role that bilateral and regional trade agreements can play in liberalizing trade and in the development of trade rules, while recognizing the need to ensure they are consistent with WTO rules. We commit to working to ensure our bilateral and regional trade agreements complement the multilateral trading system, and are open, transparent, inclusive and WTO-consistent. WTO-consistent plurilateral trade agreements with broad participation can play an important role in complementing global liberalization initiatives. G20 Environmental Goods Agreement (EGA) participants welcome the landing zone achieved in the WTO EGA negotiations, and reaffirm their aim to redouble efforts to bridge remaining gaps and conclude an ambitious, future-oriented EGA that seeks to eliminate tariffs on a broad range of environmental goods by the end of 2016, after finding effective ways to address the core concerns of participants.

28. We reiterate our opposition to protectionism on trade and investment in all its forms. We extend our commitments to standstill and rollback of protectionist measures till the end of 2018, reaffirm our determination to deliver on them and support the work of the WTO, UNCTAD and OECD in monitoring protectionism. We emphasize that the benefits of trade and open markets must be communicated to the wider public more effectively and accompanied by appropriate domestic policies to ensure that benefits are widely distributed.

29.We endorse the G20 Strategy for Global Trade Growth, under which the G20 will lead by example to lower trade costs, harness trade and investment policy coherence, boost trade in services, enhance trade finance, promote e-commerce development, and address trade and development. We welcome the World Trade Outlook Indicator released by the WTO as an important leading indicator of global trade. We endorse the G20 Guiding Principles for

Global Investment Policymaking, which will help foster an open, transparent and conductive global policy environment for investment.

30. We also support policies that encourage firms of all sizes, in particular women and youth entrepreneurs, women-led firms and SMEs, to take full advantage of global value chains (GVCs), and that encourage greater participation, value addition and upward mobility in GVCs by developing countries, particularly low-income countries (LICs).We welcome the B20's interest to strengthen digital trade and other work and take note of it's initiative on an Electronic World Trade Platform (eWTP).

31. We recognize that the structural problems, including excess capacity in some industries, exacerbated by a weak global economic recovery and depressed market demand, have caused a negative impact on trade and workers. We recognize that excess capacity in steel and other industries is a global issue which requires collective responses. We also recognize that subsidies and other types of support from government or government-sponsored institutions can cause market distortions and contribute to global excess capacity and therefore require attention. We commit to enhance communication and cooperation, and take effective steps to address the challenges so as to enhance market function and encourage adjustment. To this end, we call for increased information sharing and cooperation through the formation of a Global Forum on steel excess capacity, to be facilitated by the OECD with the active participation of G20 members and interested OECD members. We look forward to a progress report on the efforts of the Global Forum to the relevant G20 ministers in 2017.

Inclusive and Interconnected Development

32. Our growth, to be strong, sustainable and balanced, must also be inclusive. We are committed to ensuring the benefits of our growth reach all people and maximize the growth potential of developing and low-income countries. In this context, we place sustainable development high on the G20 agenda.

33. We pledge to enhance policy coherence on sustainable development and reaffirm our commitment to further align our work with the universal implementation of the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda on financing for development, based on the comparative advantage and the added value of the G20 and in accordance with our national circumstances, while acknowledging that the global follow-up and review of the 2030 Agenda is a UN-led process. We commit to contributing to the implementation of the 2030 Agenda by setting an example through bold, transformative collective and intended national actions in a wide range of areas. By endorsing the G20 Action Plan on the 2030 Agenda for Sustainable Development which also includes high-level principles, we reaffirm our commitment to achieve the ambition of the 2030 Agenda. We note the Addis Tax Initiative, welcome the establishment of the Technology Facilitation Mechanism and stress the importance of enhanced cooperation on technologies to achieving sustainable development.

34. We welcome the Hangzhou Comprehensive Accountability Report on G20 Development Commitments, which reflects our progress already made over the period of 2014-2016.

35. We launch the G20 Initiative on Supporting Industrialization in Africa and LDCs to strengthen their inclusive growth and development potential through voluntary policy options including: promoting inclusive and sustainable structural transformation; supporting sustainable agriculture, agri-business and agro-industry development; deepening, broadening and updating the local knowledge and production base; promoting investment in sustainable and secure energy, including renewables and energy efficiency; exploring ways to develop cooperation on industrial production and vocational training and sustainable and resilient infrastructure and industries; supporting industrialization through trade in accordance with WTO rules; and leveraging domestic and external finance and supporting equitable access to finance - with a focus on women and youth; and promoting science, technology and innovation as critical means for industrialization.

36. We will continue our work on addressing cross-border financial flows derived from illicit activities, including deliberate trade misinvoicing, which hampers the mobilization of domestic resources for development, and welcome the communication and coordination with the World Customs Organization for a study report in this regard following the Hangzhou Summit.

37. We acknowledge the important role of inclusive business in development, and welcome the establishment of the G20 Global Platform on Inclusive Business and its future actions. We welcome the G20 Inclusive Business Report for the 2016 Summit.

38. We will fulfill our collective commitment to achieve a successful 18th replenishment of the International Development Association, as well as 14th replenishment of the African Development Fund.

39. We reaffirm our commitment to promote investment with focus on infrastructure in terms of both quantity and quality. We welcome the Joint Declaration of Aspirations on Actions to Support Infrastructure Investment by 11 multilateral development banks (MDBs), including their announcements of quantitative ambitions for high-quality infrastructure projects within their respective institutional mandates as well as their efforts to maximize the quality of infrastructure projects, strengthen project pipelines, collaborate further among existing and new MDBs, strengthen the enabling environment for infrastructure investment in developing countries, as well as catalyze private resources. We stress the importance of quality infrastructure investment, which aims to ensure economic efficiency in view of life-cycle cost, safety, resilience against natural disaster, job creation, capacity building, and transfer of expertise and know-how on mutually agreed terms and conditions, while addressing social and environmental impacts and aligning with economic and development strategies. We welcome the MDB Response to the G20 MDB Balance Sheet Optimization Action Plan and call for further implementation of the Action Plan. We note that infrastructure connectivity is key to achieving sustainable development and shared prosperity. We endorse the Global Infrastructure Connectivity Alliance launched this year to enhance the synergy and cooperation among various infrastructure connectivity programs in a holistic way. We ask the WBG to serve as the Secretariat of the Alliance, working closely with the Global Infrastructure Hub (GIH), OECD, other MDBs, and interested G20 members to support its activities. We endorse the G20/OECD Guidance Note on Diversification of Financial Instruments for Infrastructure and SMEs and we welcome the Annotated Public-Private Partnership (PPP) Risk Allocation Matrices completed by the GIH to help developing countries better assess infrastructure risks. We support the effective implementation of the G20/OECD Principles of Corporate Governance and G20/OECD High-level Principles on SME Financing and look forward to the revision of the assessment methodology of the G20/OECD Principles of the Corporate Governance, which will be informed by an FSB peer review on corporate governance.

40. Generating quality employment is indispensable for sustainable development and is at the center of the G20's domestic and global agenda. We will work to ensure the benefits from economic growth, globalization and technological innovation are widely shared, creating more and better jobs, reducing inequalities and promoting inclusive labor force participation. We endorse the strategies, action plans and initiatives developed by G20 labor and employment ministers to enhance the growth and development agenda by taking effective actions to address changes in skill needs, support entrepreneurship and employability, foster decent work, ensure safer workplaces including within global supply chains and strengthen social protection systems. We endorse Sustainable Wage Policy Principles. We recognize entrepreneurship is an important driver for job creation and economic growth, reinforce our commitments in the G20 Entrepreneurship Action Plan, and welcome China's contribution in the establishment of an Entrepreneurship Research Center on G20 Economies. We also endorse the G20 Initiative to Promote Quality Apprenticeship with policy priorities of increasing the quantity, quality and diversity of apprenticeships. We will further develop the G20 employment plans in 2017 to address these commitments and monitor progress in a systemic and transparent manner in achieving the G20 goals especially on youth employment and female labor participation. We recognize strengthened labor market institutions and policies can support productivity and promote decent work, and therefore higher, sustainable wage growth, in particular for the low-income workers. We recognize the importance of addressing opportunities and challenges brought into the labor market through labor migration as well-managed migration can bring potential benefits to economies and societies.

41. The G20 will continue to prioritize its work on food security, nutrition, sustainable agricultural growth and rural development as a significant contribution to implementing the 2030 Agenda for Sustainable Development. We endorse the outcome of the G20 Agriculture Ministers Meeting and encourage our agriculture ministers to meet regularly to jointly facilitate sustainable agricultural development and food value chains, including through technological, institutional and social innovation, trade and responsible investment, as a means of food security, rural development and poverty alleviation. We support increasing efforts in this regard by the agricultural scientific and private sectors and welcome the opening of the First G20 Agricultural Entrepreneurs Forum. We recognize the role of family farmers and smallholder agriculture in development, and welcome the Good Practices on Family Farming and Smallholder Agriculture that identifies a set of policies, programs and tools that can prove useful to G20 members and beyond. We welcome the contribution by programs and initiatives that promote sustainable agricultural development, including the Global Agriculture and Food Security Program.

Further Significant Global Challenges Affecting the World Economy

42. The outcome of the referendum on the UK's membership of the EU adds to the uncertainty in the global economy.

Members of the G20 are well positioned to proactively address the potential economic and financial consequences stemming from the referendum. In the future, we hope to see the UK as a close partner of the EU.

43. We reiterate our commitment to sustainable development and strong and effective support and actions to address climate change. We commit to complete our respective domestic procedures in order to join the Paris Agreement as soon as our national procedures allow. We welcome those G20 members who joined the Agreement and efforts to enable the Paris Agreement to enter into force by the end of 2016 and look forward to its timely implementation with all its aspects. We affirm the importance of fulfilling the UNFCCC commitment by developed countries in providing means of implementation including financial resources to assist developing countries with respect to both mitigation and adaptation actions in line with Paris outcomes. We reaffirm the importance of the support provided by the Green Climate Fund. We welcome the G20 Climate Finance Study Group report on "Promoting Efficient and Transparent Provision and Mobilization of Climate Finance to Enhance Ambition of Mitigation and Adaptation Actions". We look forward to successful outcomes in related multilateral fora, including the Montreal Protocol and the International Civil Aviation Organization.

44. Worldwide massive forced displacement of people, unprecedented since the Second World War, especially those generated from violent conflicts, is a global concern. We reiterate our call in Antalya for global concerted efforts in addressing the effects, protection need and root causes of refugee crisis to share in the burden associated with it. We call for strengthening humanitarian assistance for refugees and refugee resettlement, and we invite all states, according to their individual capacity, to scale up assistance to relevant international organizations in order to enhance their capabilities to assist affected countries, intensifying efforts to find durable solutions, in particular for protracted refugee situations, and in this regard, strengthening the contribution of development assistance to host communities. We support the international efforts to respond to the ongoing crisis and note the upcoming high-level meetings which will take place during the UN General Assembly. We note the World Bank's effort to work with other international organizations and its shareholders to develop a global crisis response platform to provide support to refugees and host communities in both low and middle income countries. The G20 will continue to address forced displacement in 2017 with a view to developing concrete actions. The G20 will also examine migration issues in 2017.

45. We strongly condemn terrorism in all forms and manifestations, which poses serious challenges to international peace and security and endangers our ongoing efforts to strengthen the global economy and ensure sustainable growth and development. We reaffirm our solidarity and resolve in the fight against terrorism in all its forms and wherever it occurs. We will tackle all sources, techniques and channels of terrorist financing, including extortion, taxation, smuggling of natural resources, bank looting, looting of cultural property, external donation, and kidnapping for ransom. In confronting terrorism, we remain committed to effectively exchanging information, freezing terrorist assets, and criminalizing terrorist financing. We call for the swift, effective and universal implementation of the FATF standards and of the provisions of the UN Security Council resolution 2253 worldwide. We welcome the progress achieved by the FATF in the implementation of its new Consolidated Strategy on Combating Terrorist Financing and call for effective implementation of its operational plan. We call on the FATF to reflect by March 2017 on ways to progress in strengthening its traction capacity and enhanced effectiveness of the network of FATF and FATF-style regional bodies.

46. Antimicrobial resistance (AMR) poses a serious threat to public health, growth and global economic stability. We affirm the need to explore in an inclusive manner to fight antimicrobial resistance by developing evidence-based ways to prevent and mitigate resistance, and unlock research and development into new and existing antimicrobials from a G20 value-added perspective, and call on the WHO, FAO, OIE and OECD to collectively report back in 2017 on options to address this including the economic aspects. In this context, we will promote prudent use of antibiotics and take into consideration huge challenges of affordability and access of antimicrobials and their impact on public health. We strongly support the work of the WHO, FAO and the OIE and look forward to a successful high-level meeting on AMR during the UN General Assembly. We look forward to the discussion under the upcoming presidency for dealing with these issues.

47. We reaffirm that the G20's founding spirit is to bring together the major economies on an equal footing to catalyze action. Once we agree, we will deliver.

48. We thank China for hosting a successful Hangzhou Summit and its contribution to the G20 process, and look forward to meeting again in Germany in 2017 and in Argentina in 2018.

Alexander Stevenson

Articles of Agreement

INTERNATIONAL MONETARY FUND

AND

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

United Nations Monetary and Financial Conference

Bretton Woods, N. H. • July 1 to 22, 1944

U. S. TREASURY WASHINGTON, D. C.

ARTICLES OF AGREEMENT

INTERNATIONAL BANK
FOR
RECONSTRUCTION AND DEVELOPMENT

The Governments on whose behalf the present Agreement is signed agree as follows:

Introductory Article

The International Bank for Reconstruction and Development is established and shall operate in accordance with the following provisions:

Article I. Purposes

The purposes of the Bank are:

(i) To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.

(ii) To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.

(iii) To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories.

(iv) To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.

(v) To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

The Bank shall be guided in all its decisions by the purposes set forth above.

Article II. Membership in and Capital of the Bank

SECTION 1. *Membership.*—(*a*) The original members of the Bank shall be those members of the International Monetary Fund which accept membership in the Bank before the date specified in Article XI, Section 2 (*e*).

(*b*) Membership shall be open to other members of the Fund, at such times and in accordance with such terms as may be prescribed by the Bank.

SEC. 2. *Authorized capital.*—(*a*) The authorized capital stock of the Bank shall be $10,000,000,000, in terms of United States dollars of the weight and fineness in effect on July 1, 1944. The capital stock shall be divided into 100,000 shares having a par value of $100,000 each, which shall be available for subscription only by members.

(*b*) The capital stock may be increased when the Bank deems it advisible by a three-fourths majority of the total voting power.

SEC. 3. *Subscription of shares.*—(*a*) Each member shall subscribe shares of the capital stock of the Bank. The minimum number of shares to be subscribed by the original members shall be those set forth in Schedule A. The minimum number of shares to be subscribed by other members shall be determined by the Bank, which shall reserve a sufficient portion of its capital stock for subscription by such members.

(*b*) The Bank shall prescribe rules laying down the conditions under which members may subscribe shares of the authorized capital stock of the Bank in addition to their minimum subscriptions.

(*c*) If the authorized capital stock of the Bank is increased, each member shall have a reasonable opportunity to subscribe, under such conditions as the Bank shall decide, a proportion of the increase of stock equivalent to the proportion which its stock theretofore subscribed bears to the total capital stock of the Bank, but no member shall be obligated to subscribe any part of the increased capital.

SEC. 4. *Issue price of shares.*—Shares included in the minimum subscriptions of original members shall be issued at par. Other shares shall be issued at par unless the Bank by a majority of the total voting power decides in special circumstances to issue them on other terms.

SEC. 5. *Division and calls of subscribed capital.*—The subscription of each member shall be divided into two parts as follows:

(i) twenty percent shall be paid or subject to call under Section 7 (i) of this Article as needed by the Bank for its operations;

(ii) the remaining eighty percent shall be subject to call by the Bank only when required to meet obligations of the Bank created under Article IV, Sections 1 (*a*) (ii) and (iii).

Calls on unpaid subscriptions shall be uniform on all shares.

SEC. 6. *Limitation on liability.*—Liability on shares shall be limited to the unpaid portion of the issue price of the shares.

SEC. 7. *Method of payment of subscriptions for shares.*—Payment of subscriptions for shares shall be made in gold or United States dollars and in the currencies of the members as follows:

(i) under Section 5 (i) of this Article, two percent of the price of each share shall be payable in gold or United States dollars, and, when calls are made, the remaining eighteen percent shall be paid in the currency of the member;

(ii) when a call is made under Section 5 (ii) of this Article, payment may be made at the option of the member either in gold, in United States dollars or in the currency required to discharge the obligations of the Bank for the purpose for which the call is made;

(iii) when a member makes payments in any currency under (i) and (ii) above, such payments shall be made in amounts equal in value to the member's liability under the call. This liability shall be a proportionate part of the subscribed capital stock of the Bank as authorized and defined in Section 2 of this Article.

SEC. 8. *Time of payment of subscriptions.*—(*a*) The two percent payable on each share in gold or United States dollars under Section 7 (i) of this Article, shall be paid within sixty days of the date on which the Bank begins operations, provided that

(i) any original member of the Bank whose metropolitan territory has suffered from enemy occupation or hostilities during the present war shall be granted the right to postpone payment of one-half percent until five years after that date;

(ii) an original member who cannot make such a payment because it has not recovered possession of its gold reserves which are still seized or immobilized as a result of the war may postpone all payment until such date as the Bank shall decide.

(*b*) The remainder of the price of each share payable under Section 7 (i) of this Article shall be paid as and when called by the Bank, provided that

(i) the Bank shall, within one year of its beginning operations, call not less than eight percent of the price of the share in addition to the payment of two percent referred to in (*a*) above;

(ii) not more than five percent of the price of the share shall be called in any period of three months.

SEC. 9. *Maintenance of value of certain currency holdings of the Bank.*—(*a*) Whenever (i) the par value of a member's currency is reduced, or (ii) the foreign exchange value of a member's currency has, in the opinion of the Bank, depreciated to a significant extent within that member's territories, the member shall pay to the Bank within a reasonable time an additional amount of its own currency sufficient to maintain the value, as of the time of initial subscription, of the amount of the currency of such member, which is held by the Bank and derived from currency originally paid in to the Bank by the member under Article II, Section 7 (i), from currency referred to in Article IV, Section 2 (*b*), or from any additional currency furnished under the provisions of the present paragraph, and which has not been repurchased by the member for gold or for the currency of any member which is acceptable to the Bank.

(*b*) Whenever the par value of a member's currency is increased, the Bank shall return to such member within a reasonable time an amount of that member's currency equal to the increase in the value of the amount of such currency described in (*a*) above.

(*c*) The provisions of the preceding paragraphs may be waived by the Bank when a uniform proportionate change in the par values of the currencies of all its members is made by the International Monetary Fund.

SEC. 10. *Restriction on disposal of shares.*—Shares shall not be pledged or encumbered in any manner whatever and they shall be transferable only to the Bank.

Article III. General Provisions Relating to Loans and Guarantees

SECTION 1. *Use of resources.*—(*a*) The resources and the facilities of the Bank shall be used exclusively for the benefit of members with equitable consideration to projects for development and projects for reconstruction alike.

(*b*) For the purpose of facilitating the restoration and reconstruction of the economy of members whose metropolitan territories have suffered great devastation from enemy occupation or hostilities, the Bank, in determining the conditions and terms of loans made to such members, shall pay special regard to lightening the financial burden and expediting the completion of such restoration and reconstruction.

SEC. 2. *Dealings between members and the Bank.*—Each member shall deal with the Bank only through its Treasury, central bank, stabilization fund or other similar fiscal agency, and the Bank shall deal with members only by or through the same agencies.

SEC. 3. *Limitations on guarantees and borrowings of the Bank.*—The total amount outstanding of guarantees, participations in loans and direct loans made by the Bank shall not be increased at any time, if by such increase the total would exceed one hundred percent of the unimpaired subscribed capital, reserves and surplus of the Bank.

SEC. 4. *Conditions on which the Bank may guarantee or make loans.*—The Bank may guarantee, participate in, or make loans to any member or any political subdivision thereof and any business, industrial, and agricultural enterprise in the territories of a member, subject to the following conditions:

(i) When the member in whose territories the project is located is not itself the borrower, the member or the central bank or some comparable agency of the member which is acceptable to the Bank, fully guarantees the repayment of the principal and the payment of interest and other charges on the loan.

(ii) The Bank is satisfied that in the prevailing market conditions the borrower would be unable otherwise to obtain the loan under conditions which in the opinion of the Bank are reasonable for the borrower.

(iii) A competent committee, as provided for in Article V, Section 7, has submitted a written report recommending the project after a careful study of the merits of the proposal.

(iv) In the opinion of the Bank the rate of interest and other charges are reasonable and such rate, charges and the schedule for repayment of principal are appropriate to the project.

(v) In making or guaranteeing a loan, the Bank shall pay due regard to the prospects that the borrower, and, if the borrower is not a member, that the guarantor, will be in position to meet its obligations under the loan; and the Bank shall act prudently in the interests both of the particular member in whose territories the project is located and of the members as a whole.

(vi) In guaranteeing a loan made by other investors, the Bank receives suitable compensation for its risk.

(vii) Loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development.

SEC. 5. *Use of loans guaranteed, participated in or made by the Bank.*—(*a*) The Bank shall impose no conditions that the proceeds of a loan shall be spent in the territories of any particular member or members.

(*b*) The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.

(*c*) In the case of loans made by the Bank, it shall open an account in the name of the borrower and the amount of the loan shall be credited to this account in the currency or currencies in which the loan is made. The borrower shall be permitted by the Bank to draw on this account only to meet expenses in connection with the project as they are actually incurred.

Article IV. Operations

SECTION 1. *Methods of making or facilitating loans.*—(*a*) The Bank may make or facilitate loans which satisfy the general conditions of Article III in any of the following ways:

(i) By making or participating in direct loans out of its own funds corresponding to its unimpaired paid-up capital and surplus and, subject to Section 6 of this Article, to its reserves.

(ii) By making or participating in direct loans out of funds raised in the market of a member, or otherwise borrowed by the Bank.

(iii) By guaranteeing in whole or in part loans made by private investors through the usual investment channels.

(*b*) The Bank may borrow funds under (*a*) (ii) above or guarantee loans under (*a*) (iii) above only with the approval of the member in whose markets the funds are raised and the member in whose currency the loan is denominated, and only if those members agree that the proceeds may be exchanged for the currency of any other member without restriction.

SEC. 2. *Availability and transferability of currencies.*—(*a*) Currencies paid into the Bank under Article II, Section 7 (i), shall be loaned only with the approval in each case of the member whose currency is involved; provided, however, that if necessary, after the Bank's subscribed capital has been entirely called, such currencies shall, without restriction by the members whose currencies are offered, be used or exchanged for the currencies required to meet contractual payments of interest, other charges or amortization on the Bank's own borrowings, or to meet the Bank's liabilities with respect to such contractual payments on loans guaranteed by the Bank.

(*b*) Currencies received by the Bank from borrowers or guarantors in payment on account of principal of direct loans made with currencies referred to in (*a*) above shall be exchanged for the currencies of other members or reloaned only with the approval in each case of the members whose currencies are involved; provided, however, that if necessary, after the Bank's subscribed capital has been entirely called, such currencies shall, without restriction by the members whose currencies are offered, be used or exchanged for the currencies required to meet contractual payments of interest, other charges or amortization on the Bank's own borrowings, or to meet the Bank's liabilities with respect to such contractual payments on loans guaranteed by the Bank.

(*c*) Currencies received by the Bank from borrowers or guarantors in payment on account of principal of direct loans made by the Bank under Section 1 (*a*) (ii) of this Article, shall be held and used, without restriction by the members, to make amortization payments, or to anticipate payment of or repurchase part or all of the Bank's own obligations.

(*d*) All other currencies available to the Bank, including those raised in the market or otherwise borrowed under Section 1 (*a*) (ii) of this Article, those obtained by the sale of gold, those received as payments of interest and other charges for direct loans made under Sections 1 (*a*) (i) and (ii), and those received as payments of commissions and other charges under Section 1 (*a*) (iii), shall be used or exchanged for other currencies or gold required in the operations of the Bank without restriction by the members whose currencies are offered.

(*e*) Currencies raised in the markets of members by borrowers on loans guaranteed by the Bank under Section 1 (*a*) (iii) of this Article, shall also be used or exchanged for other currencies without restriction by such members.

SEC. 3. *Provision of currencies for direct loans.*—The following provisions shall apply to direct loans under Sections 1 (*a*) (i) and (ii) of this Article.

(*a*) The Bank shall furnish the borrower with such currencies of members, other than the member in whose territories the project is located, as are needed by the borrower for expenditures to be made in the territories of such other members to carry out the purposes of the loan.

(*b*) The Bank may, in exceptional circumstances when local currency required for the purposes of the loan cannot be raised by the borrower on reasonable terms, provide the borrower as part of the loan with an appropriate amount of that currency.

(*c*) The Bank, if the project gives rise indirectly to an increased need for foreign exchange by the member in whose territories the project is located, may in exceptional circumstances provide the borrower as part of the loan with an appropriate amount of gold or foreign exchange not in excess of the borrower's local expenditure in connection with the purposes of the loan.

(*d*) The Bank may, in exceptional circumstances, at the request of a member in whose territories a portion of the loan is spent, repurchase with gold or foreign exchange a part of that member's currency thus spent but in no case shall the part so repurchased exceed the amount by which the expenditure of the loan in those territories gives rise to the increased need for foreign exchange.

SEC. 4. *Payment provisions for direct loans.*—Loan contracts under Section 1 (*a*) (i) or (ii) of this Article shall be made in accordance with the following payment provisions:

(*a*) The terms and conditions of interest and amortization payments, maturity and dates of payment of each loan shall be determined by the Bank. The Bank shall also determine the rate and any other terms and conditions of commission to be charged in connection with such loan.

In the case of loans made under Section 1 (*a*) (ii) of this Article during the first ten years of the Bank's operations, this rate of commission shall be not less than one percent per annum and not greater than one and one-half percent per annum, and shall be charged on the outstanding portion of any such loan. At the end of this period of ten years, the rate of commission may be reduced by the Bank with respect both to the outstanding portions of loans already made and to future loans, if the reserve accumulated by the Bank under Section 6 of this Article and out of other earnings are considered by it sufficient to justify a reduction. In the case of future loans the Bank shall also have discretion to increase the rate of commission beyond the above limit, if experience indicates that an increase is advisable.

(*b*) All loan contracts shall stipulate the currency or currencies in which payments under the contract shall be made to the Bank. At the option of the borrower, however, such payments may be made in gold, or subject to the agreement of the Bank, in the currency of a member other than that prescribed in the contract.

(i) In the case of loans made under Section 1 (*a*) (i) of this Article, the loan contracts shall provide that payments to the Bank of interest, other charges and amortization shall be made in the currency loaned, unless the member whose currency is loaned agrees that such payments shall be made in some other specified currency or currencies. These payments, subject to the provisions of Article II, Section 9 (*c*), shall be equivalent to the value of such contractural payments at the time the loans were made, in terms of a currency specified for the purpose by the Bank by a three-fourths majority of the total voting power.

(ii) In the case of loans made under Section 1 (*a*) (ii) of this Article, the total amount outstanding and payable to the Bank in any one currency shall at no time exceed the total amount of the outstanding borrowings made by the Bank under Section 1 (*a*) (ii) and payable in the same currency.

(*c*) If a member suffers from an acute exchange stringency, so that the service of any loan contracted by that member or guaranteed by it or by one of its agencies cannot be provided in the stipulated manner, the member concerned may apply to the Bank for a relaxation of the conditions of payments. If the Bank is satisfied that some relaxation is in the interests of the particular member and of the operations of the Bank and of its members as a whole, it may take action under either, or both, of the following paragraphs with respect to the whole, or part, of the annual service:

(i) The Bank may, in its discretion, make arrangements with the member concerned to accept service payments on the loan in the member's currency for periods not to exceed three years upon appropriate terms regarding the use of such currency and the maintenance of its foreign exchange value; and for the repurchase of such currency on appropriate terms.

(ii) The Bank may modify the terms of amortization or extend the life of the loan, or both.

SEC. 5. *Guarantees.*—(a) In guaranteeing a loan placed through the usual investment channels, the Bank shall charge a guarantee commission payable periodically on the amount of the loan outstanding at a rate determined by the Bank. During the first ten years of the Bank's operations, this rate shall be not less than one percent per annum and not greater than one and one-half percent per annum. At the end of this period of ten years, the rate of commission may be reduced by the Bank with respect both to the outstanding portions of loans already guaranteed and to future loans if the reserves accumulated by the Bank under Section 6 of this Article and out of other earnings are considered by it sufficient to justify a reduction. In the case of future loans the Bank shall also have discretion to increase the rate of commission beyond the above limit, if experience indicates that an increase is advisable.

(*b*) Guarantee commissions shall be paid directly to the Bank by the borrower.

(*c*) Guarantees by the Bank shall provide that the Bank may terminate its liability with respect to interest if, upon default by the borrower and by the guarantor, if any, the Bank offers to purchase, at par and interest accrued to a date designated in the offer, the bonds or other obligations guaranteed.

(*d*) The Bank shall have power to determine any other terms and conditions of the guarantee.

SEC. 6. *Special reserve.*—The amount of commissions received by the Bank under Sections 4 and 5 of this Article shall be set aside as a special reserve, which shall be kept available for meeting liabilities of the Bank in accordance with Section 7 of this Article. The special reserve shall be held in such liquid form, permitted under this Agreement, as the Executive Directors may decide.

SEC. 7. *Methods of meeting liabilities of the Bank in case of defaults.*—In cases of default on loans made, participated in, or guaranteed by the Bank:

(*a*) The Bank shall make such arrangements as may be feasible to adjust the obligations under the loans, including arrangements under or analogous to those provided in Section 4 (c) of this Article.

(*b*) The payments in discharge of the Bank's liabilities on borowings or guarantees under Section 1 (a) (ii) and (iii) of this Article shall be charged:

(i) first, against the special reserve provided in Section 6 of this Article;

(ii) then, to the extent necessary and at the discretion of the Bank, against the other reserves, surplus and capital available to the Bank.

(*c*) Whenever necessary to meet contractual payments of interest, other charges or amortization on the Bank's own borrowings, or to meet the Bank's liabilities with respect to similar payments on loans guaranteed by it, the Bank may call an appropriate amount of the unpaid subscriptions of members in accordance with Article II, Sections 5 and 7. Moreover, if it believes that a default may be of long duration, the Bank may call an additional amount of such unpaid subscriptions not to exceed in any one year one percent of the total subscriptions of the members for the following purposes:

(i) To redeem prior to maturity, or otherwise discharge its liability on, all or part of the outstanding principal of any loan guaranteed by it in respect of which the debtor is in default.

(ii) To repurchase, or otherwise discharge its liability on, all or part of its own outstanding borrowings.

SEC. 8. *Miscellaneous operations.*—In addition to the operations specified elsewhere in this Agreement, the Bank shall have the power:

(i) To buy and sell securities it has issued and to buy and sell securities which it has guaranteed or in which it has invested, provided that the Bank shall obtain the approval of the member in whose territories the securities are to be bought or sold.

(ii) To guarantee securities in which it has invested for the purpose of facilitating their sale.

(iii) To borrow the currency of any member with the approval of that member.

(iv) To buy and sell such other securities as the Directors by a three-fourths majority of the total voting power may deem proper for the investment of all or part of the special reserve under Section 6 of this Article.

In exercising the powers conferred by this Section, the Bank may deal with any person, partnership, association, corporation or other legal entity in the territories of any member.

SEC. 9. *Warning to be placed on securities.*—Every security guaranteed or issued by the Bank shall bear on its face a conspicuous statement to the effect that it is not an obligation of any government unless expressly stated on the security.

SEC. 10. *Political activity prohibited.*—The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.

Article V. Organization and Management

SECTION 1. *Structure of the Bank.*—The Bank shall have a Board of Governors, Executive Directors, a President and such other officers and staff to perform such duties as the Bank may determine.

SEC. 2. *Board of Governors.*—(*a*) All the powers of the Bank shall be vested in the Board of Governors consisting of one governor and one alternate appointed by each member in such manner as it may determine. Each governor and each alternate shall serve for five years, subject to the pleasure of the member appointing him, and may be reappointed. No alternate may vote except in the absence of his principal. The Board shall select one of the governors as Chairman.

(*b*) The Board of Governors may delegate to the Executive Directors authority to exercise any powers of the Board, except the power to:

(i) Admit new members and determine the conditions of their admission;

(ii) Increase or decrease the capital stock;

(iii) Suspend a member;

(iv) Decide appeals from interpretations of this Agreement given by the Executive Directors;

(v) Make arrangements to cooperate with other international organizations (other than informal arrangements of a temporary and administrative character);

(vi) Decide to suspend permanently the operations of the Bank and to distribute its assets;

(vii) Determine the distribution of the net income of the Bank.

(*c*) The Board of Governors shall hold an annual meeting and such other meetings as may be provided for by the Board or called by the Executive Directors. Meetings of the Board shall be called by the Directors whenever requested by five members or by members having one-quarter of the total voting power.

(*d*) A quorum for any meeting of the Board of Governors shall be a majority of the Governors, exercising not less than two-thirds of the total voting power.

(*e*) The Board of Governors may by regulation establish a procedure whereby the Executive Directors, when they deem such action to be in the best interests of the Bank, may obtain a vote of the Governors on a specific question without calling a meeting of the Board.

(*f*) The Board of Governors, and the Executive Directors to the extent authorized, may adopt such rules and regulations as may be necessary or appropriate to conduct the business of the Bank.

(*g*) Governors and alternates shall serve as such without compensation from the Bank, but the Bank shall pay them reasonable expenses incurred in attending meetings.

(*h*) The Board of Governors shall determine the remuneration to be paid to the Executive Directors and the salary and terms of the contract of service of the President.

SEC. 3. *Voting.*—(*a*) Each member shall have two hundred fifty votes plus one additional vote for each share of stock held.

(*b*) Except as otherwise specifically provided, all matters before the Bank shall be decided by a majority of the votes cast.

SEC. 4. *Executive Directors.*—(*a*) The Executive Directors shall be responsible for the conduct of the general operations of the Bank, and for this purpose, shall exercise all the powers delegated to them by the Board of Governors.

(*b*) There shall be twelve Executive Directors, who need not be governors, and of whom:

(i) five shall be appointed, one by each of the five members having the largest number of shares;

(ii) seven shall be elected according to Schedule B by all the Governors other than those appointed by the five members referred to in (i) above.

For the purpose of this paragraph, "members" means governments of countries whose names are set forth in Schedule A, whether they are original members or become members in accordance with Article II, Section 1 (*b*). When governments of other countries become members, the Board of Governors may, by a four-fifths majority of the total voting power, increase the total number of directors by increasing the number of directors to be elected.

Executive directors shall be appointed or elected every two years.

(*c*) Each executive director shall appoint an alternate with full power to act for him when he is not present. When the executive directors appointing them are present, alternates may participate in meetings but shall not vote.

(*d*) Directors shall continue in office until their successors are appointed or elected. If the office of an elected director becomes vacant more than ninety days before the end of his term, another director shall be elected for the remainder of the term by the governors who elected the former director. A majority of the votes cast shall be required for election. While the office remains vacant, the alternate of the former director shall exercise his powers, except that of appointing an alternate.

(*e*) The Executive Directors shall function in continuous session at the principal office of the Bank and shall meet as often as the business of the Bank may require.

(*f*) A quorum for any meeting of the Executive Directors shall be a majority of the Directors, exercising not less than one-half of the total voting power.

(*g*) Each appointed director shall be entitled to cast the number of votes allotted under Section 3 of this Article to the member appointing him. Each elected director shall be entitled to cast the number of votes which counted toward his election. All the votes which a director is entitled to cast shall be cast as a unit.

(*h*) The Board of Governors shall adopt regulations under which a member not entitled to appoint a director under (*b*) above may send a representative to attend any meeting of the Executive Directors when a request made by, or a matter particularly affecting, that member is under consideration.

(*i*) The Executive Directors may appoint such committees as they deem advisable. Membership of such committees need not be limited to governors or directors or their alternates.

SEC. 5. *President and staff.*—(*a*) The Executive Directors shall select a President who shall not be a governor or an executive director or an alternate for either. The President shall be Chairman of the Executive Directors, but shall have no vote except a deciding vote in case of an equal division. He may participate in meetings of the Board of Governors, but shall not vote at such meetings. The President shall cease to hold office when the Executive Directors so decide.

(*b*) The President shall be chief of the operating staff of the Bank and shall conduct, under the direction of the Executive Directors, the ordinary business of the Bank. Subject to the general control of the Executive Directors, he shall be responsible for the organization, appointment and dismissal of the officers and staff.

(*c*) The President, officers and staff of the Bank, in the discharge of their offices, owe their duty entirely to the Bank and to no other authority. Each member of the Bank shall respect the international character of this duty and shall refrain from all attempts to influence any of them in the discharge of their duties.

(*d*) In appointing the officers and staff the President shall, subject to the paramount importance of securing the highest standards of efficiency and of technical competence, pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible.

SEC. 6. *Advisory Council.*—(*a*) There shall be an Advisory Council of not less than seven persons selected by the Board of Governors including representatives of banking, commercial, industrial, labor, and agricultural interests, and with as wide a national representation as possible. In those fields where specialized international organizations exist, the members of the Council representative of those fields shall be selected in agreement with such organizations. The Council shall advise the Bank on matters of general policy. The Council shall meet annually and on such other occasions as the Bank may request.

(*b*) Councillors shall serve for two years and may be reappointed. They shall be paid their reasonable expenses incurred on behalf of the Bank.

SEC. 7. *Loan committees.*—The committees required to report on loans under Article III, Section 4, shall be appointed by the Bank. Each such committee shall include an expert selected by the governor representing the member in whose territories the project is located and one or more members of the technical staff of the Bank.

SEC. 8. *Relationship to other international organizations.*—(*a*) The Bank, within the terms of this Agreement, shall cooperate with any general international organization and with public international organizations having specialized responsibilities in related fields. Any arrangements for such cooperation which would involve a modification of any provision of this Agreement may be effected only after amendment to this Agreement under Article VIII.

(*b*) In making decisions on applications for loans or guarantees relating to matters directly within the competence of any international organization of the types specified in the preceding paragraph and participated in primarily by members of the Bank, the Bank shall give consideration to the views and recommendations of such organization.

SEC. 9. *Location of offices.*—(*a*) The principal office of the Bank shall be located in the territory of the member holding the greatest number of shares.

(*b*) The Bank may establish agencies or branch offices in the territories of any member of the Bank.

SEC. 10. *Regional offices and councils.*—(*a*) The Bank may establish regional offices and determine the location of, and the areas to be covered by, each regional office.

(*b*) Each regional office shall be advised by a regional council representative of the entire area and selected in such manner as the Bank may decide.

SEC. 11. *Depositories.*—(*a*) Each member shall designate its central bank as a depository for all the Bank's holdings of its currency or, if it has no central bank, it shall designate such other institution as may be acceptable to the Bank.

(*b*) The Bank may hold other assets, including gold, in depositories designated by the five members having the largest number of shares and in such other designated depositories as the Bank may select. Initially, at least one-half of the gold holdings of the Bank shall be held in the depository designated by the member in whose territory the Bank has its principal office, and at least forty percent shall be held in the depositories designated by the remaining four members referred to above, each of such depositories to hold, initially, not less than the amount of gold paid on the shares of the member designating it. However, all transfers of gold by the Bank shall be made with due regard to the costs of transport and anticipated requirements of the Bank. In an emergency the Executive Directors may transfer all or any part of the Bank's gold holdings to any place where they can be adequately protected.

SEC. 12. *Form of holding of currency.*—The Bank shall accept from any member, in place of any part of the member's currency, paid in to the Bank under Article II, Section 7 (i), or to meet amortization payments on loans made with such currency, and not needed by the Bank in its operations, notes or similar obligations issued by the Government of the member or the depository designated by such member, which shall be non-negotiable, non-interest-bearing and payable at their par value on demand by credit to the account of the Bank in the designated depository.

SEC. 13. *Publication of reports and provision of information.*—(*a*) The Bank shall publish an annual report containing an audited statement of its accounts and shall circulate to members at intervals of three months or less a summary statement of its financial position and a profit and loss statement showing the results of its operations.

(*b*) The Bank may publish such other reports as it deems desirable to carry out its purposes.

(*c*) Copies of all reports, statements and publications made under this section shall be distributed to members.

SEC. 14. *Allocation of net income.*—(*a*) The Board of Governors shall determine annually what part of the Bank's net income, after making provision for reserves, shall be allocated to surplus and what part, if any, shall be distributed.

(*b*) If any part is distributed, up to two percent non-cumulative shall be paid, as a first charge against the distribution for any year, to each member on the basis of the average amount of the loans outstanding during the year made under Article IV, Section 1 (*a*) (i), out of currency corresponding to its subscription. If two percent is paid as a first charge, any balance remaining to be distributed shall be paid to all members in proportion to their shares. Payments to each member shall be made in its own currency, or if that currency is not available in other currency acceptable to the member. If such payments are made in currencies other than the member's own currency, the transfer of the currency and its use by the receiving member after payment shall be without restriction by the members.

Article VI. Withdrawal and Suspension of Membership: Suspension of Operations

SECTION 1. *Right of members to withdraw.*—Any member may withdraw from the Bank at any time by transmitting a notice in writing to the Bank at its principal office. Withdrawal shall become effective on the date such notice is received.

SEC. 2. *Suspension of membership.*—If a member fails to fulfill any of its obligations to the Bank, the Bank may suspend its membership by decision of a majority of the

Governors, exercising a majority of the total voting power. The member so suspended shall automatically cease to be a member one year from the date of its suspension unless a decision is taken by the same majority to restore the member to good standing.

While under suspension, a member shall not be entitled to exercise any rights under this Agreement, except the right of withdrawal, but shall remain subject to all obligations.

SEC. 3. *Cessation of membership in International Monetary Fund.*—Any member which ceases to be a member of the International Monetary Fund shall automatically cease after three months to be a member of the Bank unless the Bank by three-fourths of the total voting power has agreed to allow it to remain a member.

SEC. 4. *Settlement of accounts with governments ceasing to be members.*—(*a*) When a government ceases to be a member, it shall remain liable for its direct obligations to the Bank and for its contingent liabilities to the Bank so long as any part of the loans or guarantees contracted before it ceased to be a member are outstanding; but it shall cease to incur liabilities with respect to loans and guarantees entered into thereafter by the Bank and to share either in the income or the expenses of the Bank.

(*b*) At the time a government ceases to be a member, the Bank shall arrange for the repurchase of its shares as a part of the settlement of accounts with such government in accordance with the provisions of (*c*) and (*d*) below. For this purpose the repurchase price of the shares shall be the value shown by the books of the Bank on the day the government ceases to be a member.

(*c*) The payment for shares repurchased by the Bank under this section shall be governed by the following conditions:

(i) Any amount due to the government for its shares shall be withheld so long as the government, its central bank or any of its agencies remains liable, as borrower or guarantor, to the Bank and such amount may, at the option of the Bank, be applied on any such liability as it matures. No amount shall be withheld on account of the liability of the government resulting from its subscription for shares under Article II, Section 5 (ii). In any event, no amount due to a member for its shares shall be paid until six months after the date upon which the government ceases to be a member.

(ii) Payments for shares may be made from time to time, upon their surrender by the government, to the extent by which the amount due as the repurchase price in (*b*) above exceeds the aggregate of liabilities on loans and guarantees in (*c*) (i) above until the former member has received the full repurchase price.

(iii) Payments shall be made in the currency of the country receiving payment or at the option of the Bank in gold.

(iv) If losses are sustained by the Bank on any guarantees, participations in loans, or loans which were outstanding on the date when the government ceased to be a member, and the amount of such losses exceeds the amount of the reserve provided against losses on the date when the government ceased to be a member, such government shall be obligated to repay upon demand the amount by which the repurchase price of its shares would have been reduced, if the losses had been taken into account when the repurchase price was determined. In addition, the former member government shall remain liable on any call for unpaid subscriptions under Article II, Section 5 (ii), to the extent that it would have been required to respond if the impairment of capital had occurred and the call had been made at the time the repurchase price of its shares was determined.

(*d*) If the Bank suspends permanently its operations under Section 5 (*b*) of this Article, within six months of the date upon which any government ceases to be a member, all rights of such government shall be determined by the provisions of Section 5 of the Article.

SEC. 5. *Suspension of operations and settlement of obligations.*—(*a*) In an emergency the Executive Directors may suspend temporarily operations in respect of new loans and guarantees pending an opportunity for further consideration and action by the Board of Governors.

(*b*) The Bank may suspend permanently its operations in respect of new loans and guarantees by vote of a majority of the Governors, exercising a majority of the total voting power. After such suspension of operations the Bank shall forthwith cease all activities, except those incident to the orderly realization, conservation, and preservation of its assets and settlement of its obligations.

(*c*) The liability of all members for uncalled subscriptions to the capital stock of the Bank and in respect of the depreciation of their own currencies shall continue until all claims of creditors, including all contingent claims, shall have been discharged.

(*d*) All creditors holding direct claims shall be paid out of the assets of the Bank, and then out of payments to the Bank on calls on unpaid subscriptions. Before making any payments to creditors holding direct claims, the Executive Directors shall make such arrangements as are necessary, in their judgment, to insure a distribution to holders of contingent claims ratably with creditors holding direct claims.

(*e*) No distribution shall be made to members on account of their subscriptions to the capital stock of the Bank until

(i) all liabilities to creditors have been discharged or provided for, and

(ii) a majority of the Governors, exercising a majority of the total voting power, have decided to make a distribution.

(*f*) After a decision to make a distribution has been taken under (*e*) above, the Executive Directors may by a two-thirds majority vote make successive distributions of the assets of the Bank to members until all of the assets have been distributed. This distribution shall be subject to the prior settlement of all outstanding claims of the Bank against each member.

(*g*) Before any distribution of assets is made, the Executive Directors shall fix the proportionate share of each member according to the ratio of its shareholding to the total autstanding shares of the Bank.

(*h*) The Executive Directors shall value the assets to be distributed as at the date of distribution and then proceed to distribute in the following manner:

(i) There shall be paid to each member in its own obligations or those of its official agencies or legal entities within its territories, insofar as they are available for distribution, an amount equivalent in value to its proportionate share of the total amount to be distributed.

(ii) Any balance due to a member after payment has been made under (i) above shall be paid, in its own currency, insofar as it is held by the Bank, up to an amount equivalent in value to such balance.

(iii) Any balance due to a member after payment has been made under (i) and (ii) above shall be paid in gold or currency acceptable to the member, insofar as they are held by the Bank, up to an amount equivalent in value to such balance.

(iv) Any remaining assets held by the Bank after payments have been made to members under (i), (ii), and (iii) above shall be distributed *pro rata* among the members.

(*i*) Any member receiving assets distributed by the Bank in accordance with (*h*) above, shall enjoy the same rights with respect to such assets as the Bank enjoyed prior to their distribution.

Article VII. Status, Immunities, and Privileges

SECTION 1. *Purpose of Article.*—To enable the Bank to fulfill the functions with which it is entrusted, the status, immunities and privileges set forth in this Article shall be accorded to the Bank in the territories of each member.

SEC. 2. *Status of the Bank.*—The Bank shall possess full juridical personality, and, in particular, the capacity:

(i) to contract;

(ii) to acquire and dispose of immovable and movable property;

(iii) to institute legal proceedings.

SEC. 3. *Position of the Bank with regard to judicial process.*—Actions may be brought against the Bank only in a court of competent jurisdiction in the territories of a member in which the Bank has an office, has appointed an agent for the purpose of accepting service or notice of process, or has issued or guaranteed securities. No actions shall, however, be brought by members or persons acting for or deriving claims from members. The property and assets of the Bank shall, wheresoever located and by whomsoever held, be immune from all forms of seizure, attachment or execution before the delivery of final judgment against the Bank.

SEC. 4. *Immunity of assets from seizure.*—Property and assets of the Bank, wherever located and by whomsoever held, shall be immune from search, requisition, confiscation, expropriation or any other form of seizure by executive or legislative action.

SEC. 5. *Immunity of archives.*—The archives of the Bank shall be inviolable.

SEC. 6. *Freedom of assets from restrictions.*—To the extent necessary to carry out the operations provided for in this Agreement and subject to the provisions of this Agreement, all property and assets of the Bank shall be free from any restrictions, regulations, controls and moratoria of any nature.

SEC. 7. *Privilege for communications.*—The official communications of the Bank shall be accorded by each member the same treatment that it accords to the official communications of other members.

SEC. 8. *Immunities and privileges of officers and employees.*—All governors, executive directors, alternates, officers and employees of the Bank

(i) shall be immune from legal process with respect to acts performed by them in their official capacity except when the Bank waives this immunity;

(ii) not being local nationals, shall be accorded the same immunities from immigration restrictions, alien registration requirements and national service obligations and the same facilities as regards exchange restrictions as are accorded by members to the representatives, officials, and employees of comparable rank of other members;

(iii) shall be granted the same treatment in respect of travelling facilities as is accorded by members to representatives, officials and employees of comparable rank of other members.

SEC. 9. *Immunities from taxation.*—(*a*) The Bank, its assets, property, income and its operations and transactions authorized by this Agreement, shall be immune from all taxation and from all customs duties. The Bank shall also be immune from liability for the collection or payment of any tax or duty.

(*b*) No tax shall be levied on or in respect of salaries and emoluments paid by the Bank to executive directors, alternates, officials or employees of the Bank who are not local citizens, local subjects, or other local nationals.

(*c*) No taxation of any kind shall be levied on any obligation or security issued by the Bank (including any dividend or interest thereon) by whomsoever held

(i) which discriminates against such obligation or security solely because it is issued by the Bank; or

(ii) if the sole jurisdictional basis for such taxation is the place of currency in which it is issued, made payable or paid, or the location of any office or place of business maintained by the Bank.

(*d*) No taxation of any kind shall be levied on any obligation or security guaranteed by the Bank (including any dividend or interest thereon) by whomsoever held

(i) which discriminates against such obligation or security solely because it is guaranteed by the Bank; or

(ii) if the sole jurisdictional basis for such taxation is the location of any office or place of business maintained by the Bank.

SEC. 10. *Application of Article.*—Each member shall take such action as is necessary in its own territories for the purpose of making effective in terms of its own law the principles set forth in this Article and shall inform the Bank of the detailed action which it has taken.

Article VIII. Amendments

(*a*) Any proposal to introduce modifications in this Agreement, whether emanating from a member, a governor or the Executive Directors, shall be communicated to the Chairman of the Board of Governors who shall bring the proposal before the Board. If the proposed amendment is approved by the Board the Bank shall, by circular letter or telegram, ask all members whether they accept the proposed amendment. When three-fifths of the members, having four-fifths of the total voting power, have accepted the proposed amendment, the Bank shall certify the fact by a formal communication addressed to all members.

(*b*) Nothwithstanding (*a*) above, acceptance by all members is required in the case of any amendment modifying

(i) the right to withdraw from the Bank provided in Article VI, Section 1;

(ii) the right secured by Article II, Section 3 (*c*);

(iii) the limitation on liability provided in Article II, Section 6.

(*c*) Amendments shall enter into force for all members three months after the date of the formal communication unless a shorter period is specified in the circular letter or telegram.

Article IX. Interpretation

(*a*) Any question of interpretation of the provisions of this Agreement arising between any member and the Bank or between any members of the Bank shall be submitted to the Executive Directors for their decision. If the question particularly affects any member not entitled to appoint an executive director, it shall be entitled to representation in accordance with Article V, Section 4 (*h*).

(*b*) In any case where the Executive Directors have given a decision under (*a*) above, any member may require that the question be referred to the Board of Governors, whose decision shall be final. Pending the result of the reference to the Board, the Bank may, so far as it deems necessary, act on the basis of the decision of the Executive Directors.

(*c*) Whenever a disagreement arises between the Bank and a country which has ceased to be a member, or between the Bank and any member during the permanent suspension of the Bank, such disagreement shall be submitted to arbitration by a tribunal of three arbitrators, one appointed by the Bank, another by the country involved and an umpire who, unless the parties otherwise agree, shall be appointed by the President of the Permanent Court of International Justice or such other authority as may have been prescribed by regulation adopted by the Bank. The umpire shall have full power to settle all questions of procedure in any case where the parties are in disagreement with respect thereto.

Article X. Approval Deemed Given

Whenever the approval of any member is required before any act may be done by the Bank, except in Article VIII, approval shall be deemed to have been given unless the member presents an objection within such reasonable period as the Bank may fix in notifying the member of the proposed act.

Article XI. Final Provisions

SECTION 1. *Entry into force.*—This Agreement shall enter into force when it has been signed on behalf of governments whose minimum subscriptions comprise not less than sixty-five percent of the total subscriptions set forth in Schedule A and when the instruments referred to in Section 2 (*a*) of this Article have been deposited on their behalf, but in no event shall this Agreement enter into force before May 1, 1945.

SEC. 2. *Signature.*—(*a*) Each government on whose behalf this Agreement is signed shall deposit with the Government of the United States of America an instrument setting forth that it has accepted this Agreement in accordance with its law and has taken all steps necessary to enable it to carry out all of its obligations under this Agreement.

(*b*) Each government shall become a member of the Bank as from the date of the deposit on its behalf of the instrument referred to in (*a*) above, except that no government shall become a member before this Agreement enters into force under Section 1 of this Article.

(*c*) The Government of the United States of America shall inform the governments of all countries whose names are set forth in Schedule A, and all governments whose membership is approved in accordance with Article II, Section 1 (*b*), of all signatures of this Agreement and of the deposit of all instruments referred to in (*a*) above.

(*d*) At the time this Agreement is signed on its behalf, each government shall transmit to the Government of the United States of America one one-hundredth of one percent of the price of each share in gold or United States dollars for the purpose of meeting administrative expenses of the Bank. This payment shall be credited on account of the payment to be made in accordance with Article II, Section 8 (*a*). The Government of the United States of America shall hold such funds in a special deposit account and shall transmit them to the Board of Governors of the Bank when the initial meeting has been called under Section 3 of this Article. If this Agreement has not come into force by December 31, 1945, the Government of the United States of America shall return such funds to the governments that transmitted them.

(*e*) This Agreement shall remain open for signature at Washington on behalf of the governments of the countries whose names are set forth in Schedule A until December 31, 1945.

(*f*) After December 31, 1945, this Agreement shall be open for signature on behalf of the government of any country whose membership has been approved in accordance with Article II, Section 1 (*b*).

(*g*) By their signature of this Agreement, all governments accept it both on their own behalf and in respect of all their colonies, overseas territories, all territories under their protection, suzerainty, or authority and all territories in respect of which they exercise a mandate.

(*h*) In the case of governments whose metropolitan territories have been under enemy occupation, the deposit of the instrument referred to in (*a*) above may be delayed until one hundred and eighty days after the date on which these territories have been liberated. If, however, it is not deposited by any such government before the expiration of this period, the signature affixed on behalf of that government shall become void and the portion of its subscription paid under (*d*) above shall be returned to it.

(*i*) Paragraphs (*d*) and (*h*) shall come into force with regard to each signatory government as from the date of its signature.

SEC. 3. *Inauguration of the Bank.*—(*a*) As soon as this Agreement enters into force under Section 1 of this Article, each member shall appoint a governor and the member to whom the largest number of shares is allocated in Schedule A shall call the first meeting of the Board of Governors.

(*b*) At the first meeting of the Board of Governors, arrangements shall be made for the selection of provisional executive directors. The governments of the five countries, to which the largest number of shares are allocated in Schedule A, shall appoint provisional executive directors. If one or more of such governments have not become members, the executive directorships which they would be entitled to fill shall remain vacant until they become members, or until January 1, 1946, whichever is the earlier. Seven provisional executive directors shall be elected in accordance with the provisions of Schedule B and shall remain in office until the date of the first regular election of executive directors which shall be held as soon as practicable after January 1, 1946.

(*c*) The Board of Governors may delegate to the provisional executive directors any powers except those which may not be delegated to the Executive Directors.

(*d*) The Bank shall notify members when it is ready to commence operations.

Done at Washington, in a single copy which shall remain deposited in the archives of the Government of the United States of America, which shall transmit certified copies to all governments whose names are set forth in Schedule A and to all governments whose membership is approved in accordance with Article II, Section 1 (*b*).

Schedule A. Subscriptions

[Millions of dollars]

Australia	200	Iran	24
Belgium	225	Iraq	6
Bolivia	7	Liberia	.5
Brazil	105	Luxembourg	10
Canada	325	Mexico	65
Chile	35	Netherlands	275
China	600	New Zealand	50
Colombia	35	Nicaragua	.8
Costa Rica	2	Norway	50
Cuba	35	Panama	.2
Czechoslovakia	125	Paraguay	.8
Denmark	(1)	Peru	17.5
Dominican Republic	2	Philippine Commonwealth	15
Ecuador	3.2	Poland	125
Egypt	40	Union of South Africa	100
El Salvador	1	Union of Soviet Socialist Republics	1,200
Ethiopia	3	United Kingdom	1,300
France	450	United States	3,175
Greece	25	Uruguay	10.5
Guatemala	2	Venezuela	10.5
Haiti	2	Yugoslavia	40
Honduras	1		
Iceland	1		
India	400		
		Total	9,100

[1] The subscription of Denmark shall be determined by the Bank after Denmark accepts membership in accordance with these Articles of Agreement.

Schedule B. Election of Executive Directors

1. The election of the elective executive directors shall be by ballot of the Governors eligible to vote under Article V, Section 4 (*b*).

2. In balloting for the elective executive directors, each governor eligible to vote shall cast for one person all of the votes to which the member appointing him is entitled under Section 3 of Article V. The seven persons receiving the greatest number of votes shall be executive directors, except that no person who receives less than four-

teen percent of the total of the votes which can be cast (eligible votes) shall be considered elected.

3. When seven persons are not elected on the first ballot, a second ballot shall be held in which the person who received the lowest number of votes shall be ineligible for election and in which there shall vote only (*a*) those governors who voted in the first ballot for a person not elected and (*b*) those governors whose votes for a person elected are deemed under 4 below to have raised the votes cast for that person above fifteen percent of the eligible votes.

4. In determining whether the votes cast by a governor are to be deemed to have raised the total of any person above fifteen percent of the eligible votes, the fifteen percent shall be deemed to include first, the votes of the governor casting the largest number of votes for such person, then the votes of the governor casting the next largest number, and so on until fifteen percent is reached.

5. Any governor, part of whose votes must be counted in order to raise the total of any person above fourteen percent, shall be considered as casting all of his votes for such person even if the total votes for such person thereby exceed fifteen percent.

6. If, after the second ballot, seven persons have not been elected, further ballots shall be held on the same principles until seven persons have been elected, provided that after six persons are elected, the seventh may be elected by a simple majority of the remaining votes and shall be deemed to have been elected by all such votes.

COUNTRIES REPRESENTED AND CHAIRMEN OF DELEGATIONS

AUSTRALIA.—Leslie G. Melville, *Economic Adviser to the Commonwealth Bank of Australia.*

BELGIUM.—Camille Gutt, *Minister of Finance and Economic Affairs.*

BOLIVIA.—Rene Ballivian, *Financial Counselor, Bolivian Embassy, Washington.*

BRAZIL.—Arthur de Souza Costa, *Minister of Finance.*

CANADA.—J. L. Ilsley, *Minister of Finance.*

CHILE.—Luis Alamos Barros, *Director, Central Bank of Chile.*

CHINA.—*Hsiang-Hsi K'ung, Vice President of Executive Yuan and concurrently Minister of Finance; Governor of the Central Bank of China.*

COLOMBIA.—Carlos Lleras Restrepo, *former Minister of Finance and Comptroller General.*

COSTA RICA.—Francisco de P. Gutierrez Ross, *Ambassador to the United States; former Minister of Finance and Commerce.*

CUBA.—E. I. Montoulieu, *Minister of Finance.*

CZECHOSLOVAKIA.—Ladislav Feierabend, *Minister of Finance.*

DOMINICAN REPUBLIC.—Anselmo Copello, *Ambassador to the United States.*

ECUADOR.—Esteban F. Carbo, *Financial Counselor, Ecuadoran Embassy, Washington.*

EGYPT.—Sany Lackany Bey.

EL SALVADOR.—Agustin Alfaro Moran.

ETHIOPIA.—Blatta Ephrem Tewelde Medhen, *Minister to the United States.*

FRENCH DELEGATION.—Pierre Mendes-France, *Commissioner of Finance.*

GREECE.—Kyriakos Varvaressos, *Governor of the Bank of Greece; Ambassador Extraordinary for Economic and Financial Matters.*

GUATEMALA.—Manuel Noriega Morales.

HAITI.—Andre Liautaud, *Ambassador to the United States.*

HONDURAS.—Julian R. Caceres, *Ambassador to the United States.*

ICELAND.—Magnus Sigurdsson, *Manager, National Bank of Iceland.*

INDIA.—Sir Jeremy Raisman, *Member for Finance, Government of India.*

IRAN.—Abol Hassan Ebtehaj, *Governor of National Bank of Iran.*

IRAQ.—Ibrahim Kamal, *Senator and former Minister of Finance.*

LIBERIA.—William E. Dennis, *Secretary of the Treasury.*

LUXEMBOURG.—Hugues Le Gallais, *Minister to the United States.*

MEXICO.—*Eduardo Suarez, Minister of Finance.*

NETHERLANDS.—J. W. Beyen, *Financial Adviser to the Netherlands Government.*

NEW ZEALAND.—Walter Nash, *Minister of Finance; Minister to the United States.*

NICARAGUA.—Guillermo Sevilla Sacasa, *Ambassador to the United States.*

NORWAY.—Wilhelm Keilhau, *Director, Bank of Norway, p. t., London.*

PANAMA.—Guillermo Arango, *President, Investors Service Corporation of Panama.*

PARAGUAY.—Celso R. Velazquez, *Ambassador to the United States.*

PERU.—Pedro Beltran, *Ambassador-designate to the United States.*

PHILIPPINE COMMONWEALTH.—Colonel Andres Soriano, *Secretary of Finance.*

POLAND.—Ludwik Grosfeld, *Minister of Finance.*

UNION OF SOUTH AFRICA.—S. F. N. Gie, *Minister to the United States.*

UNION OF SOVIET SOCIALIST REPUBLICS.—M. S. Stepanov, *Deputy People's Commissar of Foreign Trade.*

UNITED KINGDOM.—Lord Keynes.

UNITED STATES OF AMERICA.—Henry Morgenthau, Jr., *Secretary of the Treasury.*

URUGUAY.—Mario Le Gamma Acevedo, *Expert, Ministry of Finance.*

VENEZUELA.—Rodolfo Rojas, *Minister of the Treasury.*

YUGOSLAVIA.—Vladimir Rybar, *Counselor of the Yugoslav Embassy, Washington.*

Henrik de Kauffmann, *Danish Minister to the United States, in his personal capacity.*

UNITED STATES DELEGATES

HENRY MORGENTHAU, JR., *Secretary of the Treasury—Chairman.*

FRED M. VINSON, *Director, Office of Economic Stabilization—Vice Chairman.*

DEAN ACHESON, *Assistant Secretary of State.*

EDWARD E. BROWN, *President, First National Bank of Chicago.*

LEO T. CROWLEY, *Administrator, Foreign Economic Administration.*

MARRINER S. ECCLES, *Chairman, Board of Governors of the Federal Reserve System.*

MABEL NEWCOMER, *Professor of Economics, Vassar College.*

BRENT SPENCE, *House of Representatives; Chairman, Committee on Banking and Currency.*

CHARLES W. TOBEY, *United States Senate; Member, Committee on Banking and Currency.*

ROBERT F. WAGNER, *United States Senate; Chairman, Committee on Banking and Currency.*

HARRY D. WHITE, *Assistant to the Secretary of the Treasury.*

JESSE P. WOLCOTT, *House of Representatives; Member, Committee on Banking and Currency.*

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DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)

DC2010-0002/1
April 25, 2010

**SYNTHESIS PAPER:
NEW WORLD, NEW WORLD BANK GROUP**

Attached for the April 25, 2010, Development Committee Meeting is a background document entitled "Synthesis Paper: New World, New World Bank," prepared by the staff of the World Bank.

* * *

SYNTHESIS PAPER:

NEW WORLD, NEW WORLD BANK GROUP

April 2010

New World, New World Bank Group

After the worst crisis in decades, the world economy faces an uncertain and uneven recovery with new risks to jobs and growth. The crisis response has shown why international cooperation -- and effective multilateral institutions -- matter. Called on to play a historically large role to protect the poor and lay the foundations of recovery, the World Bank Group has risen to the challenge: we have committed over $100 billion since the force of the crisis began.

We also got money where it was needed fast. Even though the World Bank Group has traditionally financed longer-term projects, our actual disbursements have exceeded the IMF's.

Past crises taught us to target this support where it would be most effective: to social safety nets for the most vulnerable; to productive investments in agriculture, infrastructure, and innovation as seeds of future opportunity; and to the private sector as an engine of growth. We launched creative ways to help our clients -- from the food crisis response to the IDA Crisis Response Facility and IFC's special vehicles for trade finance, microfinance, bank capitalization, infrastructure and distressed debt. This support benefited all: the recovery is demonstrating the key role of developing countries in generating new sources of demand. Over time, more and more developing countries can become new poles of growth for the global economy.

At the same time, we have not been diverted from laying the groundwork for new challenges such as combining development and climate change policies, and integrating governance, security, and development to help weak states coming out of conflict.

The crisis shows the possibilities of international cooperation, but it also underscores the need to modernize multilateralism -- and multilateral institutions -- to reflect a changing world. Addressing development challenges now requires institutions that are not only close to people in developing countries, but able to mobilize all key actors -- whether governments, the private sector, or civil society -- to address global threats together and support regional integration within a global system. It requires institutions that are innovative, adaptable, and able to seize new opportunities.

Building on our crisis response, we are putting before you a package of actions and reforms to modernize the World Bank Group. This aims to create a new Bank Group that:

- **Is strategically focused where we can add most value --** With our global reach, we can make a unique contribution to overcoming poverty through advancing inclusive and sustainable globalization, enhancing growth with care for the environment, and creating individual opportunity and hope. We can encourage the benefits of regional integration while avoiding the dangers of regional blocs by connecting regional interests to global goods. Looking ahead, we will focus on five priorities: targeting the poor and vulnerable, especially in Sub-Saharan Africa; creating opportunities for growth; promoting global collective action; strengthening governance; and preparing for crises.

- **Has 21st Century governance --** Voting power for developing and transition countries will increase to about 47.19% in IBRD, 39.48% in IFC, and about 46% in IDA. In the future, IBRD's shareholdings will reflect economic weights, contributions to IDA, and development contributions from the Bank Group's clients moving toward equitable voting power, with a review every five years. We are protecting the voting power of the smallest poor members. And we have created a third Board chair for Sub-Saharan Africa.

  Voice and balance will also be reflected through staffing, senior appointments, a focus on problem solving for clients, country ownership and a wider network of South-South (and South-North) experience, research and practice.

- **Remains financially strong --** We have developed a package that emphasizes mutual responsibility and sharing of interests. For IBRD, developing countries are enabling us to access their paid-in capital and are paying higher prices for loans while reform of loan maturity terms will be discussed in June. Developing and developed countries contribute to a selective capital increase of $27.8 billion of which $1.6 billion would be paid in and a general capital increase of $58.4 billion, of which 6%, or $3.5 billion, would be paid in and fully usable, with the remainder callable.

  We are also seeking to enhance IFC's financial capacity, through a combination of a voice reform connected to a selective capital increase of $200 million; consideration of a long-term hybrid instrument to shareholders (subject to realization of other capital options and Board review of terms and conditions and permitting significant capital treatment); and earnings retention.

  The World Bank Group responded vigorously to the crisis, but this has left us with little capacity to play a supportive role should recovery falter. We must remain capable of addressing new vulnerabilities as they arise. The Bank Group should also play a key role in supporting a sound, broad-based recovery that fosters multilateral cooperation and balanced growth. We are only seeking resources sufficient to allow a return to previous lending levels. We will also persist in exercising budget discipline.

- **Is more responsive, innovative, flexible, and accountable --** We are presenting a package of reforms that, taken together, represent the most ambitious reform agenda undertaken by the Bank Group: modernizing our products and services, fostering opportunities for innovation, and creating a new decentralization model that will enable us to apply cutting-edge skills closer to clients while gathering, customizing and spreading knowledge and experience more effectively. And we are sharpening our focus on results, opening access to our information and processes, and strengthening our governance and anti-corruption efforts.

Each part of the package is significant, and together they represent a dynamic transformation of the Bank Group. The package also has a shared balance. At a time when multilateral cooperation – from trade to climate change is struggling, the Bank Group is working as a cooperative of all its members. Each shareholder gains and all contribute.

Against this background, we ask that you:

- Support our post-crisis direction and reform agenda.
- Endorse the package of agreed reforms to voice and participation as outlined below, including a selective capital increase of $27.8 billion of which $1.6 billion would be paid in.
- Endorse the package for enhancing IBRD's financial capacity as outlined below, including a general capital increase for IBRD of $58.4 billion, of which 6%, or $3.5 billion, would be paid-in and fully usable, with the remainder callable.
- Endorse a package to enhance IFC's voice reform and financial capacity, consisting of an increase in basic votes and a selective capital increase of $200 million to boost developing and transition country ownership; consideration of a long-term hybrid instrument to shareholders (subject to realization of other capital options and Board review of terms and conditions and permitting significant capital treatment); and earnings retention.

Strategically focused where we can add most value

The Bank Group is setting clear priorities, sharpening our comparative advantages, and extending our complementarities with other institutions. As a global institution, we are uniquely positioned to reach across countries and regions to connect with other global actors and help tackle global issues. We bring worldwide catalytic and convening power to global and country problem-solving, along with global best practice services and standards. With world-class risk management and banking services, we can significantly leverage our resources and serve as an incubator for innovations in development financing, such as the Malawi weather derivative or the Caribbean Catastrophic Risk Insurance Facility. We offer a wide range of products and services, with knowledge and expertise gained globally but customized locally.

The core work of the World Bank Group is overcoming poverty and boosting growth; the question is how we can best carry out that mission in a changing world. We have identified five strategic priorities. We will tailor implementation to needs of key client groups: low-income and least developed countries, fragile and conflict-affected states, middle-income countries, and the Arab World—and will factor in gender and good governance as key cross-cutting issues.

- ***Targeting the poor and vulnerable, especially in Sub-Saharan Africa.*** Only five years remain to reach the Millennium Development Goals (MDGs), so we must intensify efforts to reach the poor wherever they are—in middle income countries, low income countries, and especially in Sub-Saharan Africa. We need innovative and targeted approaches to get the most "bang for the buck" from available resources. We need approaches that contribute to several goals at once and tap the innovation and capability of the private sector. And we must address the particular vulnerabilities of women and children and the special challenges facing the "bottom billion" living in fragile and conflict-affected states.

- ***Creating opportunities for growth.*** Sustained growth is the most robust and durable path out of poverty. Across our public and private sector arms, we will support developing countries with investments in agriculture, infrastructure, innovation and human capital. We will work to improve business environments and public spending, to build markets and invest in firms, and to foster growth that creates jobs and opportunities for all.

- ***Promoting global collective action.*** We will bring global connectivity, financial leverage and innovation, and world-class analysis and advocacy to global issues from climate change and trade, to agriculture and food security, energy, water, and health.

- ***Strengthening governance.*** We will help countries to place good governance at the heart of development programs and projects. Successful development requires local ownership, which depends in turn on governance and capacity. Corruption is a criminal waste of resources, and has a corrosive effect on public trust in government and institutions. We will assist countries to prevent and fight corruption, and will hold ourselves to the highest standards. We will help countries build open institutions for sound management of public resources, and service delivery. We will be an agent of change on governance: recovering stolen assets (StAR), preventing illegal tax havens, and managing revenues of extractive industries (EITI++).

- ***Preparing for crises.*** Countries need to lay the groundwork for crisis response before it is needed. We are developing new assessment, risk-sharing, financial, and policy tools to help countries better manage crises**.**

Within these five priorities, we will continually assess where we can have the most impact. For example, as other players have become more active in financing for priority diseases, the Bank Group is increasingly focusing on strengthening health systems. We will be selective, but our diverse client base and the interconnections of development challenges require a range of capabilities and actions. Past examples where the Bank has withdrawn – infrastructure, agriculture, or the financial sector – are now recognized as costly mistakes.

We are also ramping up our cooperation with other international organizations, stepping back where others have clear comparative advantage, leading where we are well placed to do so, and working together to solve problems. And we are using our expertise and balance sheet to partner with others to implement innovative solutions to development problems — such as creating market incentives to develop medical treatments (Advance Market Commitment for pneumococcal diseases) or new ways to finance vaccination (the International Finance Facility for Immunization).

We are bringing this same spirit of innovation and partnership to the replenishment of IDA16, set for later this year. This will be the last full replenishment before the 2015 MDG deadline. IDA resources remain essential to combating poverty in the poorest countries. We will be seeking the cooperation of all donors in this effort. We are also considering how to strengthen IDA's finances and long-term sustainability. We look forward to discussing these issues with you in the coming months.

21st Century governance

Voice and participation

A modernized WBG must represent the international economic realities of the early 21st Century. The first phase of voice reforms, completed a year ago, increased the voting power of developing and transition countries in IBRD to 44.06% and created a third chair on the Board for Sub-Saharan Africa. Part II country voting power was also increased in IDA, as countries took up allocated but unsubscribed shares. A donor trust fund assisted some IDA countries to take up their remaining shares. Shareholders also committed themselves to an ambitious second phase of reform by spring 2010.

In this second phase, we are significantly increasing developing and transition country voice across the Group, with the share in IBRD increasing to 47.19%. This realignment strengthens our ability to continue to support the smallest poor members, and demonstrates that a greater say for emerging and developing countries brings with it greater responsibility for the financial soundness of the Bank Group. It represents a balance of interests across shareholders with the aim of moving to equitable voting power in the World Bank over time.

For the 2010 IBRD selective capital increase only, realignment would be based on: economic weight calculated on the basis of a GDP blend; contributions to IDA, and development contributions from the Bank Group's clients, with measures to protect the voting power of the smallest poor members.

- ***Increasing developing and transition country voting power in 2010 to enhance legitimacy and effectiveness:***

    a. IBRD: an increase in voting power of 3.13%, bringing developing and transition country voting power to 47.19% — together the 2008 and 2010 reforms will increase it by 4.59%.

    b. IFC: an increase in developing and transition country voting power from the current 33.4% to 39.48%, through an increase in basic votes (to 5.55% from the current 250 per shareholder) and a selective capital increase.

    c. IDA: bringing the voting share of Part II countries to about 46%,

    d. MIGA: maintaining parity between developed and developing members.

- ***Dynamism:*** IBRD shareholding would be reviewed every five years to allow for changes based on the continuing economic growth and evolution of our members as well as contributions to IDA. IFC would similarly review shareholding every five years.

- ***Future IBRD Shareholding Formula:*** For the next shareholding review in 2015, shareholders will establish a work program and a roadmap to arrive at a benchmark for a dynamic formula, reflecting the principles agreed at the October 2009 Development Committee meeting in Istanbul, moving over time towards equitable voting power and protecting the voting power of the smallest poor countries.

Internal governance reform

Led by the Board, we are also working to enhance transparency and accountability of World Bank Group governance to support our overall program of reform and renewal. We are working closely with the Board on an agenda of issues for shareholder decision. These include freeing time for more strategic board discussions through conditional project approvals, clarifying the relationship between the board and management through a review of policy waivers and delegation of authority, and sharpening board oversight through a review of oversight units and enhanced performance reporting. The Board's work will further clarify the relationships among shareholders, the Board, and management to enhance stewardship of the institution and strengthen overall Bank Group corporate governance. Shareholders have reiterated the importance of an open, merit-based and transparent process for the selection of the World Bank President. The Board will put forward proposals for strengthening corporate governance and accountability for the WBG at the 2010 Annual Meetings.

Remaining financially strong

The Bank Group has provided over $100 billion in support since July 2008. Going into the crisis, we were well-capitalized, thanks to prudent policies and financial management, and could respond effectively to clients' needs. But the recovery remains fragile and uneven across regions. Should it falter in 2010 or 2011, we will not have the capacity to respond as we did in the past. We also need to be in a position to contribute to opportunities to boost global growth. To meet these needs, we have developed a package that emphasizes mutual responsibility and sharing of interests.

For the IBRD, we are seeking resources that are sufficient to return to our lending levels before the crisis. The package includes contributions from developing and developed countries through a general price increase last summer; reform of loan maturity terms to be discussed in June; releases of national currency paid-in capital; a selective capital increase from the voice reforms of $27.8 billion of which $1.6 billion would be paid in; and our first general capital increase for 20 years. We are proposing a general capital increase of $58.4 billion, of which 6%, or $3.5 billion, would be paid in and fully usable, with the remainder callable. The general capital increase would be agreed with the clear understanding that if it is no longer needed to back lending in the future, it will be redirected to other purposes as decided by shareholders, with strong consideration given to IDA transfers to support the poorest countries.

Budget discipline is also a key element of the package. Among the major international financial institutions, we have one of the slowest growing budgets, effectively flat in real terms since 1999, even while lending at record levels in fiscal 2009. The IMF budget, for example, has grown at twice the rate of the Bank's over the last decade. Going forward, we are determined to build on past efforts and to continue to maintain tight budget discipline.

We have also boosted our financial capacity by getting the most from our capital base. This includes an almost five-to-one leveraging of our capital which is considerably higher than the regional development banks; allowing reasonable flexibility in our equity-loan ratio relative to the strategic capital adequacy range; introducing a new exposure management framework to make the most efficient use of existing capital; and actively working with shareholders to release their national currency paid-in capital. The almost five-to-one leveraging of our balance sheet and the participation of other shareholders significantly multiplies any shareholder's investment: the investment of a country with a 5% share is multiplied one-hundred fold in its impact for development.

These actions allow us to make optimal use of our balance sheet to respond to the crisis, while remaining consistent with prudent financial management -- a key factor in our AAA rating. And in line with this prudent approach, we are further strengthening our financial model by synchronizing the annual deliberations on budget, pricing, and income allocations to ensure the financial sustainability of income transfers and formulating principles to link loan pricing to cost coverage.

We are also proposing to increase IFC's capital to allow us to increase financing for the private sector in the IDA countries, especially poor and risky markets; to restore financial flexibility; and to enable future growth and further mobilization of outside investors. We are proposing a package of options including a voice reform to boost developing and transition country ownership through an increase in basic votes and a selective capital increase of $200 million; consideration of a long-term hybrid instrument to shareholders (subject to realization of other capital options and Board review of terms and conditions and permitting significant capital treatment); and earnings retention.

A selective capital increase, achieved in the context of the Voice discussions, would generate usable resources. The hybrid instrument issuance would both raise capital and provide an innovative financing source for IFC, multiplying flexibility and capital-raising alternatives. This experience might be useful to other IFIs. IFC also has earnings that can build capital over time. Some shareholders have suggested that, especially given the volatility of IFC's private sector and equity earnings, IFC's policies on retained earnings should offer it flexibility to build capital internally.

Despite the constraints on IFC's capital, we have delivered more by increasing efficiency and effectiveness, keeping expenses below budget, focusing on development impact, and leading in results measurement. To enhance IFC's capital position, we have also divested mature equity investments and realized capital gains as development objectives were reached and market opportunities permitted. IFC will continue to focus on its equity strategy to further strengthen capital regeneration while optimizing capital use.

Becoming more responsive, innovative, flexible, and accountable

Our series of reforms, taken together, represents the most comprehensive reform agenda undertaken by the Bank Group. Our goal is to deliver a customized package of top quality global knowledge and financial services in real time to a growing range of clients—poor countries, fragile and small states, middle-income countries, and the private sector. Reforms encompass IBRD/IDA, the IFC, and MIGA, and while the specifics differ among the three institutions, the drivers of reform -- the need to get closer to the client, to enhance our financial services, and to better gather and disseminate knowledge and expertise -- are the same. Our four mutually reinforcing initiatives will modernize our services; enhance service delivery; speed-up processes, track results; and sustain our high fiduciary standards.

Modernizing services

Earlier reforms across the Bank Group enabled us to provide timely and record assistance to our clients. We are now overhauling Bank investment lending to focus on results, increase our speed and delivery, improve risk management, and better align our services with government priorities and partners in the field. We are also reviewing our instruments for clients, including consolidating our expanding trust fund portfolio. IFC is improving its business processes, while MIGA is modernizing its Convention.

We are also enhancing our knowledge services. This is critical for development as experiences in one country -- such as conditional cash transfers in Mexico -- can be shared with and tailored for others. The World Bank has been relatively good at sharing knowledge within regions. It must do a better job at this globally. We must ensure that we create incentives for capturing, sharing, and disseminating knowledge quickly to our staff and clients. To achieve this, a World

Bank Knowledge Strategy is revitalizing our knowledge products, strengthening our technical teams, and adding outside expertise.

The IFC has created practice groups across industry, regional, and service departments, using knowledge-sharing tools and social media to foster virtual teams. MIGA is working with the Berne Union of public political risk insurers on state of the art industry research.

Enhancing service delivery

We need to promote greater connectivity, more staff mobility, clearer accountabilities, and seamless knowledge flows. To do this, at both the Bank and IFC we are refreshing our matrix structure, clarifying roles, accountabilities, and reporting lines. We also need to reengineer our decentralization model. More than 5,000 Bank Group staff are already in the field. In the short term, we will strengthen our field presence in low-income and fragile states by moving more task management to country offices and adding country directors. But the current model of decentralization appears to have run its course. We need to combine close-to-the-client service, the ability for the client to tap top-flight global expertise quickly and easily, and strong central capabilities to guide a unified effort. In the medium to long term, therefore, we are considering an adjusted decentralized structure, perhaps through a combination of hubs, of varying size and capabilities, to complement country offices and with global-quality services.

Supporting reform

Human resource, information technology, and budget processes and policies need to keep up.

- ***Human resource*** reforms seek to recruit and retain the right diverse talent, foster career development, and enable greater flexibility and mobility, moving over time to a new global human resource framework. Promoting staff diversity will reflect better the global nature of the WBG.

- ***Information management and technology:*** a new three-year strategy supports our reform initiatives. It includes new platforms to support cooperation and knowledge, new systems for document search and retrieval, and improved connectivity for country offices and staff.

- ***Budget processes*** are being reformed to (i) strengthen the links among our priorities, results and budget allocations, (ii) expand planning and budget discussions to trust funds and other revenues (iii) and streamline and simplify budgeting, planning and performance systems, while continuing to focus on cost efficiency.

Getting results and maintaining standards

Demonstrating results is central to our credibility. To measure and track development effectiveness, we are:

- Strengthening results frameworks for all strategies and operations;

- Expanding core indicators to measure our outputs; and

- Building a results framework for tracking progress on reforms and transforming it into a corporate scorecard. The IFC already has the Development Outcomes Tracking System, considered best practice among multilateral development banks.

As we reform, we must also maintain our high fiduciary and other standards.

- In addition to beefing up IDA controls, the Board is working with us on an independent review of **oversight units** to strengthen them and remove redundancies.

- We are moving forward on **Governance and Anti-Corruption**, fully implementing the Volcker Panel recommendations and putting in place strengthened sanctions, including cross-debarment with other multilateral development banks. We are incorporating "lessons learned" into prevention planning and exploring new ways to promote accountability by corporations with which we work.

- We are developing an **integrated risk management** framework, to be reported on annually and overseen by a Chief Risk Officer.

- Finally, our new **Access to Information** policy, effective on July 1, 2010, puts us in the forefront of all U.N. and multilateral institutions by granting access to all information in the Bank's possession, other than narrowly defined exceptions.

To make sure we are achieving our vision, we will establish a Secretariat in the Bank headed by a Director to monitor, advise and report on internal reforms (timing of reforms is at Annex 1) reporting to Senior Management. An IFC Director of Change Management will oversee implementation of the IFC 2013 strategy.

Conclusion

Individually, these are transformational changes. In combination, they will modernize multilateralism in the World Bank Group. Together, they balance cooperation, dynamism and effectiveness – so that all shareholders can both benefit from and contribute to this vital multilateral institution and its mission.

Given the pace and scope of change globally, regionally, and within countries, the reforms and resources of this modernized World Bank Group cannot be static. We must continue to anticipate, reach out, listen to feedback loops, and determine how to adjust. Reforms are a process, not a conclusion.

Nevertheless, the changes underway position the World Bank Group very well to assist developing countries – and the world economy – as we move out of this crisis towards a new possibility of multiple poles of growth and opportunity. Now we need shareholder support and action.

Annex 1: Timeline for Deliverables

Reform	End Fiscal Year 2010	End Calendar Year 2010	End Fiscal Year 2011
Reforming loan maturity terms	• Bring proposal for restoration of loan maturity limits to the level before 2008 while offering borrowers the option to extend the maturity with a premium to provide augmentation of $1.2 billion of capital by FY19.		
Releasing existing NCPIC	• Work intensively with shareholders holding unreleased NCPIC to release as much as possible as soon as possible.		
Synchronizing year-end financial discussions	• Synchronize year-end discussions on budget, pricing and net income. • Discuss a sustainable financial model that unifies budget, pricing and net income decisions. • Develop pricing principles that link loan pricing to lending-related cost coverage, and consider expected losses. • Develop proposal for net income allocation principles that, subject to Board decision, place a priority on IDA transfers – after ensuring		

	adequate transfers to reserves – that would: • Support IDA transfers at a flat real level until the IBRD returns to the lower end of the capital adequacy range, currently 23%. • Allow for modest growth in IDA transfers when the E/L is within the capital adequacy range, currently between 23-27%. • Link the income allocation principles to the contingent-out mechanism where, subject to future Board decision, redirection of the GCI resources, with strong consideration to IDA transfers, would start after IBRD's E/L ratio has reached the upper bound of its capital adequacy range, currently 27%, and with a review to determine timing of the redirection taking place once IBRD reaches the middle of its capital adequacy range, currently 25%.		
Modernizing services	• Fully roll out operational risk assessment framework, new model of implementation support, and remodeled reporting framework • Establish Knowledge Council • Update Trust Fund Management Framework	• Revise and consolidate policies and procedures for investment lending • Expand to 12 the number of specified teams of global experts on high priority topics	• Agree on new results-based investment lending option • Finalize reform proposals for analytical and advisory activities

Enhancing service delivery	• Strengthen field presence in low-income and fragile-states, especially Africa, by moving more task management to the field • Increase number of country directors in Africa • Establish accountability framework for Bank operations • Establish matrix leadership team	• Identify "early movers" to gain implementation experience for new decentralization model on a small scale, including establishment of at least one subregional hub in Africa to serve fragile states • Increase cross support by high-end staff and monitor implementation • Launch IFC (i) new industry groups and (ii) Istanbul operating center	• Approve new decentralization approach, including a phased and costed transition and implementation plan to commence in FY12 • Implement organizational plan to rationalize sector managers' span of control • Establish framework for network accountability including for knowledge
Enabling systems	• Consolidate discussion of net income allocations, pricing, and budget • Institute annual corporate review of managerial bench strength • Launch Information Management Technology strategy for integration and standardization • Implement WBG Dashboard for decision support • IFC roadmap for IFC 2013 recommendations and budget proposals, including cost implications of IFC 2013	• Operationalize Corporate Scorecard • Implement new recruitment process aimed at reducing cycle time • Expand use of clustered recruitment • Enhance control and knowledge transfer through implementation of new document retrieval and search system • Launch new IFC performance management cycle	• Finalize new compensation and benefits framework for approval

Transparency, accountability, and results	• Implement Access to Information policy • Establish external appeals committee for access to information policy • Establish secretariat to monitor, advise and report on internal reforms • Put in place sanctions reform, including cross-debarment • Develop and report on core indicators in four sectors for IDA	•Complete IDA controls effort • Conduct an independent review of oversight units agreed with the Board • Appoint a World Bank Group Chief Risk Officer, who will annually publish an integrated Risk Monitoring Report • Complete first Annual Results Report • Proposals for strengthening corporate governance and accountability (2010 Annual Meetings).	• Implement fully the Results Agenda by establishing corporate-level reporting framework and issuing annual results reports. Expand number of sectors with core indicators to seven

Bank Policy:

Access to Information

Bank Access to Information Policy Designation
Public

Catalogue Number
EXC4.01-POL.01

Issued and Effective
July 1, 2015

Content
Policy governing public accessibility of information in the Bank's possession.

Applicable to
The World Bank

Issuer
The President

Sponsor
Vice President, External and Corporate Relations (except for purposes of interpretation under section III.B.7 of this Policy)

THE WORLD BANK
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SECTION I – PURPOSE AND APPLICATION

1. This Policy governs the public accessibility of information in the Bank's possession. This document reflects revisions approved by the Board on April 3, 2013, and June 30, 2015, and supersedes the *World Bank Policy on Access to Information, July 1, 2013.*

2. This Policy applies to the Bank.

SECTION II – DEFINITIONS

As used in this Policy, the following terms have the meanings set forth below:

1. ***AI***: access to information.

2. ***AI Committee***: Access to Information Committee established by the Policy.

3. ***AMS***: Administrative Manual Statement of the World Bank Group.

4. ***Appeals Board***: Appeals Board established by the Policy.

5. ***Archives Unit***: the archives unit of the World Bank Group.

6. ***Articles of Agreement of IBRD***: the charter that governs IBRD.

7. ***Articles of Agreement of IDA***: the charter that governs IDA.

8. ***Attorney-Client Privilege***: the exception set forth in section III.B.2(d) of this Policy.

9. ***Bank***: see definition for World Bank.

10. ***Board***: the board of Executive Directors of IBRD and IDA.

11. ***Board Committee***: a committee of the Board.

12. ***Board of Governors***: the body with which all powers of the Bank are vested, pursuant to the respective Articles of Agreement of IBRD and of IDA.

13. ***Board of Governors Documents***: documents that are specifically prepared by staff for (a) discussion or consideration (decision) by the Board of Governors, (b) discussion by the Board of Governors committees, task forces, working groups and other bodies created under the auspices of the committee or of the Board of Governors, or (c) information for the Board of Governors or the Board of Governors committees, task forces, working groups and other bodies created under their auspices.

14. ***Board of Governors Documents and Records***: collectively, the Board of Governors Documents and the Board of Governors Records.

15. ***Board of Governors Records***: records of the discussions of the Board of Governors or of the Board of Governors committees, task forces, working groups and other bodies created under the auspices of the committee or of the Board of Governors, such as summary proceedings, statements and speeches of Governors and World Bank management, verbatim transcripts and minutes.

16. ***Board Papers***: documents that are specifically prepared by staff for (a) discussion or consideration (decision) by the Board, (b) discussion by a Board Committee, or (c) information to the Board or a Board Committee.

17. ***Board Records***: records of Board or Board Committee discussions such as verbatim transcripts, minutes, statements of Executive Directors, Chairman's Summings-up, Summaries of Discussions and Chair Summaries.

18. ***Borrowers***: borrowers of Bank financing and, for the purpose of this Policy, the term includes credit and grant recipients and guarantors of such Bank financing.

19. ***CAS***: see definition for Country Assistance Strategy.

20. ***CAS Completion Report***: completion report prepared near the end of a CAS cycle.

21. ***CAS Progress Report***: progress report of a CAS.

22. ***Chair Summaries***: single category of Board Records that replace Chairman's Summings-up and Summaries of Discussions beginning July 1, 2013.

23. ***Chairman's Concluding Remarks***: written statements, prepared until June 30, 2010, that reflected discussions by the Board on major issues concerning matters such as country assistance strategies, transitional support strategies, and interim strategy notes.

24. ***Chairman's Summings-up*** or ***Summings-up***: brief statement that summarizes the conclusions of the chair of the Board, or of the Committee of the Whole, concerning policy, strategy and other important topical issues discussed by the Board or the Committee of the Whole.

25. ***Code of Conduct for Board Officials***: the code of conduct adopted by the Board for IBRD, IFC, IDA and MIGA for Board Officials (as the term is defined in the document) to set forth principles and ethical standards for Board officials in connection with, or having bearing on, their status and responsibilities to these organizations.

26. ***Committee of the Whole***: a Board committee made up of all Executive Directors, and whose role is to make recommendations or exchange views on matters of interest to the Board.

27. ***Communications of Governors and/or Executive Directors' Offices***: the exception set forth in section III.B.2(b) of this Policy.

28. ***Confidential***: the definition for this term as set forth in AMS 6.21A, *Information Classification and Control Policy*.

29. ***Corporate Administrative Matters***: the exception set forth in section III.B.2(h) of this Policy.

30. ***Country Assistance Strategy***: country assistance strategy that provides the framework for Bank assistance to a given country over a period of time.

31. ***Country Portfolio Performance Review*** or ***CPPR***: reviews prepared pursuant to OP/BP 13.16, *Country Portfolio Performance Reviews.*

32. ***CPIA***: Country Policy and Institutional Assessment.

33. ***CPPR***: See definition for Country Portfolio Performance Review.

34. ***Deliberative Information***: the exception set forth in section III.B.2(i) of this Policy.

35. ***Development Policy Financing*** or ***DPF***: development policy financing (formerly referred to as "Development Policy Operations" or "DPO") as the term is defined in OP 8.60, *Development Policy Financing*.

36. ***Development Policy Operations*** or ***DPO***: see definition for Development Policy Financing.

37. ***Directive/Procedure***: *Bank Directive/Procedure: Access to Information*, July 1, 2015, Catalogue No. ECR4.01-DIR.01.

38. ***DPF***: see definition for Development Policy Financing.

39. ***DPO***: see definition for Development Policy Operations.

40. ***Economic and Sector Work***: work that provides the basis for the Bank's diagnosis of a given country's development prospects.

41. ***Ethics Committee***: the committee, established pursuant the Code of Conduct for Board Officials, that considers matters relating to the interpretation or application of that document; and for the purposes of this Policy, the term also means the exception set forth in section III.B.2(c) of this Policy.

42. ***Executive Directors***: persons elected or appointed as executive directors of the World Bank to be responsible for the conduct of the general operations of the Bank and exercise all the powers delegated to them by the Board of Governors pursuant to the respective Articles of Agreement of IBRD and of IDA.

43. ***Factual Technical Documents***: documents that underpin project preparation.

44. ***Financial Information***: the exception set forth in section III.B.2(j) of this Policy.

45. ***Financial Sector Assessment Program*** or ***FSAP***: a joint program of the Fund and World Bank that provides a comprehensive framework through which assessors and authorities in participating countries can identify financial system vulnerabilities and develop appropriate policy responses.

46. ***FSAP***: see definition for Financial Sector Assessment Program.

47. ***Fund***: International Monetary Fund.

48. ***General Counsel***: World Bank Group General Counsel.

49. ***Green Sheets***: reports to the Board from Board Committees.

50. ***Governors***: the governors of the Board of Governors.

51. ***Heavily Indebted Poor Country (HIPC) Initiative***: initiative aimed at reducing the external debt stock of heavily indebted poor countries to sustainable levels.

52. ***HIPC***: see definition for Heavily Indebted Poor Country.

53. ***IAD***: Internal Audit vice presidency of the World Bank Group.

54. ***ICSID***: International Centre for Settlement of Investment Disputes.

55. ***IBRD***: International Bank for Reconstruction and Development.

56. ***ICR***: see definition for Implementation Completion and Results Report.

57. ***IDA***: International Development Association.

58. ***IEG***: Independent Evaluation Group.

59. ***IFC***: International Finance Corporation.

60. ***IMF***: International Monetary Fund.

61. ***Implementation Completion and Results Report*** or ***ICR***: report that assesses an operation upon completion.

62. ***Information***: documents of any type (e.g., paper, electronic, photograph, film, sound recordings, videotapes) prepared or received by the Bank in the course of its official business.

63. ***Information Provided by Member Countries or Third Parties in Confidence***: the exception set forth in section III.B.2(g) of this Policy.

64. ***Information Restricted Under Separate Disclosure Regimes and Other Investigative Information***: the exception set forth in section III.B.2(f) of this Policy.

65. ***Inspection Panel***: the panel established pursuant to Resolution IBRD 93–10 and Resolution IDA 93–6, dated September 22, 1993.

66. ***INT***: Integrity vice presidency of the World Bank.

67. ***Integrated Safeguards Data Sheet***: document setting forth a project's basic information, and identifies key issues under the Bank's safeguards policies, including environmental and social issues, and provides relevant information concerning their management in the proposed operation.

68. ***Interim Strategy Note***: document prepared for countries that are in transition from conflict or political crisis, countries going through an unusually uncertain period, and countries where the Bank is reengaging after a prolonged hiatus.

69. ***IP***: Inspection Panel.

70. ***Joint Staff Advisory Notes on PSRP***: document prepared by IDA and Fund staff as feedback to the country and to the Boards of the World Bank and the Fund on priority areas for strengthening the poverty reduction strategy and its implementation.

71. ***Letter of Development Policy***: a borrower's document setting forth the program of actions, objectives and policies to be supported by a DPF.

72. ***Loans***: World Bank loans, which for the purpose of this Policy may include IDA credits and grants, grants made out of the Bank's net income and administrative budget, and trust fund grants.

73. ***Loan Agreement***: an agreement between the Bank and a borrower providing for a Loan.

74. ***Managing Director***: a managing director of the World Bank

75. ***Memoranda of the President or MOP***: the President's memoranda to the Board.

76. ***MIGA***: Multilateral Investment Guarantee Agency.

77. ***Monthly Loan and Credit Statement***: monthly statements of all Bank loans and credits.

78. ***Monthly Operational Summary*** or ***MOS***: monthly report on the status of each lending operation under preparation for Bank financing.

79. ***MOP***: see definition for Memoranda of the President.

80. ***MOS***: see definition for Monthly Operational Summary.

81. ***Note on Cancelled Operations***: a note prepared for an operation that fails to become effective or is cancelled before significant implementation is initiated.

82. ***Official Use Only***: the definition set forth in AMS 6.21A, *Information Classification and Control Policy*, for this term.

83. ***OP/BP***: Operational policy and Bank procedure for Bank operations.

84. ***Personal Information***: the exception set forth in section III.B.2(a) of this Policy.

85. ***Policy***: *Bank Policy: Access to Information*, July 1, 2015, Catalogue No. EXC4.01-POL.01.

86. ***PowerPoint***: a Microsoft slide-based presentation program.

87. ***Poverty Reduction Strategy Paper*** or ***PRSP***: paper setting forth the framework for poverty reduction in a country.

88. ***President***: President of the World Bank Group.

89. ***Principles of Staff Employment***: the general conditions and terms of employment set out in the Staff Manual.

90. ***Procurement Plan***: borrower's procurement plan prepared in accordance with the *Guidelines: Procurement of Goods, Works, and Non-Consulting Services under IBRD Loans and IDA Credits & Grants by World Bank Borrowers.*

91. ***Program Document***: document that describes a DPF and sets forth the Bank's appraisal and assessment of the feasibility of, and justification for, the program to be supported by the Bank.

92. ***Project***: the project described in a Loan Agreement, for which the Loan is extended.

93. ***Project Appraisal Document***: document that describes a project and sets forth the Bank's appraisal and assessment of the feasibility of, and justification for, the project.

94. ***PRSP***: see definition for Poverty Reduction Strategy Paper.

95. ***QAG***: Quality Assurance Group.

96. ***Resolution***: resolution of the Board.

97. ***Restricted information***: information that falls under one or more of the exceptions set forth in this Policy and information to which the World Bank's prerogative to restrict has been applied.

98. ***Sanctions Board***: the World Bank Group Sanctions Board.

99. ***Sanctions Board Statute***: the statute governing the Sanctions Board.

100. ***Sanctions Board Procedures***: the World Bank procedures to be followed in cases involving sanctionable practices as defined in the procedures.

101. ***Security and Safety***: the exception set forth in section III.B.2(e) of this Policy.

102. ***Sector Strategy Paper*** or ***SSP***: paper which reviews the Bank's experience in a given sector and sets forth the Bank's strategy for future work in the sector.

103. ***SOPE***: see definition for Status of Projects in Execution.

104. ***SSP***: see definition for Sector Strategy Paper.

105. ***Staff Appraisal Report***: document that preceded the Project Appraisal Document.

106. ***Staff Manual***: the manual that sets forth the Principles of Staff Employment and Staff Rules for World Bank staff.

107. ***Staff Rules***: the rules set forth in the Staff Manual.

108. ***Status of Projects in Execution*** or ***SOPE***: annual report to the Board on the implementation status of projects in execution.

109. ***Strictly Confidential***: the definition for this term as set forth in AMS 6.21A, *Information Classification and Control Policy*.

110. ***Summary of Discussion***: a summary of discussion concerning certain items discussed at a meeting of the Board that does not attribute the views of individual Executive Directors.

111. ***Third party***: any individual, group of individuals, organization, or other entity that provides information to the Bank.

112. ***Tranche Release Document***: document prepared for each tranche of a multi-tranche DPF that reports on the status of the program being supported under the DPF.

113. ***Treasury***: the Treasury vice presidency of the World Bank.

114. ***UCS***: use of country systems.

115. ***WBG***: see definition for World Bank Group.

116. ***World Bank*** or ***Bank***: collectively IBRD and IDA.

117. ***World Bank Group*** or ***WBG***: collectively IBRD, IDA, IFC, ICSID and MIGA.

Section III – Scope

A. GUIDING PRINCIPLES

1. This Policy is based on five principles:

- Maximizing access to information;
- Setting out a clear list of exceptions;
- Safeguarding the deliberative process;
- Providing clear procedures for making information available; and
- Recognizing requesters' right to an appeals process.

B. THE POLICY

1. The Bank allows access to any information in its possession that is not on a list of exceptions (set forth in section III.B.2 of this Policy). In addition, over time the Bank declassifies and makes publicly available certain information that falls under the exceptions (as explained in section III.B.6 of this Policy).[1] Notwithstanding the broad intent of this Policy, the Bank reserves the right, under exceptional circumstances, to disclose certain information covered by the list of exceptions, or to restrict access to information that it normally discloses (as explained in section IV of this Policy).

2. **The Exceptions.** The Bank does not provide access to information whose disclosure could cause harm to specific parties or interests. Accordingly, the Bank does not provide access to documents that contain or refer to the information listed in subparagraphs (a) through (j) below.

(a) ***Personal Information***. The Bank's Principles of Staff Employment require the Bank to establish and maintain appropriate safeguards to respect the personal privacy of staff members and protect the confidentiality of personal information about them. Accordingly, the Bank does not provide access to the following information, except to the extent expressly permitted by the Staff Rules:

i. Personal information, including personal staff records, medical information, and personal communications (including e-mail)[2] of the following individuals and their families: Executive Directors, their alternates, and their senior advisers; the President of the Bank; other Bank officials; and Bank staff.

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[1] For the purpose of this Policy, the terms "disclose," "provide access," and "make publicly available" (and their variants) are used interchangeably.

[2] *See* Policy at section III.B.5(c).

ii. Information relating to staff appointment and selection processes.

iii. Information relating to proceedings of the Bank's internal conflict resolution mechanisms.

iv. Information relating to investigations of allegations of staff misconduct and personal conflicts of interest.

(b) ***Communications of Governors and/or Executive Directors' Offices.*** The Bank does not provide access to:

i. Communications within and between individual Governors and/or Executive Directors' offices.

ii. Communications between individual Governors and/or Executive Directors' offices and the member country or countries they represent.

iii. Communications between individual Governors and/or Executive Directors' offices and third parties.

(c) ***Ethics Committee.*** The Bank does not provide access to proceedings of the Ethics Committee for Board officials (unless the Executive Directors initiate a decision to disclose such information).

(d) ***Attorney-Client Privilege.*** The Bank does not provide access to information subject to attorney-client privilege, including, among other things, communications provided and/or received by the General Counsel, in-house Bank counsel, and other legal advisors.

(e) ***Security and Safety.*** The Bank does not provide access to:

i. Information whose disclosure would compromise the security of Bank staff and their families, contractors, other individuals, and Bank assets.

ii. Information about logistical and transport arrangements related to the Bank's shipments of its assets and documents and the shipment of staff's personal effects.

iii. Information whose disclosure is likely to endanger the life, health, or safety of any individual, or the environment.

(f) ***Information Restricted Under Separate Disclosure Regimes and Other Investigative Information.*** The Bank does not provide access to information whose disclosure is restricted under the separate disclosure regimes of IEG,[3]

[3] *See* Access to Information Policy for the Independent Evaluation Group.

IP,[4] INT,[5] and the Bank's sanctions process.[6] The Bank also does not provide access to any other information that would prejudice an investigation that is not addressed under such separate disclosure regimes.

(g) ***Information Provided by Member Countries or Third Parties in Confidence.*** The Bank has an obligation to protect information that it receives in confidence. Thus, the Bank does not provide access to information provided to it by a member country or a third party on the understanding of confidentiality, without the express permission of that member country or third party.[7]

(h) ***Corporate Administrative Matters.*** The Bank does not provide access to information relating to the Bank's corporate administrative matters, including, but not limited to, corporate expenses, procurement, real estate, and other activities.

(i) ***Deliberative Information.*** The Bank, like any institution or group, needs space to consider and debate, away from public scrutiny. It generally operates by consensus, and it needs room to develop that consensus. During the process it seeks, and takes into account, the input of many stakeholders; but it must preserve the integrity of its deliberative processes by facilitating and safeguarding the free and candid exchange of ideas. Therefore, while the Bank makes publicly available the decisions, results, and agreements that result from its deliberative processes, it does not provide access to the following information:[8]

i. Information (including e-mail, notes, letters, memoranda, draft reports, or other documents) prepared for, or exchanged during the course of,

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[4] *See* Resolution No. IBRD 93-10, No. IDA 93-6, September 1993 (Resolution) establishing the Inspection Panel, and subsequent clarifications to the Resolution (i.e., *Review of the Resolution Establishing the Inspection Panel: 1996 Clarification of Certain Aspects of the Inspection Panel;* and *1999 Clarification of the Board's Second Review of the Inspection Panel)*, all available on the Inspection Panel website.

[5] This includes information gathered, received, or generated by INT in connection with or related to inquiries, investigations, audits, or any other types of INT reviews, programs, products, or outputs, as well as any other information gathered, received, or generated by INT on a confidential basis.

[6] This includes information whose disclosure is restricted under the *Sanctions Board Statute* and the *Sanctions Procedures*.

[7] When a member country or a third party provides financial, business, proprietary, or other non-public information to the Bank with the understanding that it will not be disclosed, the Bank treats the information accordingly. Material held by the Bank in which other parties hold the copyright may be made available for review, but copying or distributing such material is limited to respect the rights of the copyright holder. See also relevant discussion in section III.B.3 of the Directive/Procedure.

[8] Certain deliberative information is eligible for declassification and disclosure over time, as indicated in section III.B.6 of this Policy.

its deliberations with member countries or other entities with which the Bank cooperates.[9]

ii. Information (including e-mail, notes, letters, memoranda, draft reports or other documents) prepared for, or exchanged during the course of, its own internal deliberations, including the following documents pertaining to Board of Governors and Board deliberations:

(A) Verbatim transcripts of meetings of the Boards of Governors and their committees, task forces, working groups and other bodies created under their auspices.

(B) Verbatim transcripts of Board meetings and Board Committee meetings, and the Memoranda of the President that accompany Board Papers.

(C) Statements of Executive Directors and staff in the context of Board meetings or Board Committee meetings.

(D) Reports to the Board from its Committees (Green Sheets) if subsequent Board discussion is expected.[10]

(E) Communications and memoranda originating in Executive Directors' offices relating to Board or Board Committee proceedings.

(F) Miscellaneous memoranda or informal notes distributed to the full Board or to a Board Committee.[11]

iii. Statistics prepared, or analyses carried out, solely to inform the Bank's internal decision-making processes (such as analyses of country creditworthiness, credit ratings, and risk, the write-ups underpinning the Country Policy and Institutional Assessment (CPIA) for IBRD and IDA borrowers, and the CPIA ratings for IBRD borrowers).

[9] This includes financial sector stress tests, the aide-mémoire following Bank-Fund financial sector assessments under the Financial Sector Assessment Program (FSAP), the report following the Bank's assessment of government debt management capacity, other technical advisory reports requested by member countries from Treasury, deliberations relating to IDA replenishments, IDA country allocations, and deliberations with donors relating to trust funds.

[10] However, if no subsequent Board meeting is expected, the Bank makes publicly available reports to the Board from its Committees, with deliberative information removed (summary portion of the Green Sheet).

[11] This is a heterogeneous group of documents that includes information notes, technical briefing papers, PowerPoint presentations that supplement Board Papers, presentations to Board Committees, and administrative papers (such as meeting notices) that are not used as a basis for consultation or decision but are used solely for information or administrative purposes.

iv. Audit reports prepared by IAD, except its finalized annual and quarterly activity reports.

(j) ***Financial Information.*** The Bank does not provide access to the following financial information:[12]

i. Estimates of future borrowings by IBRD, contributions by individual donors to IDA, financial forecasts and credit assessments, and data on investment, hedging, borrowing, and cash management transactions[13] generated by or for the Bank's treasury operations for the World Bank Group entities and other parties.

ii. Documents, analysis, correspondence, or other information used or produced to execute financial and budgetary transactions, or to support the preparation of internal and external financial reports.

iii. Details of individual transactions under loans and trust funds, information regarding amounts overdue from borrowers, or actions taken before any loans are placed in nonaccrual status.

iv. Banking or billing information of World Bank Group entities, member countries, clients, donors, recipients, or vendors, including consultants.

3. **Board of Governors Proceedings.** Board of Governors Documents and Records relating to or arising from meetings held jointly with the IMF may be made publicly available if and when the IMF provides its written approval to disclose. The following Board of Governors Documents and Records that are routinely available from the Bank are posted on the Bank's external website:[14]

(a) Reports of the Executive Directors recommending decisions to the Boards of Governors on such matters as capital increases and replenishments are posted on the Bank's external website at the end of the Boards of Governors' deliberative process.

(b) Resolutions adopted by the Boards of Governors at the Annual Meetings or through a vote by mail.

(c) Statements of the Governors and of the President during the Annual Meetings.

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[12] Certain financial information is eligible for declassification and disclosure over time, as indicated in section III.B.6 this Policy.

[13] This includes holdings, positions, and performance information for World Bank Group entities and other parties.

[14] Board of Governors Documents and Records, as defined in section II of this Policy, are not all prepared following every Board of Governors meeting.

(d) Summary Proceedings of the Annual Meetings of the Boards of Governors.

(e) Agendas of the meetings of the Joint Ministerial Committee of the Boards of Governors of the Bank and the IMF on the Transfer of Real Resources to Developing Countries (known as the Development Committee); communiques and announcements issued by the Development Committee; statements and declarations submitted by Development Committee members during the meetings of the Development Committee; and reports, papers, notes and other documents prepared by Bank staff for the meetings of the Development Committee.

(f) Statements Submitted to the Meeting of the Development Committee.

4. **Board Proceedings.** Board Papers and Board Records that are routinely available from the Bank are posted on the Bank's external website at specific Board milestones.[15] Some Board discussions may deal with issues that fall under the exceptions of the policy. In such cases, the related Board Records are classified as *Confidential* and *Strictly Confidential* and are not disclosed unless they become eligible for declassification under the declassification schedule provided under section III.B.5 of this Policy. Board Records of a Board meeting or Board Committee meeting initially held as a regular session but subsequently converted into an executive session or a restricted executive session are considered (as applicable) to be Board Records of a meeting of an executive session or a restricted executive session, as converted, in their entirety.

(a) The following Board Records *prepared on or after July 1, 2010*, are posted at the end of the Board's deliberative process:

i. Minutes of Board meetings.[16]
ii. Minutes of Board Committee meetings.
iii. Summings-up of Board meetings and Committee of the Whole meetings.[17]
iv. Summaries of Discussion (related to Board meetings).
v. Reports to the Board from its Committees (Green Sheets) with deliberative information removed (summary portion of the Green Sheets), if a subsequent Board discussion is not expected.
vi. Annual reports of Board Committees.

(b) Board Papers distributed for discussion or consideration (decision) by the Board are posted at the end of the Board's deliberative process, once they are finalized. However, the following Board Papers whose preparation may

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[15] Board Records, as defined in section II of this Policy, are not all prepared following every Board meeting.

[16] Board minutes created after April 1, 2005, are already publicly available. For Board minutes created before April 1, 2005, see section III.B.6(b) of this Policy.

[17] Beginning July 1, 2013, Chairman's Summings-up and Summaries of Discussions are replaced by a single category of Board Records called Chair Summaries.

have involved consultations with affected parties, civil society groups, and other stakeholders are posted before the Board discussion:

i. Operational policy papers and sector strategy papers that are prepared following a public consultation process, if the Executive Directors have already reviewed a draft version of the paper.[18]

ii. Country assistance strategy papers, project appraisal documents, and program documents, if the member country consents to such early disclosure.

(c) Board Papers distributed for discussion by a Board committee are posted at the end of the committee's deliberation if a subsequent Board discussion is not anticipated.

(d) Board Papers distributed to the Executive Directors for information are posted upon distribution.

5. **Electronic Mail.** E-mail, which has become the Bank's predominant medium of communication, is treated as follows:

(a) E-mails that contain or convey decisions or outcomes and that are filed in the Bank's records management system and classified as *Public* are publicly available.

(b) E-mails that are filed in the Bank's records management system but classified as *Official Use Only*, *Confidential*, or *Strictly Confidential* are not publicly available unless the information content of the e-mail becomes eligible for declassification and disclosure over time.

(c) The Bank does not provide access to e-mail that resides outside its records management system (including e-mail that does not pertain to official matters and e-mail containing personal information or communications of Bank staff and other officials; see also sections III.B.2(a)i, and III.B.2(i)i and ii of this Policy).

6. **Declassification.** The Bank declassifies and discloses – routinely on the Bank's external website, and in response to requests – certain types of restricted information (including information prepared under earlier disclosure policies of the Bank) as their sensitivity diminishes over time. Some restricted information is not eligible for declassification.

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[18] If a draft version has not been previously reviewed by the Executive Directors, the paper is still made available to the public at least two weeks before the Board discussion if the Board approves such early disclosure.

(a) ***Information Not Eligible for Declassification.*** The information that is restricted from disclosure under the exceptions of *Personal Information, Communications of Governors and/or Executive Directors' Offices*, *Ethics Committee*, *Attorney-Client Privilege*, *Security and Safety*, *Information Restricted Under Separate Disclosure Regimes and Other Investigative Information*, *Information Provided by Member Countries or Third Parties in Confidence, Corporate Administrative Matters*, and *Financial Information* (as it relates to banking or billing information of World Bank Group entities, member countries, clients, donors, recipients, or vendors, including consultants), and the financial and deliberative information that contains or relates to such information, and/or information for which the IMF has not provided its written approval to disclose pursuant to section III.B.3 of this Policy, is not declassified or made publicly available.[19]

(b) ***Information Eligible for Declassification.*** The following documents are declassified and made publicly available 5, 10, or 20 years after the date on the document,[20] *provided that they do not contain or refer to information that is not eligible for declassification as set out in paragraph 6(a) of this section*[21].

i. ***After 5 years***

- Board minutes prepared before April 1, 2005, other than those of executive sessions and restricted executive sessions.
- Minutes of Board Committee meetings prepared before July 1, 2010, other than those of executive sessions and restricted executive sessions.
- Chairman's Concluding Remarks and Summings-up of Board meetings prepared before January 1, 2002.
- Summings-up of Committee of the Whole Meetings prepared before July 1, 2010.
- Summaries of Discussion (relating to Board meetings) prepared before July 1, 2010.
- Annual reports of Board Committees prepared before July 1, 2010.
- Board Papers that were prepared before July 1, 2010, and are classified *Official Use Only*.
- Final documents listed in the annex of this Policy that were prepared before July 1, 2010, and classified as *Official Use Only*. (Draft

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19 *See* Policy at sections III.B.2(a) through (h), and (j) iv.

20 In applying these declassification schedules, the relevant date for unpublished documents is the date when the document was created; the relevant date for published documents is the date of publication.

21 With respect to the Board Records of a Board meeting or a Board Committee meeting that are listed in this section, as indicated in section III.B.4 of this Policy, if the meeting was initially held as a regular session but subsequently converted into an executive session or a restricted executive session, the related Board Records are considered (as applicable) to be Board Records of a meeting of an executive session or a restricted executive session, as converted, in their entirety.

documents and other deliberative documents, although classified as *Official Use Only*, are considered to be deliberative information and are declassified only after 20 years.)

ii. ***After 10 years***

- Verbatim transcripts of regular sessions of Board meetings and Board Committee meetings.
- Verbatim transcripts of meetings held as regular sessions of the Boards of Governors and of the Board of Governors Committees, task forces, working groups and other bodies created under their auspices.
- Statements of individual Executive Directors and staff in the context of regular sessions of Board meetings or Board Committee meetings.
- Reports to the Board from its Committees (Green Sheets).
- Miscellaneous memoranda or informal notes distributed to the full Board or to a Board Committee.

iii. ***After 20 years***

- Verbatim transcripts of executive sessions and restricted executive sessions of Board meetings and Board Committee meetings.
- Verbatim transcripts of meetings held as executive sessions or restricted executive sessions of the Boards of Governors and of the Board of Governors Committees, task forces, working groups and other bodies created under their auspices.
- Verbatim transcripts of meetings of the Development Committee.
- Statements of individual Executive Directors and staff in the context of executive sessions and restricted executive sessions of Board meetings and Board Committee meetings.
- Minutes of executive sessions and restricted executive sessions of the Board and its Committees.
- Communications and memoranda originating in Executive Directors' offices relating to Board or Board Committee proceedings.
- Board Papers that are classified as *Confidential* or *Strictly Confidential*.
- Memoranda of the President that accompany Board Papers.
- Final documents listed in the annex of this Policy that were prepared before July 1, 2010, and classified as *Confidential* or *Strictly Confidential*.
- Financial information restricted under section III.B.2(j) i, ii, and iii of this Policy, unless the information pertains to the exceptions set forth in sections III.B.2(a) through (h) or III.B.2(j) iv of this Policy.
- Other documents in the possession of the Bank's Archives Unit, unless the documents pertain to the exceptions set forth in sections

III.B.2(a) through (h) or III.B.2(j) iv of this Policy, including any deliberative or financial information containing or referring to those exceptions.

7. **Access to Information Committee.** To facilitate the AI Policy's implementation, the AI Committee is an administrative body that reports to Bank management and advises management on the application of this Policy to complex issues, reviews proposals to disclose information that is on the list of exceptions,[22] receives and rules on appeals under this Policy,[23] establishes service fees and service standards, and issues guidelines to staff on policy implementation. The AI Committee has the authority to interpret this Policy in line with the Policy's guiding principles, and to uphold or reverse prior decisions to deny access, with the exception of decisions made by the Bank's Board.

8. **Appeals*.***

(a) A requester who is denied access to information by the Bank may file an appeal if:

i. the requester is able to establish a *prima facie* case that the Bank has violated this Policy by improperly or unreasonably restricting access to information that it would normally disclose under the Policy; *or*

ii. the requester is able to make a public interest case to override the Policy exceptions that restrict the information requested (limited to those exceptions set out in sections III.B.2(h) (*Corporate Administrative Matters*), III.B.2(i) (*Deliberative Information*), and III.B.2(j) i, ii and iii (relating to certain *Financial Information*) of this Policy).

(b) The two stage appeals mechanism consists of the following:

i. ***Appealing the Initial Denial—Access to Information Committee.*** Appeals of a Bank decision to deny access are first considered by the Bank's AI Committee.[24] For appeals that assert a public interest case to override a Policy exception,[25] the decision of the AI Committee is final. The AI Committee may decide to refer a particular issue to the relevant Managing Director for his/her recommendation, which the AI Committee takes into account in its decision.[26] Appeals to the AI Committee must be filed, in writing, within 60 calendar days of the Bank's initial decision

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22 *See* section IV.1 of this Policy for details on the Bank's prerogative to disclose restricted information under exceptional circumstances.

23 *See* section III.B.8 of this Policy on the provisions relating to appeals.

24 Because the AI Committee has no authority over decisions by the Board, appeals of Board decisions are automatically dismissed.

25 *See* section III.B.8(a) ii of this Policy.

26 This may include instances when the AI Committee has provided direct input in the initial decision to deny access.

to deny access to the requested information. The AI Committee makes its best efforts to reach a decision on appeals within 45 working days of receiving an appeal (delays are communicated in writing to the requester).

ii. ***Appealing the AI Committee's Denial—Appeals Board.*** The Bank has established an independent Appeals Board[27] to consider appeals alleging that the Bank violated this Policy by restricting access to information that it would normally disclose under the Policy,[28] if the AI Committee upholds the initial decision to deny access; the Appeals Board does not consider appeals concerning requests to override the Policy's exceptions.[29] The Appeals Board has the authority to uphold or reverse the relevant decisions of the AI Committee, and the Appeals Board's decisions in such instances are final. Appeals to the Appeals Board must be filed, in writing, within 60 calendar days after the AI Committee's decision to uphold the Bank's initial decision to deny access. The Appeals Board makes its best efforts to consider all appeals that are received within a reasonable time period before the next scheduled Appeals Board session.

(c) The remedy available to a requester who prevails on appeal is limited to receiving the information requested.

SECTION IV – EXCEPTIONS

1. **Bank's Prerogative to Disclose Restricted Information.** The Bank reserves the right to disclose, under exceptional circumstances, certain corporate administrative information,[30] deliberative information,[31] and financial information[32] that is restricted under the exceptions, if the Bank determines that the overall benefits of such disclosure outweigh the potential harm to the interest(s) protected by the exception(s). In exercising this prerogative:

(a) The disclosure of Board of Governors Documents and Records and of Board Papers or Board Records classified as *Confidential* or *Strictly Confidential*, requires Board approval.

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[27] The Appeals Board established under this Policy comprises three outside experts on access to information matters. Panel members are nominated by the President of the World Bank and endorsed by the Bank's Board of Executive Directors.

[28] *See* section III.B.8(a) i of this Policy.

[29] *See* section III.B.8(a) ii of this Policy.

[30] *See* section III.B.2(h) of this Policy.

[31] *See* section III.B.2(i) of this Policy.

[32] *See* section III.B.2(j) i, ii and iii of this Policy.

(b) The disclosure of information provided to the Bank by a member country or a third party in confidence requires the written consent of the member country or the third party concerned.

(c) The disclosure of other restricted information requires the approval of the Bank's AI Committee.

2. **Bank's Prerogative to Restrict Access.** Except for verbatim transcripts of meetings (a) of the Boards of Governors, (b) of the Board of Governors Committees, task forces, working groups and other bodies created under their auspices, and (c) of the Development Committee, the Bank also reserves the right not to disclose, under exceptional circumstances, information that it would normally disclose if it determines that such disclosure is likely to cause harm that outweighs the benefits of disclosure. This prerogative may be exercised only by:

(a) The Board, with respect to Board Records. In the case of verbatim transcripts and statements of individual Executive Directors and staff, prepared on or after July 1, 2013, the Bank's prerogative to restrict access to such Board Records will only be effective up to a maximum of 20 years after the date of the document;

(b) The vice president concerned, with respect to Board Papers; and

(c) The director concerned, with respect to other information.

SECTION V – WAIVER

1. Provisions of this Policy may be waived by the Board.

SECTION VI – EFFECTIVE DATE

1. This Policy is effective as of July 1, 2015.

SECTION VII – ISSUER

1. This Policy is issued by the President.

SECTION VIII – SPONSOR

1. The Sponsor of this Policy is the Vice President, External and Corporate Relations.

SECTION IX – RELATED DOCUMENTS

1. Bank Directive/Procedure: Access to Information, July 1, 2015, Catalogue No. ECR4.01-DIR.01.

2. Interpretations of the Bank Policy: Access to Information Policy, issued by the AI Committee. *See http://go.worldbank.org/ZU1HZL0O60.*

3. *World Bank Access to Information – Staff Handbook. See http://go.worldbank.org/5VDOZRRFK0*.

4. *Access to Information – Disclosure of Documents in LEG's Possession that are Created After July 1, 2010*.

5. *World Bank Policy on Access to Information: Guidance for Staff on Handling Procurement Information. See http://intresources.worldbank.org/INTPROCUREMENT/Resources/Access_to_Information_Procurement_(updated_May2012).pdf*.

6. *World Bank Policy on Access to Information: Guidance for Financial Management Staff. See http://intresources.worldbank.org/INTRANETFINANCIALMGMT/Resources/275850-1277472907120/FMAIGuidance24JUN2010JULY14.pdf*.

7. *Access to Information: Disclosure of Documents related to Carbon Finance that are Created after July 1, 2010*. *See http://intranet.worldbank.org/WBSITE/INTRANET/OPERATIONS/INFODISCLOSURE/0,,contentMDK:23400220~pagePK:64864633~piPK:64864621~theSitePK:5033531,00.html.*

8. AMS 6.21A, *Information Classification and Control Policy*. *See http://go.worldbank.org/8SBSLGMLD0*.

9. *Classification Handbook for Restricted Information. See http://go.worldbank.org/8SBSLGMLD0.*

10. *Toward Greater Transparency Through Access to Information – The World Bank's Disclosure Policy*, December 10, 2009 (R2009-0259/2; IDA/R2009-0273/2).

11. *Access to Information Policy – Implementation Issues Related to Board Records and Papers*, June 20, 2011 (COGAM 2011-0010/1).

12. *World Bank Policy on Access to Information – Experience in the First 18 months of Implementation*, October 18, 2012 (COGAM2012-0011/2).

13. World Bank Policy on Access to Information – Proposed Modification, March 25, 2013 (R2013-0051; IDA/R2013-0072).

14. *World Bank Policy on Access to Information*, June 27, 2013 (SecM2013-0301; IDA/SecM2013-0401).

15. *World Bank Policy on Access to Information – Proposed Modification*, June 24, 2015 (R2015-0129; IDA/R2015-0191).

Questions regarding this Policy should be addressed to the Sponsor.

ANNEX

Declassification Schedule for Certain Historical Documents prepared before July 1, 2010. Pursuant to section III.B.6(b) of this Policy, the final documents listed in this Annex—if they were created before July 1, 2010, and were not already made public pursuant to earlier disclosure policies of the World Bank—are eligible for declassification according to the following schedule:

- 5 years after the date of a document classified as *Official Use Only*, and
- 20 years after the date of a document classified as *Confidential*, or *Strictly Confidential*.

The documents are eligible for declassification if they do not contain or refer to information that fall under an exception that is not eligible for declassification (see section III.B.6(a) of the Policy).

(a) **Operational documents prepared by the Bank**

- Country Assistance Strategies (CASs)
- CAS Progress Reports
- Interim Strategy Notes
- CAS Completion Reports (included as an annex to the follow-on CAS)
- Public information notice for a CAS
- Joint Staff Advisory Notes on PRSPs
- Country financing parameters (including the analyses that underpin their preparation)
- Economic and Sector Work and non-lending technical assistance reports
- Factual Technical Documents that underpin project preparation
- Project Appraisal Documents (previously Staff Appraisal Reports)
- Project papers
- Program Documents for Development Policy Operations (DPOs)
- Supplemental financing documents (DPOs)
- Tranche Release Documents (DPOs)
- Integrated Safeguards Data Sheets
- Country assessment reports on the Use of Country Systems (UCS)
- Project assessments for UCS pilot countries
- Implementation Completion and Results Reports (ICR)
- Note on Cancelled Operations (NCO) (previously Project Completion Note)

- Monthly Loan and Credit Statements
- Monthly Operational Summary of the lending pipeline (MOS)
- Status of Projects in Execution (SOPE)
- Country Portfolio Performance Reviews (CPPRs)
- Sector Strategy Papers (SSPs), draft SSPs, draft concept notes and consultation plan for an SSP
- All other operational policy and strategy papers
- Numerical CPIA ratings for countries eligible for IDA financing
- Numerical IDA country performance ratings (derived from CPIA ratings)
- Funding proposals for activities financed through Bank-administered trust funds
- Preliminary, decision-point, and completion-point documents prepared under the Heavily Indebted Poor Country (HIPC) Initiative
- QAG synthesis

(b) **Financial information**

- Annual budget document

(c) **Documents prepared by a member country**

- Poverty Reduction Strategy Papers
- Letters of Development Policy
- Procurement Plans and updates

(d) **Board proceedings**

- Executive Directors' work program

BASLE COMMITTEE
ON
BANKING SUPERVISION

INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS

Basle
July 1988

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International Convergence of Capital Measurement and Capital Standards

Introduction

1. This report presents the outcome of the Committee's[1] work over several years to secure international convergence of supervisory regulations governing the capital adequacy of international banks. Following the publication of the Committee's proposals in December 1987, a consultative process was set in train in all G-10 countries and the proposals were also circulated to supervisory authorities worldwide. As a result of those consultations some changes were made to the original proposals. The present paper is now a statement of the Committee agreed by all its members. It sets out the details of the agreed framework for measuring capital adequacy and the minimum standard to be achieved which the national supervisory authorities represented on the Committee intend to implement in their respective countries. The framework and this standard have been endorsed by the Group of Ten central-bank Governors.

2. With a view to implementation as soon as possible, it is intended that national authorities should now prepare papers setting out their views on the timetable and the manner in which this accord will be implemented in their respective countries. This document is being circulated to supervisory authorities worldwide with a view to encouraging the adoption of this framework in countries outside the G-10 in respect of banks conducting significant international business.

3. Two fundamental objectives lie at the heart of the Committee's work on regulatory convergence. These are, firstly, that the new framework should serve to strengthen the soundness and stability of the international banking system; and secondly that the framework should be in fair and have a high degree of consistency in its application to banks in different countries with a view to diminishing an existing source of competitive inequality among international banks. The Committee notes that, in responding to the invitation to comment on its original proposals, banks have welcomed the general shape and rationale of the framework and have expressed support for the view that it should be applied as uniformly as possible at the national level.

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1 The Basle Committee on Banking Supervision comprises representatives of the central banks and supervisory authorities of the Group of Ten countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, United States) and Luxembourg. The Committee meets at the Bank for International Settlements, Basle, Switzerland.

4. Throughout the recent consultations, close contact has been maintained between the Committee in Basle and the authorities of the European Community in Brussels who are pursuing a parallel initiative to develop a common solvency ratio to be applied to credit institutions in the Community. The aim has been to ensure the maximum degree of consistency between the framework agreed in Basle and the framework to be applied in the Community. It is the Committee's hope and expectation that this consistency can be achieved, although it should be noted that regulations in the European Community are designed to apply to credit institutions generally, whereas the Committee's framework is directed more specifically with banks undertaking international business in mind.

5. In developing the framework described in this document the Committee has sought to arrive at a set of principles which are conceptually sound and at the same time pay due regard to particular features of the present supervisory and accounting systems in individual member countries. It believes that this objective has been achieved. The framework provides for a transitional period so that the existing circumstances in different countries can be reflected in flexible arrangements that allow time for adjustment.

6. In certain very limited respects (notably as regards some of the risk weightings) the framework allows for a degree of national discretion in the way in which it is applied. The impact of such discrepancies on the overall ratios is likely to be negligible and it is not considered that they will compromise the basic objectives. Nevertheless, the Committee intends to monitor and review the application of the framework in the period ahead with a view to achieving even greater consistency.

7. It should be stressed that the agreed framework is designed to establish *minimum* levels of capital for internationally active banks. National authorities will be free to adopt arrangements that set higher levels.

8. It should also be emphasised that capital adequacy as measured by the present framework, though important, is one of a number of factors to be taken into account when assessing the strength of banks. The framework in this document is mainly directed towards assessing capital in relation to credit risk (the risk of counterparty failure) but other risks, notably interest rate risk and the investment risk on securities, need to be taken into account by supervisors in assessing overall capital adequacy. The Committee is examining possible approaches in relation to these risks. Furthermore, and more generally, capital ratios, judged in isolation, may provide a misleading guide to relative strength. Much also depends on the quality of a bank's assets and, importantly, the level of provisions a bank may be holding outside its capital against assets of doubtful value. Recognising the close relationship between capital and provisions, the Committee will continue to monitor provisioning policies by banks in member countries and will seek to promote convergence of policies in this field as in other regulatory matters. In assessing progress by banks in member countries towards meeting the

agreed capital standards, the Committee will therefore take careful account of any differences in existing policies and procedures for setting the level of provisions among countries' banks and in the form in which such provisions are constituted.

9. The Committee is aware that differences between countries in the fiscal treatment and accounting presentation for tax purposes of certain classes of provisions for losses and of capital reserves derived from retained earnings may to some extent distort the comparability of the real or apparent capital positions of international banks. Convergence in tax regimes, though desirable, lies outside the competence of the Committee and tax considerations are not addressed in this paper. However, the Committee wishes to keep these tax and accounting matters under review to the extent that they affect the comparability of the capital adequacy of different countries' banking systems.

10. This agreement is intended to be applied to banks on a consolidated basis, including subsidiaries undertaking banking and financial business. At the same time, the Committee recognises that ownership structures and the position of banks within financial conglomerate groups are undergoing significant changes. The Committee will be concerned to ensure that ownership structures should not be such as to weaken the capital position of the bank or expose it to risks stemming from other parts of the group. The Committee will continue to keep these developments under review in the light of the particular regulations in member countries, in order to ensure that the integrity of the capital of banks is maintained. In the case of several of the subjects for further work mentioned above, notably investment risk and the consolidated supervision of financial groups, the European Community has undertaken or is undertaking work with similar objectives and close liaison will be maintained.

11. This document is divided into four sections. The first two describe the framework: Section I the constituents of capital and Section II the risk weighting system. Section III deals with the target standard ratio; and Section IV with transitional and implementing arrangements.

I. The constituents of capital

(a) Core capital (basic equity)

12. The Committee considers that the key element of capital on which the main emphasis should be placed is equity capital[2] and disclosed reserves. This key element of capital is the only element common to all countries' banking systems; it is wholly visible in

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2 Issued and fully paid ordinary shares/common stock and non-cumulative perpetual preferred stock (but excluding cumulative preferred stock).

the published accounts and is the basis on which most market judgements of capital adequacy are made; and it has a crucial bearing on profit margins and a bank's ability to compete. This emphasis on equity capital and disclosed reserves reflects the importance the Committee attaches to securing a progressive enhancement in the quality, as well as the level, of the total capital resources maintained by major banks.

13. Notwithstanding this emphasis, the member countries of the Committee also consider that there are a number of other important and legitimate constituents of a bank's capital base which may be included within the system of measurement (subject to certain conditions set out in sub-section (b) below).

14. The Committee has therefore concluded that capital, for supervisory purposes, should be defined in two tiers in a way which will have the effect of requiring at least 50% of a bank's capital base to consist of a core element comprised of equity capital and published reserves from post-tax retained earnings (tier 1). The other elements of capital (supplementary capital) will be admitted into tier 2 up to an amount equal to that of the core capital. These supplementary capital elements and the particular conditions attaching to their inclusion in the capital base are set out below and in more detail in Annex 1. Each of these elements may be included or not included by national authorities at their discretion in the light of their national accounting and supervisory regulations.[3]

(b) Supplementary capital

(i) Undisclosed reserves

15. Unpublished or hidden reserves may be constituted in various ways according to differing legal and accounting regimes in member countries. Under this heading are included only reserves which, though unpublished, have been passed through the profit and loss account and which are accepted by the bank's supervisory authorities. They may be inherently of the same intrinsic quality as published retained earnings, but, in the context of an internationally agreed minimum standard, their lack of transparency, together with the fact that many countries do not recognise undisclosed reserves, either as an accepted accounting concept or as a legitimate element of capital, argue for excluding them from the core equity capital element.

(ii) Revaluation reserves

16. Some countries, under their national regulatory or accounting arrangements, allow certain assets to be revalued to reflect their current value, or something closer to their current

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3 One member country, however, maintains the view that an international definition of capital should be confined to core capital elements and indicated that it would continue to press for the definition to be reconsidered by the Committee in the years ahead.

value than historic cost, and the resultant revaluation reserves to be included in the capital base. Such revaluations can arise in two ways:

(a) from a formal revaluation, carried through to the balance sheets of banks' own premises; or

(b) from a notional addition to capital of hidden values which arise from the practice of holding securities in the balance sheet valued at historic costs.

Such reserves may be included within supplementary capital provided that the assets are considered by the supervisory authority to be prudently valued, fully reflecting the possibility of price fluctuations and forced sale.

17. Alternative (b) is relevant to those banks whose balance sheets traditionally include very substantial amounts of equities held in their portfolio at historic cost but which can be, and on occasions are, realised at current prices and used to offset losses. The Committee considers these "latent" revaluation reserves can be included among supplementary elements of capital since they can be used to absorb losses on a going-concern basis, provided they are subject to a substantial discount in order to reflect concerns both about market volatility and about the tax charge which would arise were such cases to be realised. A discount of 55% on the difference between the historic cost book value and market value is agreed to be appropriate in the light of these considerations. The Committee considered, but rejected, the proposition that latent reserves arising in respect of the undervaluation of banks' premises should also be included within the definition of supplementary capital.

(iii) General provisions/general loan-loss reserves

18. General provisions or general loan-loss reserves are created against the possibility of future losses. Where they are not ascribed to particular assets and do not reflect a reduction in the valuation of particular assets, these reserves qualify for inclusion in capital and it has been agreed that they should be counted within tier 2. Where, however, provisions have been created against identified losses or in respect of a demonstrable deterioration in the value of particular assets, they are not freely available to meet unidentified losses which may subsequently arise elsewhere in the portfolio and do not possess an essential characteristic of capital. Such specific or earmarked provisions should therefore not be included in the capital base.

19. The Committee accepts, however, that, in practice, it is not always possible to distinguish clearly between general provisions (or general loan-loss reserves) which are genuinely freely available and those provisions which in reality are earmarked against assets already identified as impaired. This partly reflects the present diversity of accounting, supervisory, and, importantly, fiscal policies in respect of provisioning and in respect of national definitions of capital. This means, inevitably, that initially there will be a degree of

inconsistency in the characteristics of general provisions or general loan-loss reserves included by different member countries within the framework.

20. In the light of these uncertainties, the Committee intends during the transitional period (see paragraphs 45 to 50 below) to clarify the distinction made in member countries between those elements which should conceptually be regarded as part of capital and those which should not qualify. The Committee will aim to develop before the end of 1990 firm proposals applicable to all member countries, so as to ensure consistency in the definition of general provisions and general loan-loss reserves eligible for inclusion in the capital base by the time the interim and final minimum target standards fall to be observed.

21. As a further safeguard, in the event that agreement is not reached on the refined definition of unencumbered resources eligible for inclusion in supplementary capital, where general provisions and general loan-loss reserves may include amounts reflecting lower valuations for assets or latent but unidentified losses present in the balance sheet, the amount of such reserves or provisions that qualify as capital would be phased down so that, at the end of the transitional period, such items would constitute no more than 1.25 percentage points, or exceptionally and temporarily up to 2.0 percentage points, of risk assets within the secondary elements.

(iv) Hybrid debt capital instruments

22. In this category fall a number of capital instruments which combine certain characteristics of equity and certain characteristics of debt. Each of these has particular features which can be considered to affect its quality as capital. It has been agreed that, where these instruments have close similarities to equity, in particular when they are able to support losses on an on-going basis without triggering liquidation, they may be included in supplementary capital. In addition to perpetual preference shares carrying a cumulative fixed charge, the following instruments, for example, may qualify for inclusion: long-term preferred shares in Canada, titres participatifs and titres subordonnés à durée indéterminée in France, Genussscheine in Germany, perpetual debt instruments in the United Kingdom and mandatory convertible debt instruments in the United States. The qualifying criteria for such instruments are set out in Annex 1.

(v) Subordinated term debt

23. The Committee is agreed that subordinated term debt instruments have significant deficiencies as constituents of capital in view of their fixed maturity and inability to absorb losses except in a liquidation. These deficiencies justify an additional restriction on the amount of such debt capital which is eligible for inclusion within the capital base. Consequently, it has been concluded that subordinated term debt instruments with a minimum original term to maturity of over five years may be included within the supplementary

elements of capital, but only to a maximum of 50% of the core capital element and subject to adequate amortisation arrangements.

(c) Deductions from capital

24. It has been concluded that the following deductions should be made from the capital base for the purpose of calculating the risk-weighted capital ratio. The deductions will consist of:

(i) goodwill, as a deduction from tier 1 capital elements;

(ii) investments in subsidiaries engaged in banking and financial activities which are not consolidated in national systems. The normal practice will be to consolidate subsidiaries for the purpose of assessing the capital adequacy of banking groups. Where this is not done, deduction is essential to prevent the multiple use of the same capital resources in different parts of the group. The deduction for such investments will be made against the total capital base. The assets representing the investments in subsidiary companies whose capital had been deducted from that of the parent would not be included in total assets for the purposes of computing the ratio.

25. The Committee carefully considered the possibility of requiring deduction of banks' holdings of capital issued by other banks or deposit-taking institutions, whether in the form of equity or of other capital instruments. Several G-10 supervisory authorities currently require such a deduction to be made in order to discourage the banking system as a whole from creating cross-holdings of capital, rather than drawing capital from outside investors. The Committee is very conscious that such double-gearing (or "double-leveraging") can have systemic dangers for the banking system by making it more vulnerable to the rapid transmission of problems from one institution to another and some members consider these dangers justify a policy of full deduction of such holdings.

26. Despite these concerns, however, the Committee as a whole is not presently in favour of a general policy of deducting all holdings of other banks' capital, on the grounds that to do so could impede certain significant and desirable changes taking place in the structure of domestic banking systems.

27. The Committee has nonetheless agreed that:

(a) individual supervisory authorities should be free at their discretion to apply a policy of deduction, either for all holdings of other banks' capital, or for holdings which exceed material limits in relation to the holding bank's capital or the issuing bank's capital, or on a case-by-case basis;

(b) where no deduction is applied, banks' holdings of other banks' capital instruments will bear a weight of 100%;

(c) in applying these policies, member countries consider that reciprocal cross-holdings of bank capital designed artificially to inflate the capital position of the banks concerned should not be permitted;

(d) the Committee will closely monitor the degree of double-gearing in the international banking system and does not preclude the possibility of introducing constraints at a later date. For this purpose, supervisory authorities intend to ensure that adequate statistics are made available to enable them and the Committee to monitor the development of banks' holdings of other banks' equity and debt instruments which rank as capital under the present agreement.

II. The risk weights

28. The Committee considers that a weighted risk ratio in which capital is related to different categories of asset or off-balance-sheet exposure, weighted according to broad categories of relative riskiness, is the preferred method for assessing the capital adequacy of banks. This is not to say that other methods of capital measurement are not also useful, but they are considered by the Committee to be supplementary to the risk-weight approach. The Committee believes that a risk ratio has the following advantages over the simpler gearing ratio approach:

(i) it provides a fairer basis for making international comparisons between banking systems whose structures may differ;

(ii) it allows off-balance-sheet exposures to be incorporated more easily into the measure;

(iii) it does not deter banks from holding liquid or other assets which carry low risk.

29. The framework of weights has been kept as simple as possible and only five weights are used - 0, 10, 20, 50 and 100%. There are inevitably some broad-brush judgements in deciding which weight should apply to different types of asset and the weightings should not be regarded as a substitute for commercial judgement for purposes of market pricing of the different instruments.

30. The weighting structure is set out in detail in Annexes 2 and 3. There are six aspects of the structure to which attention is particularly drawn.

(i) Categories of risk captured in the framework

31. There are many different kinds of risks against which banks' managements need to guard. For most banks the major risk is *credit risk*, that is to say the risk of counterparty

failure, but there are many other kinds of risk - for example, investment risk, interest rate risk, exchange rate risk, concentration risk. The central focus of this framework is credit risk and, as a further aspect of credit risk, country transfer risk. In addition, individual supervisory authorities have discretion to build in certain other types of risk. Some countries, for example, will wish to retain a weighting for open foreign exchange positions or for some aspects of investment risk. No standardisation has been attempted in the treatment of these other kinds of risk in the framework at the present stage.

32. The Committee considered the desirability of seeking to incorporate additional weightings to reflect the investment risk in holdings of fixed rate government securities - one manifestation of interest rate risk which is of course present across the whole range of a bank's activities, on and off the balance sheet. For the present, it was concluded that individual supervisory authorities should be free to apply either a zero *or* a low weight to claims on governments (e.g. 10% for all securities or 10% for those maturing in under one year and 20% for one year and over). All members agreed, however, that interest rate risk generally required further study and that if, in due course, further work made it possible to develop a satisfactory method of measurement for this aspect of risk for the business as a whole, consideration should be given to applying some appropriate control alongside this credit risk framework. Work is already under way to explore the possibilities in this regard.

(ii) Country transfer risk

33. In addressing country transfer risk, the Committee has been very conscious of the difficulty of devising a satisfactory method for incorporating country transfer risk into the framework of measurement. In its earlier, consultative, paper two alternative approaches were put forward for consideration and comment. These were, firstly, a simple differentiation between claims on domestic institutions (central government, official sector and banks) and claims on all foreign countries; and secondly, differentiation on the basis of an approach involving the selection of a defined grouping of countries considered to be of high credit standing.

34. The comments submitted to the Committee by banks and banking associations in G-10 countries during the consultative period were overwhelmingly in favour of the second alternative. In support of this view, three particular arguments were strongly represented to the Committee. Firstly, it was stressed that a simple domestic/foreign split effectively ignores the reality that transfer risk varies greatly between different countries and that this risk is of sufficient significance to make it necessary to ensure that broad distinctions in the credit standing of industrialised and non-industrialised countries should be made and captured in the system of measurement, particularly one designed for international banks. Secondly, it was argued that the domestic/foreign split does not reflect the global integration of financial markets and the absence of some further refinement would discourage international banks

from holding securities issued by central governments of major foreign countries as liquid cover against their Euro-currency liabilities. To that extent a domestic/foreign approach would run counter to an important objective of the risk weighting framework, namely that it should encourage prudent liquidity management. Thirdly, and most importantly, the member states of the European Community are firmly committed to the principle that all claims on banks, central governments and the official sector within European Community countries should be treated in the same way. This means that, where such a principle is put into effect, there would be an undesirable asymmetry in the manner in which a domestic/foreign split was applied by the seven G-10 countries which are members of the Community compared with the manner in which it was applied by the non-Community countries.

35. In the light of these arguments, the Committee has concluded that a defined group of countries should be adopted as the basis for applying differential weighting coefficients, and that this group should be full members of the OECD or countries which have concluded special lending arrangements with the IMF associated with the Fund's General Arrangements to Borrow. This group of countries is referred to as the OECD in the rest of the report.

36. This decision has the following consequences for the weighting structure. Claims on central governments within the OECD will attract a zero weight (or a low weight if the national supervisory authority elects to incorporate interest rate risk); and claims on OECD non-central government public-sector entities will attract a low weight (see (iii) below). Claims on central governments and central banks outside the OECD will also attract a zero weight (or a low weight if the national supervisory authority elects to incorporate interest rate risk), provided such claims are denominated in the national currency and funded by liabilities in the same currency. This reflects the absence of risks relating to the availability and transfer of foreign exchange on such claims.

37. As regards the treatment of interbank claims, in order to preserve the efficiency and liquidity of the international interbank market there will be no differentiation between short-term claims on banks incorporated within or outside the OECD. However, the Committee draws a distinction between, on the one hand, short-term placements with other banks which is an accepted method of managing liquidity in the interbank market and carries a perception of low risk and, on the other, longer-term cross-border loans to banks which are often associated with particular transactions and carry greater transfer and/or credit risks. A 20% weight will therefore be applied to claims on all banks, wherever incorporated, with a residual maturity of up to and including one year; longer-term claims on OECD incorporated banks will be weighted at 20%; and longer-term claims on banks incorporated outside the OECD will be weighted at 100%.

(iii) Claims on non-central-government, public-sector entities (PSEs)

38. The Committee concluded that it was not possible to settle on a single common weight that can be applied to all claims on domestic public-sector entities below the level of central government (e.g. states. local authorities, etc.) in view of the special character and varying creditworthiness of these entities in different member countries. The Committee therefore opted to allow discretion to each national supervisory authority to determine the appropriate weighting factors for the PSEs within that country. In order to preserve a degree of convergence in the application of such discretion, the Committee agreed that the weights ascribed in this way should be 0, 10, 20 or 50% for domestic PSEs, but that PSEs in foreign countries within the OECD should attract a standard 20% weight. These arrangements will be subject to review by the Committee in pursuit of further convergence towards common weights and consistent definitions in member countries and in the light of decisions to be taken within the European Community on the specification of a common solvency ratio for credit institutions.

Commercial companies owned by the public sector will attract a uniform weight of 100% inter alia in order to avoid competitive inequality vis-à-vis similar private-sector commercial enterprises.

(iv) Collateral and guarantees

39. The framework recognises the importance of collateral in reducing credit risk, but only to a limited extent. In view of the varying practices among banks in different countries for taking collateral and different experiences of the stability of physical or financial collateral values, it has not been found possible to develop a basis for recognising collateral generally in the weighting system. The more limited recognition of collateral will apply only to loans secured against cash or against securities issued by OECD central governments and specified multilateral development banks. These will attract the weight given to the collateral (i.e. a zero or low weight). Loans partially collateralised by these assets will also attract the equivalent low weights on that part of the loan which is fully collateralised.

40. As regards loans or other exposures guaranteed by third parties, the Committee has agreed that loans guaranteed by OECD central governments, OECD public-sector entities, or OECD incorporated banks will attract the weight allocated to a direct claim on the guarantor (e.g. 20% in the case of banks). Loans guaranteed by non-OECD incorporated banks will also be recognised by the application of a 20% weight, but only where the underlying transaction has a residual maturity not exceeding one year. The Committee intends to monitor the application of this latter arrangement to ensure that it does not give rise to inappropriate weighting of commercial loans. In the case of loans covered by partial guarantees, only that part of the loan which is covered by the guarantee will attract the

reduced weight. The contingent liability assumed by banks in respect of guarantees will attract a credit conversion factor of 100% (see sub-section (vi) below).

(v) Loans secured on residential property

41. Loans fully secured by mortgage on occupied residential property have a very low record of loss in most countries. The framework will recognise this by assigning a 50% weight to loans fully secured by mortgage on residential property which is rented or is (or is intended to be) occupied by the borrower. In applying the 50% weight, the supervisory authorities will satisfy themselves, according to their national arrangements for the provision of housing finance, that this concessionary weight is applied restrictively for residential purposes and in accordance with strict prudential criteria. This may mean, for example, that in some member countries the 50% weight will only apply to first mortgages, creating a first charge on the property; and that in other member countries it will only be applied where strict, legally-based, valuation rules ensure a substantial margin of additional security over the amount of the loan. The 50% weight will specifically not be applied to loans to companies engaged in speculative residential building or property development. Other collateral will not be regarded as justifying the reduction of the weightings that would otherwise apply.[4]

(vi) Off-balance-sheet engagements

42. The Committee believes that it is of great importance that all off-balance-sheet activity should be caught within the capital adequacy framework. At the same time, it is recognised that there is only limited experience in assessing the risks in some of the activities; also that for some countries, a complex analytical approach and detailed and frequent reporting systems cannot easily be justified when the amounts of such business, particularly in the newer, more innovative instruments, are only small. The approach that has been agreed, which is on the same lines as that described in the Committee's report on the supervisory treatment of off-balance-sheet exposures issued to banks in March 1986, is comprehensive in that all categories of off-balance-sheet engagements, including recent innovations, will be converted to credit risk equivalents by multiplying the nominal principal amounts by a credit conversion factor, the resulting amounts then being weighted according to the nature of the counterparty. The different instruments and techniques are divided into five broad categories (within which member countries will have some limited discretion to allocate particular instruments according to their individual characteristics in national markets):

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4 One member country feels strongly that the lower weight should also apply to other loans secured by mortgages on domestic property, provided that the amount of the loan does not exceed 60% of the value of the property as calculated according to strict legal valuation criteria.

(a) those which substitute for loans (e.g. general guarantees of indebtedness, bank acceptance guarantees and standby letters of credit serving as financial guarantees for loans and securities) - these will carry a 100% credit risk conversion factor;

(b) certain transaction-related contingencies (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) - a 50% credit risk conversion factor;

(c) short-term, self-liquidating trade-related contingent liabilities arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipments) - a 20% credit risk conversion factor;

(d) commitments with an original maturity[5] exceeding one year (the longer maturity serving broadly as a proxy for higher risk facilities) and all NIFs and RUFs - a 50% credit risk conversion factor. Shorter-term commitments or commitments which can be unconditionally cancelled at any time, it is agreed, generally carry only low risk and a nil weight for these is considered to be justified on de minimis grounds;

(e) interest and exchange rate related items (e.g. swaps, options, futures) - the credit risk equivalent amount for these contracts will be calculated in one of two ways (see below and Annex 3).

43. Special treatment is needed for the items in (e) above because banks are not exposed to credit risk for the full face value of their contracts, but only to the cost of replacing the cash flow if a counterparty defaults. Most members of the Committee accept that the correct method of assessing the credit risk on these items is to calculate the current replacement cost by marking to market and to add a factor to represent potential exposure during the remaining life of the contract. Some member countries, however, are concerned about the consistency of this method in relation to the rest of the system which only makes broad distinctions between relative risks for on-balance-sheet items, particularly for banks where these off-balance-sheet items currently constitute only a very small part of the total risks. They would prefer to apply an alternative approach consisting of conversion factors based on the nominal principal sum underlying each contract according to its type and maturity. The Committee has concluded that members will be allowed to choose either of the two methods. The details of the two alternative methods are set out in Annex 3.

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5 In order to facilitate date collection, during the transitional period up to end-1992, but not beyond, national supervisory authorities will have discretion to apply residual maturity as a basis for measuring commitments.

III. A target standard ratio

44. In the light of consultations and preliminary testing of the framework, the Committee is agreed that a minimum standard should be set now which international banks generally will be expected to achieve by the end of the transitional period. It is also agreed that this standard should be set at a level that is consistent with the objective of securing over time soundly-based and consistent capital ratios for all international banks. Accordingly, the Committee confirms that the target standard ratio of capital to weighted risk assets should be set at 8% (of which the core capital element will be at least 4%). This is expressed as a common minimum standard which international banks in member countries will be expected to observe by the end of 1992, thus allowing a transitional period of some four-and-a-half years for any necessary adjustment by banks who need time to build up to those levels. The Committee fully recognises that the transition from existing, sometimes long-established, definitions of capital and methods of measurement towards a new internationally agreed standard will not necessarily be achieved easily or quickly. The full period to end-1992 is available to ensure progressive steps towards adjustment and banks whose ratios are presently below the 8% standard will not be required to take immediate or precipitate action.

IV. Transitional and implementing arrangements

(i) Transition

45. Certain transitional arrangements have been agreed upon to ensure that there are sustained efforts during the transitional period to build up individual banks' ratios towards the ultimate target standard; and to facilitate smooth adjustment and phasing in of the new arrangements within a wide variety of existing supervisory systems.

46. The transitional period will be from the date of this paper to the end of 1992, by which latter date all banks undertaking significant cross-border business will be expected to meet the standard in full (see paragraph 50 below). In addition, there will be an interim standard to be met by the end of 1990 (see paragraph 49 below).

47. Initially no formal standard or minimum level will be set. It is the general view of the Committee, however, that every encouragement should be given to those banks whose capital levels are at the low end of the range to build up their capital as quickly as possible and the Committee expects there to be no erosion of existing capital standards in individual member countries' banks. Thus, during the transitional period, all banks which need to improve capital levels up to the interim and final standards should not diminish even temporarily their current capital levels (subject to the fluctuations which can occur around the time new capital is raised). A level of 5% attained by application of the framework and transitional arrangements is considered by some countries to be a reasonable yardstick for the lower capitalised banks to seek to attain in the short term. Individual member countries will,

of course, be free to set, and announce, at the outset of the transitional period the level from which they would expect all their banks to move towards the interim and final target standard. In order to assess and compare progress during the initial period of adjustment to end-1990 in a manner which takes account both of existing supervisory systems and the new arrangements, the Committee and individual supervisory authorities will initially apply the basis of measurement set out in paragraph 48 below.

48. In measuring the capital position of banks at the start of the transitional period, a proportion of the core capital may be made up of supplementary elements up to a maximum of 25% of core capital elements, reducing to 10% by end-1990. In addition, throughout the transitional period up to end-1992, subject to more restrictive policies which individual authorities may wish to apply, term subordinated debt may be included without limit as a constituent of supplementary elements and the deduction from tier 1 capital elements in respect of goodwill may be waived.

49. At end-1990 there will be an interim minimum standard of 7.25% of which at least half should be core capital. However, between end-1990 and end-1992 up to 10% of the required core elements may be made up of supplementary elements. This means, in round figures, a minimum core capital element of 3.6%, of which tier 1 elements should total at least 3.25%, is to be achieved by the end of 1990. In addition, from end-1990, general loan-loss reserves or general provisions which include amounts reflecting lower valuations of assets or latent but unidentified losses present in the balance sheet will be limited to 1.5 percentage points, or exceptionally up to 2.0[6] percentage points, of risk assets within supplementary elements.

50. At end-1992 the transitional period ends. The minimum standard will then be 8%, of which core capital (tier 1, equity and reserves) will be at least 4%, supplementary elements no more than core capital and term subordinated debt within supplementary elements no more than 50% of tier 1. In addition, general loan-loss reserves or general provisions (having the characteristics described in paragraph 49) will be limited at end-1992 to 1.25 percentage points, or exceptionally and temporarily up to 2.0[6] percentage points, within supplementary elements.

For ease of reference, the arrangements described in paragraphs 45 to 50 are summarised in a table at Annex 4.

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6 These limits would only apply in the event that no agreement is reached on a consistent basis for including unencumbered provisions or reserves in capital (see paragraphs 20 and 21).

(ii) Implementation

51. The arrangements described in this document will be implemented at national level at the earliest possible opportunity. Each country will decide the way in which the supervisory authorities will introduce and apply these recommendations in the light of their different legal structures and existing supervisory arrangements. In some countries, changes in the capital regime may be introduced, after consultation, relatively speedily without the need for legislation. Other countries may employ more lengthy procedures, and in some cases these may require legislation. In due course the member states of the European Community will also need to ensure that their own domestic regulations are compatible with the Community's own legislative proposals in this field. None of these factors needs result in any inconsistency in the timing of implementation among member countries. For example, some countries may apply the framework in this report, formally or informally, in parallel with their existing system, certainly during the initial period of transition. In this way banks can be assisted to start the necessary process of adjustment in good time before substantive changes in national systems are formally introduced.

July 1988

Annex 1

Definition of capital included in the capital base (To apply at end-1992 - see Annex 4 for transitional arrangements)

A. Capital elements

Tier 1 (a) Paid-up share capital/common stock
(b) Disclosed reserves

Tier 2 (a) Undisclosed reserves
(b) Asset revaluation reserves
(c) General provisions/general loan-loss reserves
(d) Hybrid (debt/equity) capital instruments
(e) Subordinated debt

The sum of tier 1 and tier 2 elements will be eligible for inclusion in the capital base, subject to the following limits.

B. Limits and restrictions

(i) The total of tier 2 (supplementary) elements will be limited to a maximum of 100% of the total of tier 1 elements;

(ii) subordinated term debt will be limited to a maximum of 50% of tier 1 elements;

(iii) where general provisions/general loan-loss reserves include amounts reflecting lower valuations of asset or latent but unidentified losses present in the balance sheet, the amount of such provisions or reserves will be limited to a maximum of 1.25 percentage points, or exceptionally and temporarily up to 2.0 percentage points, of risk assets;[1]

(iv) asset revaluation reserves which take the form of latent gains on unrealised securities (see below) will be subject to a discount of 55%.

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1 This limit would only apply in the event that no agreement is reached on a consistent basis for including unencumbered provisions or reserves in capital (see paragraphs 20 and 21).

C. Deductions from the capital base

From tier 1: Goodwill

From total capital: (i) Investments in unconsolidated banking and financial subsidiary companies.

N.B. The presumption is that the framework would be applied on a consolidated basis to banking groups.

(ii) Investments in the capital of other banks and financial institutions (at the discretion of national authorities).

D. Definition of capital elements

(i) **Tier 1**: includes only *permanent shareholders' equity* (issued and fully paid ordinary shares/common stock and perpetual non-cumulative preference shares) and *disclosed reserves* (created or increased by appropriations of retained earnings or other surplus, e.g. share premiums, retained profit,[2] general reserves and legal reserves). In the case of consolidated accounts, this also includes minority interests in the equity of subsidiaries which are less than wholly owned. This basic definition of capital excludes revaluation reserves and cumulative preference shares.

(ii) **Tier 2: (a) undisclosed reserves** are eligible for inclusion within supplementary elements provided these reserves are accepted by the supervisor. Such reserves consist of that part of the accumulated after-tax surplus of retained profits which banks in some countries may be permitted to maintain as an undisclosed reserve. Apart from the fact that the reserve is not identified in the published balance sheet, it should have the same high quality and character as a disclosed capital reserve; as such, it should not be encumbered by any provision or other known liability but should be freely and immediately available to meet unforeseen future losses. This definition of undisclosed reserves excludes hidden values arising from holdings of securities in the balance sheet at below current market prices (see below).

(b) Revaluation reserves arise in two ways. Firstly, in some countries, banks (and other commercial companies) are permitted to revalue fixed assets, normally their own premises, from time to time in line with the change in market values. In some of these countries the amount of such revaluations is determined by law. Revaluations of this kind are reflected on the face of the balance sheet as a revaluation reserve.

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2 Including, at national discretion, allocations to or from reserve during the course of the year from current year's retained profit.

Secondly, hidden values of "latent" revaluation reserves may be present as a result of long-term holdings of equity securities valued in the balance sheet at the historic cost of acquisition.

Both types of revaluation reserve may be included in tier 2 provided that the assets are prudently valued, fully reflecting the possibility of price fluctuation and forced sale. In the case of "latent" revaluation reserves a discount of 55% will be applied to the difference between historic cost book value and market value to reflect the potential volatility of this form of unrealised capital and the notional tax charge on it.

(c) General provisions/general loan-loss reserves: provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within supplementary elements. Provisions ascribed to impairment of particular assets or known liabilities should be excluded. Furthermore, where general provisions/general loan-loss reserves include amounts reflecting lower valuations of assets or latent but unidentified losses already present in the balance sheet, the amount of such provisions or reserves eligible for inclusion will be limited to a maximum of 1.25 percentage points, or exceptionally and temporarily up to 2.0 percentage points.[3]

(d) Hybrid (debt/equity) capital instruments. This heading includes a range of instruments which combine characteristics of equity capital and of debt. Their precise specifications differ from country to country, but they should meet the following requirements:

- they are *unsecured, subordinated* and *fully paid-up*;
- they are *not redeemable* at the initiative of the holder or without the prior consent of the supervisory authority;
- they are *available to participate in losses* without the bank being obliged to cease trading (unlike conventional subordinated debt);
- although the capital instrument may carry an obligation to pay interest that cannot permanently be reduced or waived (unlike dividends on ordinary shareholders' equity), *it should allow service obligations to be deferred* (as with cumulative preference shares) where the profitability of the bank would not support payment.

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3 This limit would apply in the event that no agreement is reached on a consistent basis for including unencumbered provisions or reserves in capital (see paragraphs 20 and 21).

Cumulative preference shares, having these characteristics, would be eligible for inclusion in this category. In addition, the following are examples of instruments that may be eligible for inclusion: long-term preferred shares in Canada, titres participatifs and titres subordonnés à durée indéterminée in France, Genusscheine in Germany, perpetual subordinated debt and preference shares in the United Kingdom and mandatory convertible debt instruments in the United States. Debt capital instruments which do not meet these criteria may be eligible for inclusion in item (e).

(e) Subordinated term debt: includes conventional unsecured subordinated debt capital instruments with a minimum original fixed term to maturity of over five years and limited life redeemable preference shares. During the last five years to maturity, a cumulative discount (or amortisation) factor of 20% per year will be applied to reflect the diminishing value of these instruments as a continuing source of strength. Unlike instruments included in item (d), these instruments are not normally available to participate in the losses of a bank which continues trading. For this reason these instruments will be limited to a maximum of 50% of tier 1.

Annex 2

Risk weights by category of on-balance-sheet asset

0%	(a)	Cash[1]
	(b)	Claims on central governments and central banks denominated in national currency and funded in that currency
	(c)	Other claims on OECD[2] central governments[3] and central banks
	(d)	Claims collateralised by cash of OECD central-government securities[3] or guaranteed by OECD central governments[4]
0, 10, 20 or 50% (at national discretion)	(a)	Claims on domestic public-sector entities, excluding central government, and loans guaranteed[4] by such entities
20%	(a)	Claims on multilateral development banks (IBRD, IADB, AsDB, AfDB, EIB)[5] and claims guaranteed by, or collateralised by securities issued by such banks[4]
	(b)	Claims on banks incorporated in the OECD and loans guaranteed[4] by OECD incorporated banks

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1 Includes (at national discretion) gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities.

2 For the purpose of this exercise, the OECD group comprises countries which are full members of the OECD or which have concluded special lending arrangements with the IMF associated with the Fund's General Arrangements to Borrow.

3 Some member countries intend to apply weights to securities issued by OECD central governments to take account of investment risk. These weights would, for example, be 10% for all securities or 10% for those maturing in up to one year and 20% for those maturing in over one year.

4 Commercial loans partially guaranteed by these bodies will attract equivalent low weights on that part of the loan which is fully covered. Similarly, loans partially collateralised by cash or securities issued by OECD central governments and multilateral development banks will attract low weights on that part of the loan which is fully covered.

5 Claims on other multilateral development banks in which G-10 countries are shareholding members may, at national discretion, also attract a 20% weight.

(c) Claims on banks incorporated in countries outside the OECD with a residual maturity of up to one year and loans with a residual maturity of up to one year guaranteed by banks incorporated in countries outside the OECD

(d) Claims on non-domestic OECD public-sector entities, excluding central government, and loans guaranteed[4] by such entities

(e) Cash items in process of collection

50% (a) Loans fully secured by mortgage on residential property that is or will be occupied by the borrower or that is rented

100% (a) Claims on the private sector

(b) Claims on banks incorporated outside the OECD with a residual maturity of over one year

(c) Claims on central governments outside the OECD (unless denominated in national currency - and funded in that currency - see above)

(d) Claims on commercial companies owned by the public sector

(e) Premises, plant and equipment and other fixed assets

(f) Real estate and other investments (including non-consolidated investment participations in other companies)

(g) Capital instruments issued by other banks (unless deducted from capital)

(h) all other assets

Annex 3

Credit conversion factors for off-balance-sheet items

The framework takes account of the credit risk on off-balance-sheet exposures by applying credit conversion factors to the different types of off-balance-sheet instrument or transaction. With the exception of foreign exchange and interest rate related contingencies, the credit conversion factors are set out in the table below. They are derived from the estimated size and likely occurrence of the credit exposure, as well as the relative degree of credit risk as identified in the Committee's paper "*The management of banks' off-balance-sheet exposures: a supervisory perspective*" issued in March 1986. The credit conversion factors would be multiplied by the weights applicable to the category of the counterparty for an on-balance-sheet transaction (see Annex 2).

Instruments

	Instruments	Credit conversion factors
1.	Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances)	100%
2.	Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions)	50%
3.	Short-term self-liquidating trade-related contingencies (such as documentary credits collateralised by the underlying shipments)	20%

4.	Sale and repurchase agreements and asset sales with recourse,[1] where the credit risk remains with the bank	100%
5.	Forward asset purchases, forward forward deposits and partly-paid shares and securities,[1] which represent commitments with certain drawdown	100%
6.	Note issuance facilities and revolving underwriting facilities	50%
7.	Other commitments (e.g. formal standby facilities and credit lines) with an original[2] maturity of over one year	50%
8.	Similar commitments with an original[2] maturity of up to one year, or which can be unconditionally cancelled at any time	0%

(N.B. Member countries will have some limited discretion to allocate particular instruments into items 1 to 8 above according to the characteristics of the instrument in the national market.)

Foreign exchange and interest rate related contingencies

The treatment of foreign exchange and interest rate related items needs special attention because banks are not exposed to credit risk for the full face value of their contracts, but only to the potential cost of replacing the cash flow (on contracts showing positive value) if the counterparty defaults. The credit equivalent amounts will depend inter alia on the maturity of the contract and on the volatility of the rates underlying that type of instrument.

Despite the wide range of different instruments in the market, the theoretical basis for assessing the credit risk on all of them has been the same. It has consisted of an analysis of the behaviour of matched pairs of swaps under different volatility assumptions. Since exchange rate contracts involve an exchange of principal on maturity, as well as being generally more volatile, higher conversion factors are proposed for those instruments which

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1 These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into. Reverse repos (i.e. purchase and resale agreement - where the bank is the receiver of the asset) are to be treated as collateralised loans, reflecting the economic reality of the transaction. The risk is therefore to be measured as an exposure on the counterparty. Where the asset temporarily acquired is a security which attracts a preferential risk weighting, this would be recognised as collateral and the risk weighting would be reduced accordingly.

2 But see footnote 5 in the main text.

feature exchange rate risk. Interest rate contracts[3] are defined to include single-currency interest rate swaps, basis swaps, forward rate agreements, interest rate futures, interest rate options purchased and similar instruments. Exchange rate contracts[3] include cross-currency interest rate swaps, forward foreign exchange contracts, currency futures, currency options purchased and similar instruments. Exchange rate contracts with an original maturity of fourteen calendar days or less are excluded.

A majority of G-10 supervisory authorities are of the view that the best way to assess the credit risk on these items is to ask banks to calculate the current replacement cost by marketing contracts to market, thus capturing the current exposure without any need for estimation, and then adding a factor (the "add-on") to reflect the potential future exposure over the remaining life of the contract. It has been agreed that, in order to calculate the credit equivalent amount of its off-balance-sheet interest rate and foreign exchange rate instruments under this **current exposure method**, a bank would sum:

- the total replacement cost (obtained by "marking to market") of all its contracts with positive value, and
- an amount for potential future credit exposure calculated on the basis of the total notional principal amount of its book, split by residual maturity as follows:

Residual maturity	Interest rate contracts	Exchange rate contracts
Less than one year	nil	1.0%
One year and over	0.5%	5.0%

No potential credit exposure would be calculated for single currency floating/floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

A few G-10 supervisors believe that this two-step approach, incorporating a "mark-to-market" element, is not consistent with the remainder of the capital framework. They favour a simpler method whereby the potential credit exposure is estimated against each type of contract and a notional capital weight allotted, no matter what the market value of the contract might be at a particular reporting date. It has therefore been agreed supervisory

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3 Instruments traded on exchanges may be excluded where they are subject to daily margining requirements. Options purchased over the counter are included with the same conversion factors as other instruments, but this decision might be reviewed in the light of future experience.

authorities should have discretion[4] to apply the alternative method of calculation described below, in which credit conversion factors are derived without reference to the current market price of the instruments. In deciding on what those notional credit conversion factors should be, it has been agreed that a slightly more cautious bias is justified since the current exposure is not being calculated on a regular basis.

In order to arrive at the credit equivalent amount using this **original exposure method**, a bank would simply apply one of the following two sets of conversion factors to the notional principal amounts of each instrument according to the nature of the instrument and its maturity:

Maturity[5]	**Interest rate contracts**	**Exchange rate contracts**
Less than one year	0.5%	2.0%
One year and less than two years	1.0%	5.0% (i.e. 2% + 3%)
For each additional year	1.0%	3.0%

It is emphasised that the above conversion factors, as well as the "add-ons" for the current exposure method, should be regarded as provisional and may be subject to amendment as a result of changes in the volatility of exchange rates and interest rates.

Careful consideration has been given to the arguments put forward for recognising **netting**, i.e. for weighting the net rather than the gross claims arising out of swaps and similar contracts with the same counterparties. The criterion on which a decision has been based is the status of a netting contract under national bankruptcy regulations. If a liquidator of a failed counterparty has (or may have) the right to unbundle the netting contracts, demanding performance on those contracts favourable to his client and defaulting on unfavourable contracts, there is no reduction in counterparty risk. Accordingly, it has been agreed that:

- banks may net contracts subject to novation,[6] since it appears that counterparty risk is genuinely reduced by the substitution of a novated contract which legally

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4 Some national authorities may permit individual banks to choose which method to adopt, it being understood that once a bank had chosen to apply the current exposure method, it would not be allowed to switch back to the original exposure method.

5 For interest rate contracts, there is national discretion as to whether the conversion factors are to be based on original or residual maturity. For exchange rate contracts, the conversion factors are to be calculated according to the original maturity of the instrument.

6 Netting by novation as defined in this context is a bilateral contract between two counterparties under which any obligation to each other to deliver a given currency on a given date is automatically

extinguishes the previous obligation. However, since under some national bankruptcy laws liquidators may have the right to unbundle transactions undertaken within a given period under a charge of fraudulent preference, supervisory authorities will have national discretion to require a phase-in period before a novation agreement can be recognised in the weighting framework;

- banks may not for the time being net contracts subject to close-out clauses.[7] The effectiveness of such agreements in an insolvency has not yet been tested in the courts, nor has it been possible to obtain satisfactory legal opinion that liquidators would not be able to overturn them. However, the Committee does not wish to discourage market participants from employing clauses which might well afford protection in certain circumstances in some national jurisdictions and would be prepared to reverse its conclusion if subsequent decisions in the courts support the integrity of close-out netting agreements.[8] In any event, the Committee will continue its work to assess the acceptability of various forms of netting.

Once the bank has calculated the credit equivalent amounts, whether according to the current or the original exposure method, they are to be **weighted** according to the category of counterparty in the same way as in the main framework, including concessionary weighting in respect of exposures backed by eligible guarantees and collateral. In addition, since most counterparties in these markets, particularly for long-term contracts, tend to be first-class names, it has been agreed that a 50% weight will be applied in respect of counterparties which would otherwise attract a 100% weight.[9] However, the Committee will keep a close eye on the credit quality of participants in these markets and reserves the right to raise the weights if average credit quality deteriorates or if loss experience increases.

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amalgamated with all other obligations for the same currency and value date, legally substituting one single net amount for the previous gross obligations.

7 Close-out as defined in this context refers to a bilateral contract which provides that, if one of the counterparties is wound up, the outstanding obligations between the two are accelerated and netted to determine the counterparty's net exposure.

8 The other principal form of netting, payments netting, which is designed to reduce the counterparty risk arising out of daily settlements, will not be recognised in the capital framework since the counterparty's gross obligations are not in any way affected.

9 Some member countries reserve the right to apply the full 100% weight.

Annex 4

Transitional arrangements

	Initial	**End-1990**	**End-1992**
1. Minimum standard	The level prevailing at end-1987	7.25%	8.0%
2. Measurement formula	Core elements plus 100%	Core elements plus 100% (3.625% plus 3.625%)	Core elements plus 100% (4% plus 4%)
3. Supplementary elements included in core	Maximum of 25% of total core	Maximum 10% of total core (i.e. 0.36%)	None
4. Limit on general loan-loss reserves in supplementary elements*	No limit	1.5 percentage points or, exceptionally up to 2.0 percentage points	1.25 percentage points or, exceptionally and temporarily up to 2.0 percentage points
5. Limit on term subordinated debt in supplementary elements	No limit (at discretion)	No limit (at discretion)	Maximum of 50% of tier 1
6. Deduction for goodwill	Deducted from tier 1 (at discretion)	Deducted from tier 1 (at discretion)	Deducted from tier 1

* This limit would only apply in the event that no agreement is reached on a consistent basis for including unencumbered provisions or reserves in capital (see paragraphs 20 and 21).

Basel Committee
on Banking Supervision

International Convergence of Capital Measurement and Capital Standards

A Revised Framework
Comprehensive Version

This document is a compilation of the June 2004 Basel II Framework, the elements of the 1988 Accord that were not revised during the Basel II process, the 1996 Amendment to the Capital Accord to Incorporate Market Risks, and the 2005 paper on the Application of Basel II to Trading Activities and the Treatment of Double Default Effects. No new elements have been introduced in this compilation.

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Abbreviations

ABCP	Asset-backed commercial paper
ADC	Acquisition, development and construction
AMA	Advanced measurement approaches
ASA	Alternative standardised approach
CCF	Credit conversion factor
CCR	Counterparty credit risk
CDR	Cumulative default rate
CEM	Current exposure method
CF	Commodities finance
CMV	Current market value
CRM	Credit risk mitigation
DvP	Delivery-versus-payment
EAD	Exposure at default
ECA	Export credit agency
ECAI	External credit assessment institution
EL	Expected loss
EPE	Expected positive exposure
FMI	Future margin income
HVCRE	High-volatility commercial real estate
IAA	Internal assessment approach
IMM	Internal model method
IPRE	Income-producing real estate
I/O	Interest-only strips
IRB	Internal ratings-based
LGD	Loss given default
M	Effective maturity
MDB	Multilateral development bank
NIF	Note issuance facility
OF	Object finance
PD	Probability of default
PF	Project finance
PSE	Public sector entity
PvP	Payment-versus-payment
QRRE	Qualifying revolving retail exposures
RBA	Ratings-based approach

RUF	Revolving underwriting facility
SF	Supervisory formula
SFT	Securities financing transaction
SL	Specialised lending
SM	Standard method
SME	Small- and medium-sized entity
SPE	Special purpose entity
UCITS	Undertakings for collective investments in transferable securities
UL	Unexpected loss

International Convergence of Capital Measurement and Capital Standards: A Revised Framework

(Comprehensive Version: June 2006)

Introduction

1. This report presents the outcome of the Basel Committee on Banking Supervision's ("the Committee")[1] work over recent years to secure international convergence on revisions to supervisory regulations governing the capital adequacy of internationally active banks. Following the publication of the Committee's first round of proposals for revising the capital adequacy framework in June 1999, an extensive consultative process was set in train in all member countries and the proposals were also circulated to supervisory authorities worldwide. The Committee subsequently released additional proposals for consultation in January 2001 and April 2003 and furthermore conducted three quantitative impact studies related to its proposals. As a result of these efforts, many valuable improvements have been made to the original proposals. The present paper is now a statement of the Committee agreed by all its members. It sets out the details of the agreed Framework for measuring capital adequacy and the minimum standard to be achieved which the national supervisory authorities represented on the Committee will propose for adoption in their respective countries. This Framework and the standard it contains have been endorsed by the Central Bank Governors and Heads of Banking Supervision of the Group of Ten countries.

2. The Committee expects its members to move forward with the appropriate adoption procedures in their respective countries. In a number of instances, these procedures will include additional impact assessments of the Committee's Framework as well as further opportunities for comments by interested parties to be provided to national authorities. The Committee intends the Framework set out here to be available for implementation as of year-end 2006. However, the Committee feels that one further year of impact studies or parallel calculations will be needed for the most advanced approaches, and these therefore will be available for implementation as of year-end 2007. More details on the transition to the revised Framework and its relevance to particular approaches are set out in paragraphs 45 to 49.

3. This document is being circulated to supervisory authorities worldwide with a view to encouraging them to consider adopting this revised Framework at such time as they believe is consistent with their broader supervisory priorities. While the revised Framework has been designed to provide options for banks and banking systems worldwide, the Committee acknowledges that moving toward its adoption in the near future may not be a first priority for all non-G10 supervisory authorities in terms of what is needed to strengthen their supervision. Where this is the case, each national supervisor should consider carefully the benefits of the revised Framework in the context of its domestic banking system when developing a timetable and approach to implementation.

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1 The Basel Committee on Banking Supervision is a committee of banking supervisory authorities that was established by the central bank governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. It usually meets at the Bank for International Settlements in Basel, where its permanent Secretariat is located.

4. The fundamental objective of the Committee's work to revise the 1988 Accord[2] has been to develop a framework that would further strengthen the soundness and stability of the international banking system while maintaining sufficient consistency that capital adequacy regulation will not be a significant source of competitive inequality among internationally active banks. The Committee believes that the revised Framework will promote the adoption of stronger risk management practices by the banking industry, and views this as one of its major benefits. The Committee notes that, in their comments on the proposals, banks and other interested parties have welcomed the concept and rationale of the three pillars (minimum capital requirements, supervisory review, and market discipline) approach on which the revised Framework is based. More generally, they have expressed support for improving capital regulation to take into account changes in banking and risk management practices while at the same time preserving the benefits of a framework that can be applied as uniformly as possible at the national level.

5. In developing the revised Framework, the Committee has sought to arrive at significantly more risk-sensitive capital requirements that are conceptually sound and at the same time pay due regard to particular features of the present supervisory and accounting systems in individual member countries. It believes that this objective has been achieved. The Committee is also retaining key elements of the 1988 capital adequacy framework, including the general requirement for banks to hold total capital equivalent to at least 8% of their risk-weighted assets; the basic structure of the 1996 Market Risk Amendment regarding the treatment of market risk; and the definition of eligible capital.

6. A significant innovation of the revised Framework is the greater use of assessments of risk provided by banks' internal systems as inputs to capital calculations. In taking this step, the Committee is also putting forward a detailed set of minimum requirements designed to ensure the integrity of these internal risk assessments. It is not the Committee's intention to dictate the form or operational detail of banks' risk management policies and practices. Each supervisor will develop a set of review procedures for ensuring that banks' systems and controls are adequate to serve as the basis for the capital calculations. Supervisors will need to exercise sound judgements when determining a bank's state of readiness, particularly during the implementation process. The Committee expects national supervisors will focus on compliance with the minimum requirements as a means of ensuring the overall integrity of a bank's ability to provide prudential inputs to the capital calculations and not as an end in itself.

7. The revised Framework provides a range of options for determining the capital requirements for credit risk and operational risk to allow banks and supervisors to select approaches that are most appropriate for their operations and their financial market infrastructure. In addition, the Framework also allows for a limited degree of national discretion in the way in which each of these options may be applied, to adapt the standards to different conditions of national markets. These features, however, will necessitate substantial efforts by national authorities to ensure sufficient consistency in application. The Committee intends to monitor and review the application of the Framework in the period ahead with a view to achieving even greater consistency. In particular, its Accord Implementation Group (AIG) was established to promote consistency in the Framework's application by encouraging supervisors to exchange information on implementation approaches.

[2] *International Convergence of Capital Measurement and Capital Standards*, Basel Committee on Banking Supervision (July 1988), as amended.

8. The Committee has also recognised that home country supervisors have an important role in leading the enhanced cooperation between home and host country supervisors that will be required for effective implementation. The AIG is developing practical arrangements for cooperation and coordination that reduce implementation burden on banks and conserve supervisory resources. Based on the work of the AIG, and based on its interactions with supervisors and the industry, the Committee has issued general principles for the cross-border implementation of the revised Framework and more focused principles for the recognition of operational risk capital charges under advanced measurement approaches for home and host supervisors.

9. It should be stressed that the revised Framework is designed to establish *minimum* levels of capital for internationally active banks. As under the 1988 Accord, national authorities will be free to adopt arrangements that set higher levels of minimum capital. Moreover, they are free to put in place supplementary measures of capital adequacy for the banking organisations they charter. National authorities may use a supplementary capital measure as a way to address, for example, the potential uncertainties in the accuracy of the measure of risk exposures inherent in any capital rule or to constrain the extent to which an organisation may fund itself with debt. Where a jurisdiction employs a supplementary capital measure (such as a leverage ratio or a large exposure limit) in conjunction with the measure set forth in this Framework, in some instances the capital required under the supplementary measure may be more binding. More generally, under the second pillar, supervisors should expect banks to operate above minimum regulatory capital levels.

10. The revised Framework is more risk sensitive than the 1988 Accord, but countries where risks in the local banking market are relatively high nonetheless need to consider if banks should be required to hold additional capital over and above the Basel minimum. This is particularly the case with the more broad brush standardised approach, but, even in the case of the internal ratings-based (IRB) approach, the risk of major loss events may be higher than allowed for in this Framework.

11. The Committee also wishes to highlight the need for banks and supervisors to give appropriate attention to the second (supervisory review) and third (market discipline) pillars of the revised Framework. It is critical that the minimum capital requirements of the first pillar be accompanied by a robust implementation of the second, including efforts by banks to assess their capital adequacy and by supervisors to review such assessments. In addition, the disclosures provided under the third pillar of this Framework will be essential in ensuring that market discipline is an effective complement to the other two pillars.

12. The Committee is aware that interactions between regulatory and accounting approaches at both the national and international level can have significant consequences for the comparability of the resulting measures of capital adequacy and for the costs associated with the implementation of these approaches. The Committee believes that its decisions with respect to unexpected and expected losses represent a major step forward in this regard. The Committee and its members intend to continue playing a pro-active role in the dialogue with accounting authorities in an effort to reduce, wherever possible, inappropriate disparities between regulatory and accounting standards.

13. The revised Framework presented here reflects several significant changes relative to the Committee's most recent consultative proposal in April 2003. A number of these changes have already been described in the Committee's press statements of October 2003, January 2004 and May 2004. These include the changes in the approach to the treatment of expected losses (EL) and unexpected losses (UL) and to the treatment of securitisation exposures. In addition to these, changes in the treatments of credit risk mitigation and qualifying revolving retail exposures, among others, are also being incorporated. The Committee also has sought to clarify its expectations regarding the need for banks using the

advanced IRB approach to incorporate the effects arising from economic downturns into their loss-given-default (LGD) parameters.

14. The Committee believes it is important to reiterate its objectives regarding the overall level of minimum capital requirements. These are to broadly maintain the aggregate level of such requirements, while also providing incentives to adopt the more advanced risk-sensitive approaches of the revised Framework. To attain the objective, the Committee applies a scaling factor to the risk-weighted asset amounts for credit risk under the IRB approach. The current best estimate of the scaling factor using quantitative impact study data is 1.06. National authorities will continue to monitor capital requirements during the implementation period of the revised Framework. Moreover, the Committee will monitor national experiences with the revised Framework.

15. The Committee has designed the revised Framework to be a more forward-looking approach to capital adequacy supervision, one that has the capacity to evolve with time. This evolution is necessary to ensure that the Framework keeps pace with market developments and advances in risk management practices, and the Committee intends to monitor these developments and to make revisions when necessary. In this regard, the Committee has benefited greatly from its frequent interactions with industry participants and looks forward to enhanced opportunities for dialogue. The Committee also intends to keep the industry apprised of its future work agenda.

16. In July 2005, the Committee published additional guidance in the document *The Application of Basel II to Trading Activities and the Treatment of Double Default Effects*. That guidance was developed jointly with the International Organization of Securities Commissions (IOSCO) and demonstrates the capacity of the revised Framework to evolve with time. It refined the treatments of counterparty credit risk, double default effects, short-term maturity adjustment and failed transactions, and improved the trading book regime.[3]

17. One area where the Committee intends to undertake additional work of a longer-term nature is in relation to the definition of eligible capital. One motivation for this is the fact that the changes in the treatment of expected and unexpected losses and related changes in the treatment of provisions in the Framework set out here generally tend to reduce Tier 1 capital requirements relative to total capital requirements. Moreover, converging on a uniform international capital standard under this Framework will ultimately require the identification of an agreed set of capital instruments that are available to absorb unanticipated losses on a going-concern basis. The Committee announced its intention to review the definition of capital as a follow-up to the revised approach to Tier 1 eligibility as announced in its October 1998 press release, "Instruments eligible for inclusion in Tier 1 capital". It will explore further issues surrounding the definition of regulatory capital, but does not intend to propose changes as a result of this longer-term review prior to the implementation of the revised Framework set out in this document. In the meantime, the Committee will continue its efforts to ensure the consistent application of its 1998 decisions regarding the composition of regulatory capital across jurisdictions.

18. The Committee also seeks to continue to engage the banking industry in a discussion of prevailing risk management practices, including those practices aiming to

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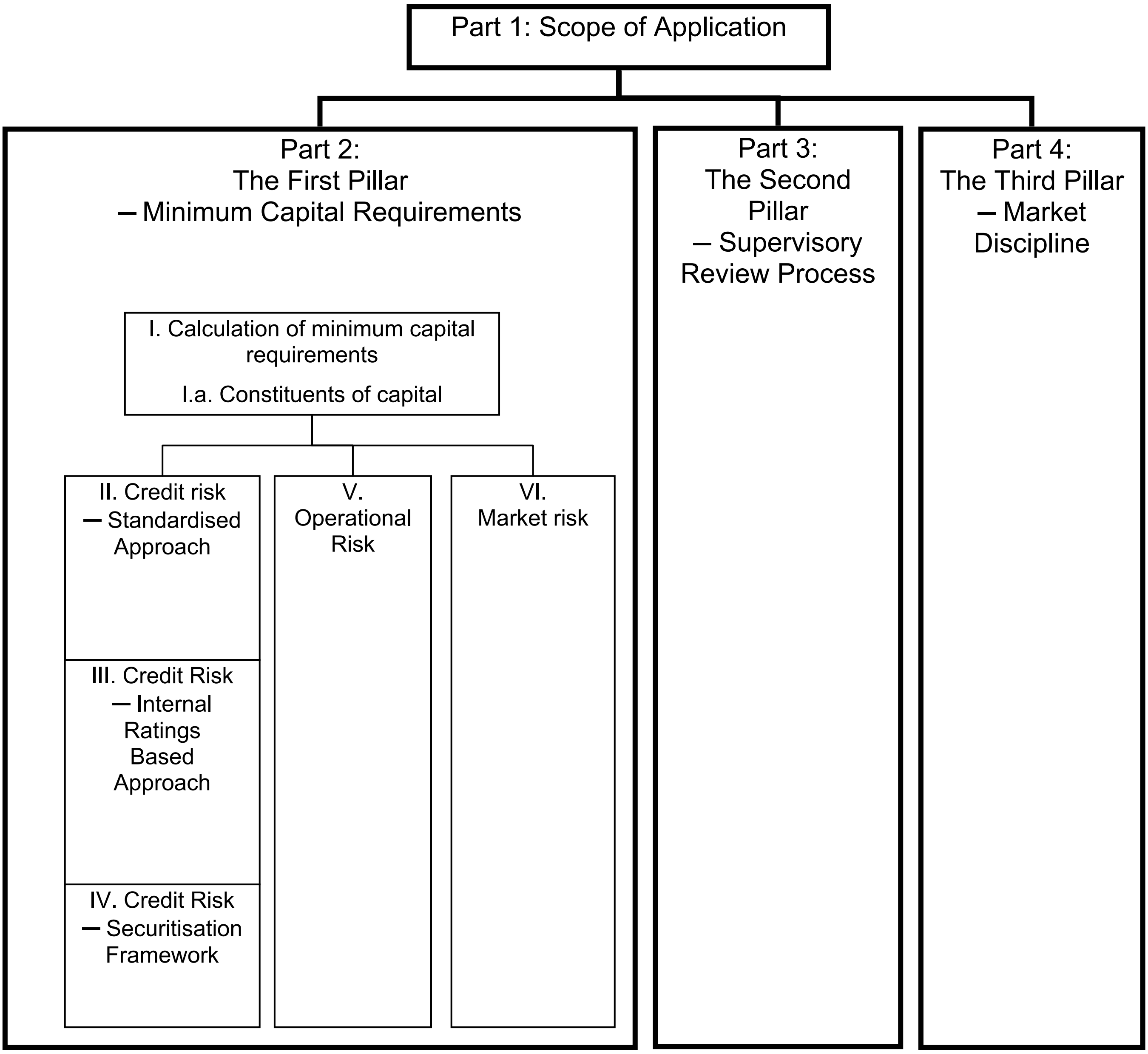
[3] The additional guidance does not modify the definition of trading book set forth in the revised Framework. Rather, it focuses on policies and procedures that banks must have in place to book exposures in their trading book. However, it is the Committee's view that, at the present time, open equity stakes in hedge funds, private equity investments and real estate holdings do not meet the definition of trading book, owing to significant constraints on the ability of banks to liquidate these positions and value them reliably on a daily basis.

produce quantified measures of risk and economic capital. Over the last decade, a number of banking organisations have invested resources in modelling the credit risk arising from their significant business operations. Such models are intended to assist banks in quantifying, aggregating and managing credit risk across geographic and product lines. While the Framework presented in this document stops short of allowing the results of such credit risk models to be used for regulatory capital purposes, the Committee recognises the importance of continued active dialogue regarding both the performance of such models and their comparability across banks. Moreover, the Committee believes that a successful implementation of the revised Framework will provide banks and supervisors with critical experience necessary to address such challenges. The Committee understands that the IRB approach represents a point on the continuum between purely regulatory measures of credit risk and an approach that builds more fully on internal credit risk models. In principle, further movements along that continuum are foreseeable, subject to an ability to address adequately concerns about reliability, comparability, validation, and competitive equity. In the meantime, the Committee believes that additional attention to the results of internal credit risk models in the supervisory review process and in banks' disclosures will be highly beneficial for the accumulation of information on the relevant issues.

19. This document is divided into four parts as illustrated in the following chart. The first part, scope of application, details how the capital requirements are to be applied within a banking group. Calculation of the minimum capital requirements for credit risk, operational risk, and market risk are provided in part two. The third and fourth parts outline expectations concerning supervisory review and market discipline, respectively.

19(i). This comprehensive version of the revised Framework incorporates the additional guidance set forth in the Committee's paper *The Application of Basel II to Trading Activities and the Treatment of Double Default Effects* (July 2005), the *Amendment to the Capital Accord to Incorporate Market Risks* (January 1996) as well as elements of the 1988 Accord that remain in effect. This version is primarily aimed at providing banks with a comprehensive view of international solvency standards. It does not contain any new elements. Each of the individual documents incorporated into this text (i.e. the 1988 Accord, the Amendment to the Capital Accord to Incorporate Market Risks, and *The Application of Basel II to Trading Activities and the Treatment of Double Default Effects)* will remain available on a stand-alone basis.

Structure of this document



Part 1: Scope of Application

I. Introduction

20. This Framework will be applied on a consolidated basis to internationally active banks. This is the best means to preserve the integrity of capital in banks with subsidiaries by eliminating double gearing.

21. The scope of application of the Framework will include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group.[4] Banking groups are groups that engage predominantly in banking activities and, in some countries, a banking group may be registered as a bank.

22. The Framework will also apply to all internationally active banks at every tier within a banking group, also on a fully consolidated basis (see illustrative chart at the end of this section).[5] A three-year transitional period for applying full sub-consolidation will be provided for those countries where this is not currently a requirement.

23. Further, as one of the principal objectives of supervision is the protection of depositors, it is essential to ensure that capital recognised in capital adequacy measures is readily available for those depositors. Accordingly, supervisors should test that individual banks are adequately capitalised on a stand-alone basis.

II. Banking, securities and other financial subsidiaries

24. To the greatest extent possible, all banking and other relevant financial activities[6] (both regulated and unregulated) conducted within a group containing an internationally active bank will be captured through consolidation. Thus, majority-owned or -controlled banking entities, securities entities (where subject to broadly similar regulation or where securities activities are deemed banking activities) and other financial entities[7] should generally be fully consolidated.

25. Supervisors will assess the appropriateness of recognising in consolidated capital the minority interests that arise from the consolidation of less than wholly owned banking,

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4 A holding company that is a parent of a banking group may itself have a parent holding company. In some structures, this parent holding company may not be subject to this Framework because it is not considered a parent of a banking group.

5 As an alternative to full sub-consolidation, the application of this Framework to the stand-alone bank (i.e. on a basis that does not consolidate assets and liabilities of subsidiaries) would achieve the same objective, providing the full book value of any investments in subsidiaries and significant minority-owned stakes is deducted from the bank's capital.

6 "Financial activities" do not include insurance activities and "financial entities" do not include insurance entities.

7 Examples of the types of activities that financial entities might be involved in include financial leasing, issuing credit cards, portfolio management, investment advisory, custodial and safekeeping services and other similar activities that are ancillary to the business of banking.

securities or other financial entities. Supervisors will adjust the amount of such minority interests that may be included in capital in the event the capital from such minority interests is not readily available to other group entities.

26. There may be instances where it is not feasible or desirable to consolidate certain securities or other regulated financial entities. This would be only in cases where such holdings are acquired through debt previously contracted and held on a temporary basis, are subject to different regulation, or where non-consolidation for regulatory capital purposes is otherwise required by law. In such cases, it is imperative for the bank supervisor to obtain sufficient information from supervisors responsible for such entities.

27. If any majority-owned securities and other financial subsidiaries are not consolidated for capital purposes, all equity and other regulatory capital investments in those entities attributable to the group will be deducted, and the assets and liabilities, as well as third-party capital investments in the subsidiary will be removed from the bank's balance sheet. Supervisors will ensure that the entity that is not consolidated and for which the capital investment is deducted meets regulatory capital requirements. Supervisors will monitor actions taken by the subsidiary to correct any capital shortfall and, if it is not corrected in a timely manner, the shortfall will also be deducted from the parent bank's capital.

III. Significant minority investments in banking, securities and other financial entities

28. Significant minority investments in banking, securities and other financial entities, where control does not exist, will be excluded from the banking group's capital by deduction of the equity and other regulatory investments. Alternatively, such investments might be, under certain conditions, consolidated on a pro rata basis. For example, pro rata consolidation may be appropriate for joint ventures or where the supervisor is satisfied that the parent is legally or de facto expected to support the entity on a proportionate basis only and the other significant shareholders have the means and the willingness to proportionately support it. The threshold above which minority investments will be deemed significant and be thus either deducted or consolidated on a pro-rata basis is to be determined by national accounting and/or regulatory practices. As an example, the threshold for pro-rata inclusion in the European Union is defined as equity interests of between 20% and 50%.

29. The Committee reaffirms the view set out in the 1988 Accord that reciprocal cross-holdings of bank capital artificially designed to inflate the capital position of banks will be deducted for capital adequacy purposes.

IV. Insurance entities

30. A bank that owns an insurance subsidiary bears the full entrepreneurial risks of the subsidiary and should recognise on a group-wide basis the risks included in the whole group. When measuring regulatory capital for banks, the Committee believes that at this stage it is, in principle, appropriate to deduct banks' equity and other regulatory capital investments in insurance subsidiaries and also significant minority investments in insurance entities. Under this approach the bank would remove from its balance sheet assets and liabilities, as well as third party capital investments in an insurance subsidiary. Alternative approaches that can be

applied should, in any case, include a group-wide perspective for determining capital adequacy and avoid double counting of capital.

31. Due to issues of competitive equality, some G10 countries will retain their existing risk weighting treatment[8] as an exception to the approaches described above and introduce risk aggregation only on a consistent basis to that applied domestically by insurance supervisors for insurance firms with banking subsidiaries.[9] The Committee invites insurance supervisors to develop further and adopt approaches that comply with the above standards.

32. Banks should disclose the national regulatory approach used with respect to insurance entities in determining their reported capital positions.

33. The capital invested in a majority-owned or controlled insurance entity may exceed the amount of regulatory capital required for such an entity (surplus capital). Supervisors may permit the recognition of such surplus capital in calculating a bank's capital adequacy, under limited circumstances.[10] National regulatory practices will determine the parameters and criteria, such as legal transferability, for assessing the amount and availability of surplus capital that could be recognised in bank capital. Other examples of availability criteria include: restrictions on transferability due to regulatory constraints, to tax implications and to adverse impacts on external credit assessment institutions' ratings. Banks recognising surplus capital in insurance subsidiaries will publicly disclose the amount of such surplus capital recognised in their capital. Where a bank does not have a full ownership interest in an insurance entity (e.g. 50% or more but less than 100% interest), surplus capital recognised should be proportionate to the percentage interest held. Surplus capital in significant minority-owned insurance entities will not be recognised, as the bank would not be in a position to direct the transfer of the capital in an entity which it does not control.

34. Supervisors will ensure that majority-owned or controlled insurance subsidiaries, which are not consolidated and for which capital investments are deducted or subject to an alternative group-wide approach, are themselves adequately capitalised to reduce the possibility of future potential losses to the bank. Supervisors will monitor actions taken by the subsidiary to correct any capital shortfall and, if it is not corrected in a timely manner, the shortfall will also be deducted from the parent bank's capital.

V. Significant investments in commercial entities

35. Significant minority and majority investments in commercial entities which exceed certain materiality levels will be deducted from banks' capital. Materiality levels will be

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8 For banks using the standardised approach this would mean applying no less than a 100% risk weight, while for banks on the IRB approach, the appropriate risk weight based on the IRB rules shall apply to such investments.

9 Where the existing treatment is retained, third party capital invested in the insurance subsidiary (i.e. minority interests) cannot be included in the bank's capital adequacy measurement.

10 In a deduction approach, the amount deducted for all equity and other regulatory capital investments will be adjusted to reflect the amount of capital in those entities that is in surplus to regulatory requirements, i.e. the amount deducted would be the lesser of the investment or the regulatory capital requirement. The amount representing the surplus capital, i.e. the difference between the amount of the investment in those entities and their regulatory capital requirement, would be risk-weighted as an equity investment. If using an alternative group-wide approach, an equivalent treatment of surplus capital will be made.

determined by national accounting and/or regulatory practices. Materiality levels of 15% of the bank's capital for individual significant investments in commercial entities and 60% of the bank's capital for the aggregate of such investments, or stricter levels, will be applied. The amount to be deducted will be that portion of the investment that exceeds the materiality level.

36. Investments in significant minority- and majority-owned and -controlled commercial entities below the materiality levels noted above will be risk-weighted at no lower than 100% for banks using the standardised approach. For banks using the IRB approach, the investment would be risk weighted in accordance with the methodology the Committee is developing for equities and would not be less than 100%.

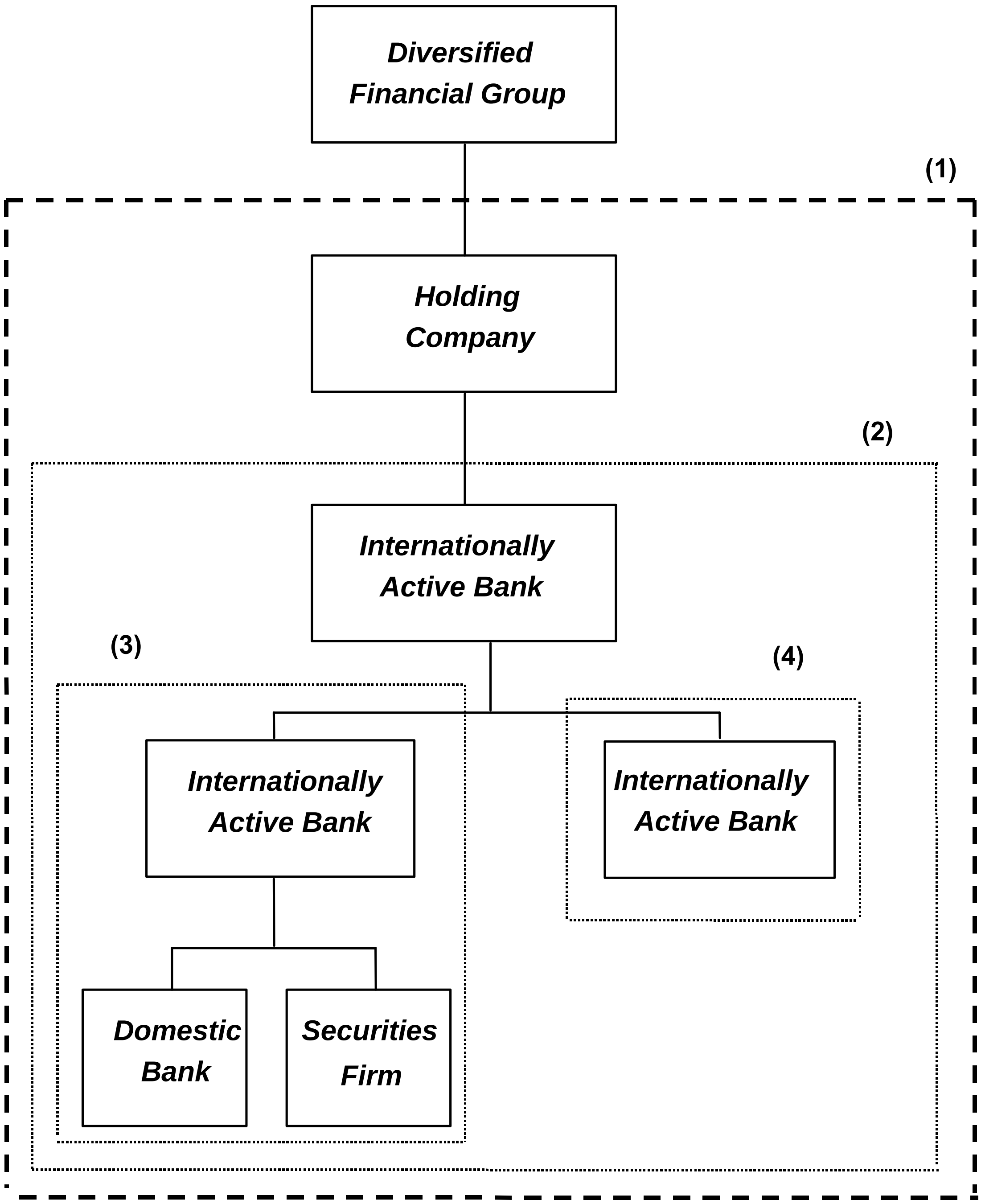
VI. Deduction of investments pursuant to this part

37. Where deductions of investments are made pursuant to this part on scope of application, the deductions will be 50% from Tier 1 and 50% from Tier 2 capital.

38. Goodwill relating to entities subject to a deduction approach pursuant to this part should be deducted from Tier 1 in the same manner as goodwill relating to consolidated subsidiaries, and the remainder of the investments should be deducted as provided for in this part. A similar treatment of goodwill should be applied, if using an alternative group-wide approach pursuant to paragraph 30.

39. The limits on Tier 2 and Tier 3 capital and on innovative Tier 1 instruments will be based on the amount of Tier 1 capital after deduction of goodwill but before the deductions of investments pursuant to this part on scope of application (see Annex 1 for an example how to calculate the 15% limit for innovative Tier 1 instruments).

ILLUSTRATION OF NEW SCOPE OF APPLICATION OF THIS FRAMEWORK



(1) Boundary of predominant banking group. The Framework is to be applied at this level on a consolidated basis, i.e. up to holding company level (paragraph 21).

(2), (3) and **(4)**: the Framework is also to be applied at lower levels to all internationally active banks on a consolidated basis.

Part 2: The First Pillar – Minimum Capital Requirements

I. Calculation of minimum capital requirements

40. Part 2 presents the calculation of the total minimum capital requirements for credit, market and operational risk. The capital ratio is calculated using the definition of regulatory capital and risk-weighted assets. The total capital ratio must be no lower than 8%. Tier 2 capital is limited to 100% of Tier 1 capital.

A. Regulatory capital

41. The definition of eligible regulatory capital, as outlined in the 1988 Accord and clarified in the 27 October 1998 press release on "Instruments eligible for inclusion in Tier 1 capital", remains in place except for the modifications in paragraphs 37 to 39 and 43. The definition is outlined in paragraphs 49 (i) to 49 (xviii) and in Annex Ia.

42. Under the standardised approach to credit risk, general provisions, as explained in paragraphs 381 to 383, can be included in Tier 2 capital subject to the limit of 1.25% of risk-weighted assets.

43. Under the internal ratings-based (IRB) approach, the treatment of the 1988 Accord to include general provisions (or general loan-loss reserves) in Tier 2 capital is withdrawn. Banks using the IRB approach for securitisation exposures or the PD/LGD approach for equity exposures must first deduct the EL amounts subject to the corresponding conditions in paragraphs 563 and 386, respectively. Banks using the IRB approach for other asset classes must compare (i) the amount of total eligible provisions, as defined in paragraph 380, with (ii) the total expected losses amount as calculated within the IRB approach and defined in paragraph 375. Where the total expected loss amount exceeds total eligible provisions, banks must deduct the difference. Deduction must be on the basis of 50% from Tier 1 and 50% from Tier 2. Where the total expected loss amount is less than total eligible provisions, as explained in paragraphs 380 to 383, banks may recognise the difference in Tier 2 capital up to a maximum of 0.6% of credit risk-weighted assets. At national discretion, a limit lower than 0.6% may be applied.

B. Risk-weighted assets

44. Total risk-weighted assets are determined by multiplying the capital requirements for market risk and operational risk by 12.5 (i.e. the reciprocal of the minimum capital ratio of 8%) and adding the resulting figures to the sum of risk-weighted assets for credit risk. The Committee applies a scaling factor in order to broadly maintain the aggregate level of minimum capital requirements, while also providing incentives to adopt the more advanced risk-sensitive approaches of the Framework.[11] The scaling factor is applied to the risk-weighted asset amounts for credit risk assessed under the IRB approach.

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[11] The current best estimate of the scaling factor is 1.06. National authorities will continue to monitor capital requirements during the implementation period of this Framework. Moreover, the Committee will monitor national experiences with this Framework.

C. Transitional arrangements

45. For banks using the IRB approach for credit risk or the Advanced Measurement Approaches (AMA) for operational risk, there will be a capital floor following implementation of this Framework. Banks must calculate the difference between (i) the floor as defined in paragraph 46 and (ii) the amount as calculated according to paragraph 47. If the floor amount is larger, banks are required to add 12.5 times the difference to risk-weighted assets.

46. The capital floor is based on application of the 1988 Accord. It is derived by applying an adjustment factor to the following amount: (i) 8% of the risk-weighted assets, (ii) plus Tier 1 and Tier 2 deductions, and (iii) less the amount of general provisions that may be recognised in Tier 2. The adjustment factor for banks using the foundation IRB approach for the year beginning year-end 2006 is 95%. The adjustment factor for banks using (i) either the foundation and/or advanced IRB approaches, and/or (ii) the AMA for the year beginning year-end 2007 is 90%, and for the year beginning year-end 2008 is 80%. The following table illustrates the application of the adjustment factors. Additional transitional arrangements including parallel calculation are set out in paragraphs 263 to 269.

	From year-end 2005	**From year-end 2006**	**From year-end 2007**	**From year-end 2008**
Foundation IRB approach[12]	Parallel calculation	95%	90%	80%
Advanced approaches for credit and/or operational risk	Parallel calculation or impact studies	Parallel calculation	90%	80%

47. In the years in which the floor applies, banks must also calculate (i) 8% of total risk-weighted assets as calculated under this Framework, (ii) less the difference between total provisions and expected loss amount as described in Section III.G (see paragraphs 374 to 386), and (iii) plus other Tier 1 and Tier 2 deductions. Where a bank uses the standardised approach to credit risk for any portion of its exposures, it also needs to exclude general provisions that may be recognised in Tier 2 for that portion from the amount calculated according to the first sentence of this paragraph.

48. Should problems emerge during this period, the Committee will seek to take appropriate measures to address them, and, in particular, will be prepared to keep the floors in place beyond 2009 if necessary.

49. The Committee believes it is appropriate for supervisors to apply prudential floors to banks that adopt the IRB approach for credit risk and/or the AMA for operational risk following year-end 2008. For banks that do not complete the transition to these approaches in the years specified in paragraph 46, the Committee believes it is appropriate for supervisors to continue to apply prudential floors — similar to those of paragraph 46 — to provide time to ensure that individual bank implementations of the advanced approaches are sound. However, the Committee recognises that floors based on the 1988 Accord will become increasingly impractical to implement over time and therefore believes that supervisors should have the flexibility to develop appropriate bank-by-bank floors that are

[12] The foundation IRB approach includes the IRB approach to retail.

consistent with the principles outlined in this paragraph, subject to full disclosure of the nature of the floors adopted. Such floors may be based on the approach the bank was using before adoption of the IRB approach and/or AMA.

Ia. The constituents of capital

A. Core capital (basic equity or Tier 1)

49(i). The Committee considers that the key element of capital on which the main emphasis should be placed is equity capital[13] and disclosed reserves. This key element of capital is the only element common to all countries' banking systems; it is wholly visible in the published accounts and is the basis on which most market judgements of capital adequacy are made; and it has a crucial bearing on profit margins and a bank's ability to compete. This emphasis on equity capital and disclosed reserves reflects the importance the Committee attaches to securing an appropriate quality, and the level, of the total capital resources maintained by major banks.

49(ii). Notwithstanding this emphasis, the member countries of the Committee also consider that there are a number of other important and legitimate constituents of a bank's capital base which may be included within the system of measurement (subject to certain conditions set out in paragraphs 49(iv) to 49(xii) below).

49(iii). The Committee has therefore concluded that capital, for supervisory purposes, should be defined in two tiers in a way which will have the effect of requiring at least 50% of a bank's capital base to consist of a core element comprised of equity capital and published reserves from post-tax retained earnings (Tier 1). The other elements of capital (supplementary capital) will be admitted into Tier 2 limited to 100% of Tier 1. These supplementary capital elements and the particular conditions attaching to their inclusion in the capital base are set out in paragraphs 49(iv) to 49(xii) below and in more detail in Annex 1a. Each of these elements may be included or not included by national authorities at their discretion in the light of their national accounting and supervisory regulations.

B. Supplementary capital (Tier 2)

1. Undisclosed reserves

49(iv). Unpublished or hidden reserves may be constituted in various ways according to differing legal and accounting regimes in member countries. Under this heading are included only reserves which, though unpublished, have been passed through the profit and loss account and which are accepted by the bank's supervisory authorities. They may be inherently of the same intrinsic quality as published retained earnings, but, in the context of an internationally agreed minimum standard, their lack of transparency, together with the fact that many countries do not recognise undisclosed reserves, either as an accepted accounting concept or as a legitimate element of capital, argue for excluding them from the core equity capital element.

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[13] Issued and fully paid ordinary shares/common stock and non-cumulative perpetual preferred stock (but excluding cumulative preferred stock).

2. Revaluation reserves

49(v). Some countries, under their national regulatory or accounting arrangements, allow certain assets to be revalued to reflect their current value, or something closer to their current value than historic cost, and the resultant revaluation reserves to be included in the capital base. Such revaluations can arise in two ways:

(a) from a formal revaluation, carried through to the balance sheets of banks' own premises; or

(b) from a notional addition to capital of hidden values which arise from the practice of holding securities in the balance sheet valued at historic costs.

Such reserves may be included within supplementary capital provided that the assets are considered by the supervisory authority to be prudently valued, fully reflecting the possibility of price fluctuations and forced sale.

49(vi). Alternative (b) in paragraph 49(v) above is relevant to those banks whose balance sheets traditionally include very substantial amounts of equities held in their portfolio at historic cost but which can be, and on occasions are, realised at current prices and used to offset losses. The Committee considers these "latent" revaluation reserves can be included among supplementary elements of capital since they can be used to absorb losses on a going-concern basis, provided they are subject to a substantial discount in order to reflect concerns both about market volatility and about the tax charge which would arise were such cases to be realised. A discount of 55% on the difference between the historic cost book value and market value is agreed to be appropriate in the light of these considerations. The Committee considered, but rejected, the proposition that latent reserves arising in respect of the undervaluation of banks' premises should also be included within the definition of supplementary capital.

3. General provisions/general loan-loss reserves

49(vii). General provisions or general loan-loss reserves are created against the possibility of losses not yet identified. Where they do not reflect a known deterioration in the valuation of particular assets, these reserves qualify for inclusion in Tier 2 capital. Where, however, provisions or reserves have been created against identified losses or in respect of an identified deterioration in the value of any asset or group of subsets of assets, they are not freely available to meet unidentified losses which may subsequently arise elsewhere in the portfolio and do not possess an essential characteristic of capital. Such provisions or reserves should therefore not be included in the capital base.

49(viii). The supervisory authorities represented on the Committee undertake to ensure that the supervisory process takes due account of any identified deterioration in value. They will also ensure that general provisions or general loan-loss reserves will only be included in capital if they are not intended to deal with the deterioration of particular assets, whether individual or grouped.

49(ix). This would mean that all elements in general provisions or general loan-loss reserves designed to protect a bank from identified deterioration in the quality of specific assets (whether foreign or domestic) should be ineligible for inclusion in capital. In particular, elements that reflect identified deterioration in assets subject to country risk, in real estate lending and in other problem sectors would be excluded from capital.

49(x). General provisions/general loan-loss reserves that qualify for inclusion in Tier 2 under the terms described above do so subject to a limit of

(a) 1.25 percentage points of weighted risk assets to the extent a bank uses the Standardised Approach for credit risk; and

(b) 0.6 percentage points of credit risk-weighted assets in accordance with paragraph 43 to the extent a bank uses the IRB Approach for credit risk.

4. Hybrid debt capital instruments

49(xi). In this category fall a number of capital instruments which combine certain characteristics of equity and certain characteristics of debt. Each of these has particular features which can be considered to affect its quality as capital. It has been agreed that, where these instruments have close similarities to equity, in particular when they are able to support losses on an on-going basis without triggering liquidation, they may be included in supplementary capital. In addition to perpetual preference shares carrying a cumulative fixed charge, the following instruments, for example, may qualify for inclusion: long-term preferred shares in Canada, titres participatifs and titres subordonnés à durée indéterminée in France, Genussscheine in Germany, perpetual debt instruments in the United Kingdom and mandatory convertible debt instruments in the United States. The qualifying criteria for such instruments are set out in Annex 1a.

5. Subordinated term debt

49(xii). The Committee is agreed that subordinated term debt instruments have significant deficiencies as constituents of capital in view of their fixed maturity and inability to absorb losses except in a liquidation. These deficiencies justify an additional restriction on the amount of such debt capital which is eligible for inclusion within the capital base. Consequently, it has been concluded that subordinated term debt instruments with a minimum original term to maturity of over five years may be included within the supplementary elements of capital, but only to a maximum of 50% of the core capital element and subject to adequate amortisation arrangements.

C. Short-term subordinated debt covering market risk (Tier 3)

49(xiii). The principal form of eligible capital to cover market risks consists of shareholders' equity and retained earnings (Tier 1 capital) and supplementary capital (Tier 2 capital) as defined in paragraphs 49(i) to 49(xii). But banks may also, at the discretion of their national authority, employ a third tier of capital ("Tier 3"), consisting of short-term subordinated debt as defined in paragraph 49(xiv) below for the *sole* purpose of meeting a proportion of the capital requirements for market risks, subject to the following conditions:

- Banks will be entitled to use Tier 3 capital solely to support market risks as defined in paragraphs 709 to 718(Lxix). This means that any capital requirement arising in respect of credit and counterparty risk in the terms of this Framework, including the credit counterparty risk in respect of OTCs and SFTs in both trading and banking books, needs to be met by the existing definition of capital base set out in paragraphs 49(i) to 49(xii) above (i.e. Tiers 1 and 2);

- Tier 3 capital will be limited to 250% of a bank's Tier 1 capital that is required to support market risks. This means that a minimum of about 28½% of market risks needs to be supported by Tier 1 capital that is not required to support risks in the remainder of the book;

- Tier 2 elements may be substituted for Tier 3 up to the same limit of 250% in so far as the overall limits set out in paragraph 49(iii) above are not breached, that is to say eligible Tier 2 capital may not exceed total Tier 1 capital, and long-term subordinated debt may not exceed 50% of Tier 1 capital;

- In addition, since the Committee believes that Tier 3 capital is only appropriate to meet market risk, a significant number of member countries are in favour of retaining the principle in the present Framework that Tier 1 capital should represent at least half of total eligible capital, i.e. that the sum total of Tier 2 plus Tier 3 capital should not exceed total Tier 1. However, the Committee has decided that any decision whether or not to apply such a rule should be a matter for national discretion. Some member countries may keep the constraint, except in cases where banking activities are proportionately very small. Additionally, national authorities will have discretion to refuse the use of short-term subordinated debt for individual banks or for their banking systems generally.

49(xiv). For short-term subordinated debt to be eligible as Tier 3 capital, it needs, if circumstances demand, to be capable of becoming part of a bank's permanent capital and thus be available to absorb losses in the event of insolvency. It must, therefore, at a minimum:

- be unsecured, subordinated and fully paid up;

- have an original maturity of at least two years;

- not be repayable before the agreed repayment date unless the supervisory authority agrees;

- be subject to a lock-in clause which stipulates that neither interest nor principal may be paid (even at maturity) if such payment means that the bank falls below or remains below its minimum capital requirement.

D. Deductions from capital

49(xv). It has been concluded that the following deductions should be made from the capital base for the purpose of calculating the risk-weighted capital ratio. The deductions will consist of:

(i) Goodwill, as a deduction from Tier 1 capital elements;

(ii) Increase in equity capital resulting from a securitisation exposure, as a deduction from Tier 1 capital elements, pursuant to paragraph 562 below;

(iii) Investments in subsidiaries engaged in banking and financial activities which are not consolidated in national systems. The normal practice will be to consolidate subsidiaries for the purpose of assessing the capital adequacy of banking groups. Where this is not done, deduction is essential to prevent the multiple use of the same capital resources in different parts of the group. The deduction for such investments will be made in accordance with paragraph 37 above. The assets representing the investments in subsidiary companies whose capital had been deducted from that of the parent would not be included in total assets for the purposes of computing the ratio.

49(xvi). The Committee carefully considered the possibility of requiring deduction of banks' holdings of capital issued by other banks or deposit-taking institutions, whether in the form of equity or of other capital instruments. Several G-10 supervisory authorities currently require such a deduction to be made in order to discourage the banking system as a whole from creating cross-holdings of capital, rather than drawing capital from outside investors. The Committee is very conscious that such double-gearing (or "double-leveraging") can have systemic dangers for the banking system by making it more vulnerable to the rapid transmission of problems from one institution to another and some members consider these dangers justify a policy of full deduction of such holdings.

49(xvii). Despite these concerns, however, the Committee as a whole is not presently in favour of a general policy of deducting all holdings of other banks' capital, on the grounds that to do so could impede certain significant and desirable changes taking place in the structure of domestic banking systems.

49(xviii). The Committee has nonetheless agreed that:

(a) Individual supervisory authorities should be free at their discretion to apply a policy of deduction, either for all holdings of other banks' capital, or for holdings which exceed material limits in relation to the holding bank's capital or the issuing bank's capital, or on a case-by-case basis;

(b) Where no deduction is applied, banks' holdings of other banks' capital instruments will bear a weight of 100%;

(c) The Committee considers that reciprocal cross-holdings of bank capital artificially designed to inflate the capital position of the banks will be deducted for capital adequacy purposes;

(d) The Committee will closely monitor the degree of double-gearing in the international banking system and does not preclude the possibility of introducing constraints at a later date. For this purpose, supervisory authorities intend to ensure that adequate statistics are made available to enable them and the Committee to monitor the development of banks' holdings of other banks' equity and debt instruments which rank as capital under the present agreement.

II. Credit Risk – The Standardised Approach

50. The Committee permits banks a choice between two broad methodologies for calculating their capital requirements for credit risk. One alternative, the Standardised Approach, will be to measure credit risk in a standardised manner, supported by external credit assessments.[14]

51. The other alternative, the Internal Ratings-based Approach, which is subject to the explicit approval of the bank's supervisor, would allow banks to use their internal rating systems for credit risk.

52. The following section sets out revisions to the 1988 Accord for risk weighting banking book exposures. Exposures that are not explicitly addressed in this section will retain the current treatment; however, exposures related to securitisation are dealt with in Section IV. Furthermore, the credit equivalent amount of Securities Financing Transactions (SFT)[15] and OTC derivatives that expose a bank to counterparty credit risk[16] is to be calculated under the rules set forth in Annex 4[17]. In determining the risk weights in the standardised approach, banks may use assessments by external credit assessment institutions recognised as eligible for capital purposes by national supervisors in accordance with the criteria defined in paragraphs 90 and 91. Exposures should be risk-weighted net of specific provisions.[18]

A. Individual claims

1. Claims on sovereigns

53. Claims on sovereigns and their central banks will be risk weighted as follows:

Credit Assessment	**AAA to AA-**	**A+ to A-**	**BBB+ to BBB-**	**BB+ to B-**	**Below B-**	**Unrated**
Risk Weight	0%	20%	50%	100%	150%	100%

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[14] The notations follow the methodology used by one institution, Standard & Poor's. the use of Standard & Poor's credit ratings is an example only; those of some other external credit assessment institutions could equally well be used. The ratings used throughout this document, therefore, do not express any preferences or determinations on external assessment institutions by the Committee.

[15] Securities Financing Transactions (SFT) are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on the market valuations and the transactions are often subject to margin agreements.

[16] The counterparty credit risk is defined as the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. An economic loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value at the time of default. Unlike a firm's exposure to credit risk through a loan, where the exposure to credit risk is unilateral and only the lending bank faces the risk of loss, the counterparty credit risk creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.

[17] Annex 4 of this Framework is based on the treatment of counterparty credit risk set out in Part 1 of the Committee's paper *The Application of Basel II to Trading Activities and the Treatment of Double Default Effects* (July 2005).

[18] A simplified standardised approach is outlined in Annex 11.

54. At national discretion, a lower risk weight may be applied to banks' exposures to their sovereign (or central bank) of incorporation denominated in domestic currency and funded[19] in that currency.[20] Where this discretion is exercised, other national supervisory authorities may also permit their banks to apply the same risk weight to domestic currency exposures to this sovereign (or central bank) funded in that currency.

55. For the purpose of risk weighting claims on sovereigns, supervisors may recognise the country risk scores assigned by Export Credit Agencies (ECAs). To qualify, an ECA must publish its risk scores and subscribe to the OECD agreed methodology. Banks may choose to use the risk scores published by individual ECAs that are recognised by their supervisor, or the consensus risk scores of ECAs participating in the "Arrangement on Officially Supported Export Credits".[21] The OECD agreed methodology establishes eight risk score categories associated with minimum export insurance premiums. These ECA risk scores will correspond to risk weight categories as detailed below.

ECA risk scores	0-1	2	3	4 to 6	7
Risk weight	0%	20%	50%	100%	150%

56. Claims on the Bank for International Settlements, the International Monetary Fund, the European Central Bank and the European Community may receive a 0% risk weight.

2. Claims on non-central government public sector entities (PSEs)

57. Claims on domestic PSEs will be risk-weighted at national discretion, according to either option 1 or option 2 for claims on banks.[22] When option 2 is selected, it is to be applied without the use of the preferential treatment for short-term claims.

58. Subject to national discretion, claims on certain domestic PSEs may also be treated as claims on the sovereigns in whose jurisdictions the PSEs are established.[23] Where this

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[19] This is to say that the bank would also have corresponding liabilities denominated in the domestic currency.

[20] This lower risk weight may be extended to the risk weighting of collateral and guarantees. See Sections II.D.3 and II.D.5.

[21] The consensus country risk classification is available on the OECD's website (http://www.oecd.org) in the Export Credit Arrangement web-page of the Trade Directorate.

[22] This is regardless of the option chosen at national discretion for claims on banks of that country. It therefore does not imply that when one option has been chosen for claims on banks, the same option should also be applied to claims on PSEs.

[23] The following examples outline how PSEs might be categorised when focusing on one specific feature, namely revenue raising powers. However, there may be other ways of determining the different treatments applicable to different types of PSEs, for instance by focusing on the extent of guarantees provided by the central government:

- **Regional governments and local authorities** could qualify for the same treatment as claims on their sovereign or central government if these governments and local authorities have specific revenue raising powers and have specific institutional arrangements the effect of which is to reduce their risks of default.
- **Administrative bodies responsible to central governments, regional governments or to local authorities and other non-commercial undertakings** owned by the governments or local authorities may not warrant the same treatment as claims on their sovereign if the entities do not have revenue raising powers or other arrangements as described above. If strict lending rules apply to these entities and a declaration of bankruptcy is not possible because of their special public status, it may be appropriate to treat these claims in the same manner as claims on banks.

discretion is exercised, other national supervisors may allow their banks to risk weight claims on such PSEs in the same manner.

3. Claims on multilateral development banks (MDBs)

59. The risk weights applied to claims on MDBs will generally be based on external credit assessments as set out under option 2 for claims on banks but without the possibility of using the preferential treatment for short-term claims. A 0% risk weight will be applied to claims on highly rated MDBs that fulfil to the Committee's satisfaction the criteria provided below.[24] The Committee will continue to evaluate eligibility on a case-by-case basis. The eligibility criteria for MDBs risk weighted at 0% are:

- very high quality long-term issuer ratings, i.e. a majority of an MDB's external assessments must be AAA;
- shareholder structure is comprised of a significant proportion of sovereigns with long-term issuer credit assessments of AA- or better, or the majority of the MDB's fund-raising are in the form of paid-in equity/capital and there is little or no leverage;
- strong shareholder support demonstrated by the amount of paid-in capital contributed by the shareholders; the amount of further capital the MDBs have the right to call, if required, to repay their liabilities; and continued capital contributions and new pledges from sovereign shareholders;
- adequate level of capital and liquidity (a case-by-case approach is necessary in order to assess whether each MDB's capital and liquidity are adequate); and,
- strict statutory lending requirements and conservative financial policies, which would include among other conditions a structured approval process, internal creditworthiness and risk concentration limits (per country, sector, and individual exposure and credit category), large exposures approval by the board or a committee of the board, fixed repayment schedules, effective monitoring of use of proceeds, status review process, and rigorous assessment of risk and provisioning to loan loss reserve.

4. Claims on banks

60. There are two options for claims on banks. National supervisors will apply one option to all banks in their jurisdiction. No claim on an unrated bank may receive a risk weight lower than that applied to claims on its sovereign of incorporation.

61. Under the first option, all banks incorporated in a given country will be assigned a risk weight one category less favourable than that assigned to claims on the sovereign of that

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- **Commercial undertakings** owned by central governments, regional governments or by local authorities may be treated as normal commercial enterprises. However, if these entities function as a corporate in competitive markets even though the state, a regional authority or a local authority is the major shareholder of these entities, supervisors should decide to consider them as corporates and therefore attach to them the applicable risk weights.

[24] MDBs currently eligible for a 0% risk weight are: the World Bank Group comprised of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC), the Asian Development Bank (ADB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), the European Investment Bank (EIB), the European Investment Fund (EIF), the Nordic Investment Bank (NIB), the Caribbean Development Bank (CDB), the Islamic Development Bank (IDB), and the Council of Europe Development Bank (CEDB).

country. However, for claims on banks in countries with sovereigns rated BB+ to B- and on banks in unrated countries the risk weight will be capped at 100%.

62. The second option bases the risk weighting on the external credit assessment of the bank itself with claims on unrated banks being risk-weighted at 50%. Under this option, a preferential risk weight that is one category more favourable may be applied to claims with an original maturity[25] of three months or less, subject to a floor of 20%. This treatment will be available to both rated and unrated banks, but not to banks risk weighted at 150%.

63. The two options are summarised in the tables below.

Option 1

Credit assessment of Sovereign	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk weight under Option 1	20%	50%	100%	100%	150%	100%

Option 2

Credit assessment of Banks	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
Risk weight under Option 2	20%	50%	50%	100%	150%	50%
Risk weight for short-term claims[26] under Option 2	20%	20%	20%	50%	150%	20%

64. When the national supervisor has chosen to apply the preferential treatment for claims on the sovereign as described in paragraph 54, it can also assign, under both options 1 and 2, a risk weight that is one category less favourable than that assigned to claims on the sovereign, subject to a floor of 20%, to claims on banks of an original maturity of 3 months or less denominated and funded in the domestic currency.

5. Claims on securities firms

65. Claims on securities firms may be treated as claims on banks provided these firms are subject to supervisory and regulatory arrangements comparable to those under this

[25] Supervisors should ensure that claims with (contractual) original maturity under 3 months which are expected to be rolled over (i.e. where the effective maturity is longer than 3 months) do not qualify for this preferential treatment for capital adequacy purposes.

[26] Short-term claims in Option 2 are defined as having an original maturity of three months or less. These tables do not reflect the potential preferential risk weights for domestic currency claims that banks may be allowed to apply based on paragraph 64.

Framework (including, in particular, risk-based capital requirements).[27] Otherwise such claims would follow the rules for claims on corporates.

6. Claims on corporates

66. The table provided below illustrates the risk weighting of rated corporate claims, including claims on insurance companies. The standard risk weight for unrated claims on corporates will be 100%. No claim on an unrated corporate may be given a risk weight preferential to that assigned to its sovereign of incorporation.

Credit assessment	**AAA to AA-**	**A+ to A-**	**BBB+ to BB-**	**Below BB-**	**Unrated**
Risk weight	20%	50%	100%	150%	100%

67. Supervisory authorities should increase the standard risk weight for unrated claims where they judge that a higher risk weight is warranted by the overall default experience in their jurisdiction. As part of the supervisory review process, supervisors may also consider whether the credit quality of corporate claims held by individual banks should warrant a standard risk weight higher than 100%.

68. At national discretion, supervisory authorities may permit banks to risk weight all corporate claims at 100% without regard to external ratings. Where this discretion is exercised by the supervisor, it must ensure that banks apply a single consistent approach, i.e. either to use ratings wherever available or not at all. To prevent "cherry-picking" of external ratings, banks should obtain supervisory approval before utilising this option to risk weight all corporate claims at 100%.

7. Claims included in the regulatory retail portfolios

69. Claims that qualify under the criteria listed in paragraph 70 may be considered as retail claims for regulatory capital purposes and included in a regulatory retail portfolio. Exposures included in such a portfolio may be risk-weighted at 75%, except as provided in paragraph 75 for past due loans.

70. To be included in the regulatory retail portfolio, claims must meet the following four criteria:

- Orientation criterion — The exposure is to an individual person or persons or to a small business;

- Product criterion — The exposure takes the form of any of the following: revolving credits and lines of credit (including credit cards and overdrafts), personal term loans and leases (e.g. instalment loans, auto loans and leases, student and educational loans, personal finance) and small business facilities and commitments. Securities (such as bonds and equities), whether listed or not, are specifically

[27] That is, capital requirements that are comparable to those applied to banks in this Framework. Implicit in the meaning of the word "comparable" is that the securities firm (but not necessarily its parent) is subject to consolidated regulation and supervision with respect to any downstream affiliates.

excluded from this category. Mortgage loans are excluded to the extent that they qualify for treatment as claims secured by residential property (see paragraph 72).

- Granularity criterion – The supervisor must be satisfied that the regulatory retail portfolio is sufficiently diversified to a degree that reduces the risks in the portfolio, warranting the 75% risk weight. One way of achieving this may be to set a numerical limit that no aggregate exposure to one counterpart[28] can exceed 0.2% of the overall regulatory retail portfolio.

- Low value of individual exposures. The maximum aggregated retail exposure to one counterpart cannot exceed an absolute threshold of €1 million.

71. National supervisory authorities should evaluate whether the risk weights in paragraph 69 are considered to be too low based on the default experience for these types of exposures in their jurisdictions. Supervisors, therefore, may require banks to increase these risk weights as appropriate.

8. Claims secured by residential property

72. Lending fully secured by mortgages on residential property that is or will be occupied by the borrower, or that is rented, will be risk weighted at 35%. In applying the 35% weight, the supervisory authorities should satisfy themselves, according to their national arrangements for the provision of housing finance, that this concessionary weight is applied restrictively for residential purposes and in accordance with strict prudential criteria, such as the existence of substantial margin of additional security over the amount of the loan based on strict valuation rules. Supervisors should increase the standard risk weight where they judge the criteria are not met.

73. National supervisory authorities should evaluate whether the risk weights in paragraph 72 are considered to be too low based on the default experience for these types of exposures in their jurisdictions. Supervisors, therefore, may require banks to increase these risk weights as appropriate.

9. Claims secured by commercial real estate

74. In view of the experience in numerous countries that commercial property lending has been a recurring cause of troubled assets in the banking industry over the past few decades, the Committee holds to the view that mortgages on commercial real estate do not, in principle, justify other than a 100% weighting of the loans secured.[29]

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[28] Aggregated exposure means gross amount (i.e. not taking any credit risk mitigation into account) of all forms of debt exposures (e.g. loans or commitments) that individually satisfy the three other criteria. In addition, "to one counterpart" means one or several entities that may be considered as a single beneficiary (e.g. in the case of a small business that is affiliated to another small business, the limit would apply to the bank's aggregated exposure on both businesses).

[29] The Committee, however, recognises that, in exceptional circumstances for well-developed and long-established markets, mortgages on office and/or multi-purpose commercial premises and/or multi-tenanted commercial premises may have the potential to receive a preferential risk weight of 50% for the tranche of the loan that does not exceed the lower of 50% of the market value or 60% of the mortgage lending value of the property securing the loan. Any exposure beyond these limits will receive a 100% risk weight. This exceptional treatment will be subject to very strict conditions. In particular, two tests must be fulfilled, namely that (i) losses stemming from commercial real estate lending up to the lower of 50% of the market value or 60% of loan-to-

10. Past due loans

75. The unsecured portion of any loan (other than a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions (including partial write-offs), will be risk-weighted as follows: [30]

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan;
- 100% risk weight when specific provisions are no less than 20% of the outstanding amount of the loan;
- 100% risk weight when specific provisions are no less than 50% of the outstanding amount of the loan, but with supervisory discretion to reduce the risk weight to 50%.

76. For the purpose of defining the secured portion of the past due loan, eligible collateral and guarantees will be the same as for credit risk mitigation purposes (see Section II.B).[31] Past due retail loans are to be excluded from the overall regulatory retail portfolio when assessing the granularity criterion specified in paragraph 70, for risk-weighting purposes.

77. In addition to the circumstances described in paragraph 75, where a past due loan is fully secured by those forms of collateral that are not recognised in paragraphs 145 and 146, a 100% risk weight may apply when provisions reach 15% of the outstanding amount of the loan. These forms of collateral are not recognised elsewhere in the standardised approach. Supervisors should set strict operational criteria to ensure the quality of collateral.

78. In the case of qualifying residential mortgage loans, when such loans are past due for more than 90 days they will be risk weighted at 100%, net of specific provisions. If such loans are past due but specific provisions are no less than 20% of their outstanding amount, the risk weight applicable to the remainder of the loan can be reduced to 50% at national discretion.

11. Higher-risk categories

79. The following claims will be risk weighted at 150% or higher:

- Claims on sovereigns, PSEs, banks, and securities firms rated below B-.
- Claims on corporates rated below BB-.
- Past due loans as set out in paragraph 75.

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value (LTV) based on mortgage-lending-value (MLV) must not exceed 0.3% of the outstanding loans in any given year; and that (ii) overall losses stemming from commercial real estate lending must not exceed 0.5% of the outstanding loans in any given year. This is, if either of these tests is not satisfied in a given year, the eligibility to use this treatment will cease and the original eligibility criteria would need to be satisfied again before it could be applied in the future. Countries applying such a treatment must publicly disclose that these and other additional conditions (that are available from the Basel Committee Secretariat) are met. When claims benefiting from such an exceptional treatment have fallen past due, they will be risk-weighted at 100%.

[30] Subject to national discretion, supervisors may permit banks to treat non-past due loans extended to counterparties subject to a 150% risk weight in the same way as past due loans described in paragraphs 75 to 77.

[31] There will be a transitional period of three years during which a wider range of collateral may be recognised, subject to national discretion.

- Securitisation tranches that are rated between BB+ and BB- will be risk weighted at 350% as set out in paragraph 567.

80. National supervisors may decide to apply a 150% or higher risk weight reflecting the higher risks associated with some other assets, such as venture capital and private equity investments.

12. Other assets

81. The treatment of securitisation exposures is presented separately in Section IV. The standard risk weight for all other assets will be 100%.[32] Investments in equity or regulatory capital instruments issued by banks or securities firms will be risk weighted at 100%, unless deducted from the capital base according to Part 1.

13. Off-balance sheet items

82. Off-balance-sheet items under the standardised approach will be converted into credit exposure equivalents through the use of credit conversion factors (CCF). Counterparty risk weightings for OTC derivative transactions will not be subject to any specific ceiling.

83. Commitments with an original maturity up to one year and commitments with an original maturity over one year will receive a CCF of 20% and 50%, respectively. However, any commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, will receive a 0% CCF.[33]

83(i). Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances) will receive a CCF of 100%.

83(ii). Sale and repurchase agreements and asset sales with recourse,[34] where the credit risk remains with the bank will receive a CCF of 100%.

84. A CCF of 100% will be applied to the lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (i.e. repurchase/reverse repurchase and securities lending/securities borrowing transactions). See Section II.D.3 for the calculation of risk-weighted assets where the credit converted exposure is secured by eligible collateral.

84(i). Forward asset purchases, forward forward deposits and partly-paid shares and securities[35], which represent commitments with certain drawdown will receive a CCF of 100%.

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[32] However, at national discretion, gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities can be treated as cash and therefore risk-weighted at 0%. In addition, cash items in the process of collection can be risk-weighted at 20%.

[33] In certain countries, retail commitments are considered unconditionally cancellable if the terms permit the bank to cancel them to the full extent allowable under consumer protection and related legislation.

[34] These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

84(ii). Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) will receive a CCF of 50%.

84(iii). Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) will receive a CCF of 50%.

85. For short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), a 20% CCF will be applied to both issuing and confirming banks.

86. Where there is an undertaking to provide a commitment on an off-balance sheet item, banks are to apply the lower of the two applicable CCFs.

87. The credit equivalent amount of OTC derivatives and SFTs that expose a bank to counterparty credit risk is to be calculated under the rules set forth in Annex 4 of this Framework.

88. Banks must closely monitor securities, commodities, and foreign exchange transactions that have failed, starting the first day they fail. A capital charge to failed transactions must be calculated in accordance with Annex 3 of this Framework.

89. With regard to unsettled securities, commodities, and foreign exchange transactions, the Committee is of the opinion that banks are exposed to counterparty credit risk from trade date, irrespective of the booking or the accounting of the transaction. Therefore, banks are encouraged to develop, implement and improve systems for tracking and monitoring the credit risk exposure arising from unsettled transactions as appropriate for producing management information that facilitates action on a timely basis. Furthermore, when such transactions are not processed through a delivery-versus-payment (DvP) or payment-versus-payment (PvP) mechanism, banks must calculate a capital charge as set forth in Annex 3 of this Framework.

B. External credit assessment

1. The recognition process

90. National supervisors are responsible for determining whether an external credit assessment institution (ECAI) meets the criteria listed in the paragraph below. The assessments of ECAIs may be recognised on a limited basis, e.g. by type of claims or by jurisdiction. The supervisory process for recognising ECAIs should be made public to avoid unnecessary barriers to entry.

2. Eligibility criteria

91. An ECAI must satisfy each of the following six criteria.

- ***Objectivity***: The methodology for assigning credit assessments must be rigorous, systematic, and subject to some form of validation based on historical experience.

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[35] These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

Moreover, assessments must be subject to ongoing review and responsive to changes in financial condition. Before being recognised by supervisors, an assessment methodology for each market segment, including rigorous backtesting, must have been established for at least one year and preferably three years.

- ***Independence***: An ECAI should be independent and should not be subject to political or economic pressures that may influence the rating. The assessment process should be as free as possible from any constraints that could arise in situations where the composition of the board of directors or the shareholder structure of the assessment institution may be seen as creating a conflict of interest.
- ***International access/Transparency***: The individual assessments should be available to both domestic and foreign institutions with legitimate interests and at equivalent terms. In addition, the general methodology used by the ECAI should be publicly available.
- ***Disclosure***: An ECAI should disclose the following information: its assessment methodologies, including the definition of default, the time horizon, and the meaning of each rating; the actual default rates experienced in each assessment category; and the transitions of the assessments, e.g. the likelihood of AA ratings becoming A over time.
- ***Resources***: An ECAI should have sufficient resources to carry out high quality credit assessments. These resources should allow for substantial ongoing contact with senior and operational levels within the entities assessed in order to add value to the credit assessments. Such assessments should be based on methodologies combining qualitative and quantitative approaches.
- ***Credibility***: To some extent, credibility is derived from the criteria above. In addition, the reliance on an ECAI's external credit assessments by independent parties (investors, insurers, trading partners) is evidence of the credibility of the assessments of an ECAI. The credibility of an ECAI is also underpinned by the existence of internal procedures to prevent the misuse of confidential information. In order to be eligible for recognition, an ECAI does not have to assess firms in more than one country.

C. Implementation considerations

1. The mapping process

92. Supervisors will be responsible for assigning eligible ECAIs' assessments to the risk weights available under the standardised risk weighting framework, i.e. deciding which assessment categories correspond to which risk weights. The mapping process should be objective and should result in a risk weight assignment consistent with that of the level of credit risk reflected in the tables above. It should cover the full spectrum of risk weights.

93. When conducting such a mapping process, factors that supervisors should assess include, among others, the size and scope of the pool of issuers that each ECAI covers, the range and meaning of the assessments that it assigns, and the definition of default used by the ECAI. In order to promote a more consistent mapping of assessments into the available risk weights and help supervisors in conducting such a process, Annex 2 provides guidance as to how such a mapping process may be conducted.

94. Banks must use the chosen ECAIs and their ratings consistently for each type of claim, for both risk weighting and risk management purposes. Banks will not be allowed to "cherry-pick" the assessments provided by different ECAIs.

95. Banks must disclose ECAIs that they use for the risk weighting of their assets by type of claims, the risk weights associated with the particular rating grades as determined by supervisors through the mapping process as well as the aggregated risk-weighted assets for each risk weight based on the assessments of each eligible ECAI.

2. Multiple assessments

96. If there is only one assessment by an ECAI chosen by a bank for a particular claim, that assessment should be used to determine the risk weight of the claim.

97. If there are two assessments by ECAIs chosen by a bank which map into different risk weights, the higher risk weight will be applied.

98. If there are three or more assessments with different risk weights, the assessments corresponding to the two lowest risk weights should be referred to and the higher of those two risk weights will be applied.

3. Issuer versus issues assessment

99. Where a bank invests in a particular issue that has an issue-specific assessment, the risk weight of the claim will be based on this assessment. Where the bank's claim is not an investment in a specific assessed issue, the following general principles apply.

- In circumstances where the borrower has a specific assessment for an issued debt — but the bank's claim is not an investment in this particular debt — a high quality credit assessment (one which maps into a risk weight lower than that which applies to an unrated claim) on that specific debt may only be applied to the bank's unassessed claim if this claim ranks *pari passu* or senior to the claim with an assessment in all respects. If not, the credit assessment cannot be used and the unassessed claim will receive the risk weight for unrated claims.
- In circumstances where the borrower has an issuer assessment, this assessment typically applies to senior unsecured claims on that issuer. Consequently, only senior claims on that issuer will benefit from a high quality issuer assessment. Other unassessed claims of a highly assessed issuer will be treated as unrated. If either the issuer or a single issue has a low quality assessment (mapping into a risk weight equal to or higher than that which applies to unrated claims), an unassessed claim on the same counterparty will be assigned the same risk weight as is applicable to the low quality assessment.

100. Whether the bank intends to rely on an issuer- or an issue-specific assessment, the assessment must take into account and reflect the entire amount of credit risk exposure the bank has with regard to all payments owed to it.[36]

101. In order to avoid any double counting of credit enhancement factors, no supervisory recognition of credit risk mitigation techniques will be taken into account if the credit enhancement is already reflected in the issue specific rating (see paragraph 114).

[36] For example, if a bank is owed both principal and interest, the assessment must fully take into account and reflect the credit risk associated with repayment of both principal and interest.

4. Domestic currency and foreign currency assessments

102. Where unrated exposures are risk weighted based on the rating of an equivalent exposure to that borrower, the general rule is that foreign currency ratings would be used for exposures in foreign currency. Domestic currency ratings, if separate, would only be used to risk weight claims denominated in the domestic currency.[37]

5. Short-term/long-term assessments

103. For risk-weighting purposes, short-term assessments are deemed to be issue-specific. They can only be used to derive risk weights for claims arising from the rated facility. They cannot be generalised to other short-term claims, except under the conditions of paragraph 105. In no event can a short-term rating be used to support a risk weight for an unrated long-term claim. Short-term assessments may only be used for short-term claims against banks and corporates. The table below provides a framework for banks' exposures to specific short-term facilities, such as a particular issuance of commercial paper:

Credit assessment	**A-1/P-1**[38]	**A-2/P-2**	**A-3/P-3**	**Others**[39]
Risk weight	20%	50%	100%	150%

104. If a short-term rated facility attracts a 50% risk-weight, unrated short-term claims cannot attract a risk weight lower than 100%. If an issuer has a short-term facility with an assessment that warrants a risk weight of 150%, all unrated claims, whether long-term or short-term, should also receive a 150% risk weight, unless the bank uses recognised credit risk mitigation techniques for such claims.

105. In cases where national supervisors have decided to apply option 2 under the standardised approach to short term interbank claims to banks in their jurisdiction, the interaction with specific short-term assessments is expected to be the following:

- The general preferential treatment for short-term claims, as defined under paragraphs 62 and 64, applies to all claims on banks of up to three months original maturity when there is no specific short-term claim assessment.
- When there is a short-term assessment and such an assessment maps into a risk weight that is more favourable (i.e. lower) or identical to that derived from the general preferential treatment, the short-term assessment should be used for the specific claim only. Other short-term claims would benefit from the general preferential treatment.

[37] However, when an exposure arises through a bank's participation in a loan that has been extended, or has been guaranteed against convertibility and transfer risk, by certain MDBs, its convertibility and transfer risk can be considered by national supervisory authorities to be effectively mitigated. To qualify, MDBs must have preferred creditor status recognised in the market and be included in footnote 24. In such cases, for risk weighting purposes, the borrower's domestic currency rating may be used instead of its foreign currency rating. In the case of a guarantee against convertibility and transfer risk, the local currency rating can be used only for the portion that has been guaranteed. The portion of the loan not benefiting from such a guarantee will be risk-weighted based on the foreign currency rating.

[38] The notations follow the methodology used by Standard & Poor's and by Moody's Investors Service. The A-1 rating of Standard & Poor's includes both A-1+ and A-1-.

[39] This category includes all non-prime and B or C ratings.

- When a specific short-term assessment for a short term claim on a bank maps into a less favourable (higher) risk weight, the general short-term preferential treatment for interbank claims cannot be used. All unrated short-term claims should receive the same risk weighting as that implied by the specific short-term assessment.

106. When a short-term assessment is to be used, the institution making the assessment needs to meet all of the eligibility criteria for recognising ECAIs as presented in paragraph 91 in terms of its short-term assessment.

6. Level of application of the assessment

107. External assessments for one entity within a corporate group cannot be used to risk weight other entities within the same group.

7. Unsolicited ratings

108. As a general rule, banks should use *solicited* ratings from eligible ECAIs. National supervisory authorities may, however, allow banks to use *unsolicited* ratings in the same way as solicited ratings. However, there may be the potential for ECAIs to use unsolicited ratings to put pressure on entities to obtain solicited ratings. Such behaviour, when identified, should cause supervisors to consider whether to continue recognising such ECAIs as eligible for capital adequacy purposes.

D. The standardised approach — credit risk mitigation

1. Overarching issues

(i) Introduction

109. Banks use a number of techniques to mitigate the credit risks to which they are exposed. For example, exposures may be collateralised by first priority claims, in whole or in part with cash or securities, a loan exposure may be guaranteed by a third party, or a bank may buy a credit derivative to offset various forms of credit risk. Additionally banks may agree to net loans owed to them against deposits from the same counterparty.

110. Where these techniques meet the requirements for legal certainty as described in paragraph 117 and 118 below, the revised approach to CRM allows a wider range of credit risk mitigants to be recognised for regulatory capital purposes than is permitted under the 1988 Accord.

(ii) General remarks

111. The framework set out in this Section II is applicable to the banking book exposures in the standardised approach. For the treatment of CRM in the IRB approach, see Section III.

112. The comprehensive approach for the treatment of collateral (see paragraphs 130 to 138 and 145 to 181) will also be applied to calculate the counterparty risk charges for OTC derivatives and repo-style transactions booked in the trading book.

113. No transaction in which CRM techniques are used should receive a higher capital requirement than an otherwise identical transaction where such techniques are not used.

114. The effects of CRM will not be double counted. Therefore, no additional supervisory recognition of CRM for regulatory capital purposes will be granted on claims for which an issue-specific rating is used that already reflects that CRM. As stated in paragraph 100 of the

section on the standardised approach, principal-only ratings will also not be allowed within the framework of CRM.

115. While the use of CRM techniques reduces or transfers credit risk, it simultaneously may increase other risks (residual risks). Residual risks include legal, operational, liquidity and market risks. Therefore, it is imperative that banks employ robust procedures and processes to control these risks, including strategy; consideration of the underlying credit; valuation; policies and procedures; systems; control of roll-off risks; and management of concentration risk arising from the bank's use of CRM techniques and its interaction with the bank's overall credit risk profile. Where these risks are not adequately controlled, supervisors may impose additional capital charges or take other supervisory actions as outlined in Pillar 2.

116. The Pillar 3 requirements must also be observed for banks to obtain capital relief in respect of any CRM techniques.

(iii) Legal certainty

117. In order for banks to obtain capital relief for any use of CRM techniques, the following minimum standards for legal documentation must be met.

118. All documentation used in collateralised transactions and for documenting on-balance sheet netting, guarantees and credit derivatives must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review to verify this and have a well founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.

2. Overview of Credit Risk Mitigation Techniques[40]

(i) Collateralised transactions

119. A collateralised transaction is one in which:

- banks have a credit exposure or potential credit exposure; and
- that credit exposure or potential credit exposure is hedged in whole or in part by collateral posted by a counterparty[41] or by a third party on behalf of the counterparty.

120. Where banks take eligible financial collateral (e.g. cash or securities, more specifically defined in paragraphs 145 and 146 below), they are allowed to reduce their credit exposure to a counterparty when calculating their capital requirements to take account of the risk mitigating effect of the collateral.

Overall framework and minimum conditions

121. Banks may opt for either the simple approach, which, similar to the 1988 Accord, substitutes the risk weighting of the collateral for the risk weighting of the counterparty for the

[40] See Annex 10 for an overview of methodologies for the capital treatment of transactions secured by financial collateral under the standardised and IRB approaches.

[41] In this section "counterparty" is used to denote a party to whom a bank has an on- or off-balance sheet credit exposure or a potential credit exposure. That exposure may, for example, take the form of a loan of cash or securities (where the counterparty would traditionally be called the borrower), of securities posted as collateral, of a commitment or of exposure under an OTC derivatives contract.

collateralised portion of the exposure (generally subject to a 20% floor), or for the comprehensive approach, which allows fuller offset of collateral against exposures, by effectively reducing the exposure amount by the value ascribed to the collateral. Banks may operate under either, but not both, approaches in the banking book, but only under the comprehensive approach in the trading book. Partial collateralisation is recognised in both approaches. Mismatches in the maturity of the underlying exposure and the collateral will only be allowed under the comprehensive approach.

122. However, before capital relief will be granted in respect of any form of collateral, the standards set out below in paragraphs 123 to 126 must be met under either approach.

123. In addition to the general requirements for legal certainty set out in paragraphs 117 and 118, the legal mechanism by which collateral is pledged or transferred must ensure that the bank has the right to liquidate or take legal possession of it, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined credit events set out in the transaction documentation) of the counterparty (and, where applicable, of the custodian holding the collateral). Furthermore banks must take all steps necessary to fulfil those requirements under the law applicable to the bank's interest in the collateral for obtaining and maintaining an enforceable security interest, e.g. by registering it with a registrar, or for exercising a right to net or set off in relation to title transfer collateral.

124. In order for collateral to provide protection, the credit quality of the counterparty and the value of the collateral must not have a material positive correlation. For example, securities issued by the counterparty ─ or by any related group entity ─ would provide little protection and so would be ineligible.

125. Banks must have clear and robust procedures for the timely liquidation of collateral to ensure that any legal conditions required for declaring the default of the counterparty and liquidating the collateral are observed, and that collateral can be liquidated promptly.

126. Where the collateral is held by a custodian, banks must take reasonable steps to ensure that the custodian segregates the collateral from its own assets.

127. A capital requirement will be applied to a bank on either side of the collateralised transaction: for example, both repos and reverse repos will be subject to capital requirements. Likewise, both sides of a securities lending and borrowing transaction will be subject to explicit capital charges, as will the posting of securities in connection with a derivative exposure or other borrowing.

128. Where a bank, acting as an agent, arranges a repo-style transaction (i.e. repurchase/reverse repurchase and securities lending/borrowing transactions) between a customer and a third party and provides a guarantee to the customer that the third party will perform on its obligations, then the risk to the bank is the same as if the bank had entered into the transaction as a principal. In such circumstances, a bank will be required to calculate capital requirements as if it were itself the principal.

The simple approach

129. In the simple approach the risk weighting of the collateral instrument collateralising or partially collateralising the exposure is substituted for the risk weighting of the counterparty. Details of this framework are provided in paragraphs 182 to 185.

The comprehensive approach

130. In the comprehensive approach, when taking collateral, banks will need to calculate their adjusted exposure to a counterparty for capital adequacy purposes in order to take account of the effects of that collateral. Using haircuts, banks are required to adjust both the amount of the exposure to the counterparty and the value of any collateral received in support of that counterparty to take account of possible future fluctuations in the value of either,[42] occasioned by market movements. This will produce volatility adjusted amounts for both exposure and collateral. Unless either side of the transaction is cash, the volatility adjusted amount for the exposure will be higher than the exposure and for the collateral it will be lower.

131. Additionally where the exposure and collateral are held in different currencies an additional downwards adjustment must be made to the volatility adjusted collateral amount to take account of possible future fluctuations in exchange rates.

132. Where the volatility-adjusted exposure amount is greater than the volatility-adjusted collateral amount (including any further adjustment for foreign exchange risk), banks shall calculate their risk-weighted assets as the difference between the two multiplied by the risk weight of the counterparty. The framework for performing these calculations is set out in paragraphs 147 to 150.

133. In principle, banks have two ways of calculating the haircuts: (i) standard supervisory haircuts, using parameters set by the Committee, and (ii) own-estimate haircuts, using banks' own internal estimates of market price volatility. Supervisors will allow banks to use own-estimate haircuts only when they fulfil certain qualitative and quantitative criteria.

134. A bank may choose to use standard or own-estimate haircuts independently of the choice it has made between the standardised approach and the foundation IRB approach to credit risk. However, if banks seek to use their own-estimate haircuts, they must do so for the full range of instrument types for which they would be eligible to use own-estimates, the exception being immaterial portfolios where they may use the standard supervisory haircuts.

135. The size of the individual haircuts will depend on the type of instrument, type of transaction and the frequency of marking-to-market and remargining. For example, repo-style transactions subject to daily marking-to-market and to daily remargining will receive a haircut based on a 5-business day holding period and secured lending transactions with daily mark-to-market and no remargining clauses will receive a haircut based on a 20-business day holding period. These haircut numbers will be scaled up using the square root of time formula depending on the frequency of remargining or marking-to-market.

136. For certain types of repo-style transactions (broadly speaking government bond repos as defined in paragraphs 170 and 171) supervisors may allow banks using standard supervisory haircuts or own-estimate haircuts not to apply these in calculating the exposure amount after risk mitigation.

137. The effect of master netting agreements covering repo-style transactions can be recognised for the calculation of capital requirements subject to the conditions in paragraph 173.

[42] Exposure amounts may vary where, for example, securities are being lent.

138. As a further alternative to standard supervisory haircuts and own-estimate haircuts banks may use VaR models for calculating potential price volatility for repo-style transactions and other similar SFTs, as set out in paragraphs 178 to 181 (i) below. Alternatively, subject to supervisory approval, they may also calculate, for these transactions, an expected positive exposure, as set forth in Annex 4 of this Framework.

(ii) On-balance sheet netting

139. Where banks have legally enforceable netting arrangements for loans and deposits they may calculate capital requirements on the basis of net credit exposures subject to the conditions in paragraph 188.

(iii) Guarantees and credit derivatives

140. Where guarantees or credit derivatives are direct, explicit, irrevocable and unconditional, and supervisors are satisfied that banks fulfil certain minimum operational conditions relating to risk management processes they may allow banks to take account of such credit protection in calculating capital requirements.

141. A range of guarantors and protection providers are recognised. As under the 1988 Accord, a substitution approach will be applied. Thus only guarantees issued by or protection provided by entities with a lower risk weight than the counterparty will lead to reduced capital charges since the protected portion of the counterparty exposure is assigned the risk weight of the guarantor or protection provider, whereas the uncovered portion retains the risk weight of the underlying counterparty.

142. Detailed operational requirements are given below in paragraphs 189 to 193.

(iv) Maturity mismatch

143. Where the residual maturity of the CRM is less than that of the underlying credit exposure a maturity mismatch occurs. Where there is a maturity mismatch and the CRM has an original maturity of less than one year, the CRM is not recognised for capital purposes. In other cases where there is a maturity mismatch, partial recognition is given to the CRM for regulatory capital purposes as detailed below in paragraphs 202 to 205. Under the simple approach for collateral maturity mismatches will not be allowed.

(v) Miscellaneous

144. Treatments for pools of credit risk mitigants and first- and second-to-default credit derivatives are given in paragraphs 206 to 210 below.

3. Collateral

(i) Eligible financial collateral

145. The following collateral instruments are eligible for recognition in the simple approach:

(a)	Cash (as well as certificates of deposit or comparable instruments issued by the lending bank) on deposit with the bank which is incurring the counterparty exposure.[43, 44]
(b)	Gold.
(c)	Debt securities rated by a recognised external credit assessment institution where these are either:
•	at least BB- when issued by sovereigns or PSEs that are treated as sovereigns by the national supervisor; or
•	at least BBB- when issued by other entities (including banks and securities firms); or
•	at least A-3/P-3 for short-term debt instruments.
(d)	Debt securities not rated by a recognised external credit assessment institution where these are:
•	issued by a bank; and
•	listed on a recognised exchange; and
•	classified as senior debt; and
•	all rated issues of the same seniority by the issuing bank must be rated at least BBB- or A-3/P-3 by a recognised external credit assessment institution; and
•	the bank holding the securities as collateral has no information to suggest that the issue justifies a rating below BBB- or A-3/P-3 (as applicable); and
•	the supervisor is sufficiently confident about the market liquidity of the security.
(e)	Equities (including convertible bonds) that are included in a main index.
(f)	Undertakings for Collective Investments in Transferable Securities (UCITS) and mutual funds where:
•	a price for the units is publicly quoted daily; and
•	the UCITS/mutual fund is limited to investing in the instruments listed in this paragraph.[45]

146. The following collateral instruments are eligible for recognition in the comprehensive approach:

(a)	All of the instruments in paragraph 145;
(b)	Equities (including convertible bonds) which are not included in a main index but

[43] Cash funded credit linked notes issued by the bank against exposures in the banking book which fulfil the criteria for credit derivatives will be treated as cash collateralised transactions.

[44] When cash on deposit, certificates of deposit or comparable instruments issued by the lending bank are held as collateral at a third-party bank in a non-custodial arrangement, if they are openly pledged/assigned to the lending bank and if the pledge/assignment is unconditional and irrevocable, the exposure amount covered by the collateral (after any necessary haircuts for currency risk) will receive the risk weight of the third-party bank.

[45] However, the use or potential use by a UCITS/mutual fund of derivative instruments solely to hedge investments listed in this paragraph and paragraph 146 shall not prevent units in that UCITS/mutual fund from being eligible financial collateral.

	which are listed on a recognised exchange;
(c)	UCITS/mutual funds which include such equities.

(ii) The comprehensive approach

Calculation of capital requirement

147. For a collateralised transaction, the exposure amount after risk mitigation is calculated as follows:

E* = max {0, [E x (1 + He) – C x (1 – Hc – Hfx)]}

where:

E* = the exposure value after risk mitigation

E = current value of the exposure

He = haircut appropriate to the exposure

C = the current value of the collateral received

Hc = haircut appropriate to the collateral

Hfx = haircut appropriate for currency mismatch between the collateral and exposure

148. The exposure amount after risk mitigation will be multiplied by the risk weight of the counterparty to obtain the risk-weighted asset amount for the collateralised transaction.

149. The treatment for transactions where there is a mismatch between the maturity of the counterparty exposure and the collateral is given in paragraphs 202 to 205.

150. Where the collateral is a basket of assets, the haircut on the basket will be $H = \sum_i a_i H_i$, where a_i is the weight of the asset (as measured by units of currency) in the basket and H_i the haircut applicable to that asset.

Standard supervisory haircuts

151. These are the standard supervisory haircuts (assuming daily mark-to-market, daily remargining and a 10-business day holding period), expressed as percentages:

Issue rating for debt securities	Residual Maturity	Sovereigns[46, 47]	Other issuers[48]
AAA to AA-/A-1	≤ 1 year	0.5	1
	>1 year, ≤ 5 years	2	4
	> 5 years	4	8
A+ to BBB-/ A-2/A-3/P-3 and unrated bank securities per para. 145(d)	≤ 1 year	1	2
	>1 year, ≤ 5 years	3	6
	> 5 years	6	12
BB+ to BB-	All	15	
Main index equities (including convertible bonds) and Gold		15	
Other equities (including convertible bonds) listed on a recognised exchange		25	
UCITS/Mutual funds		Highest haircut applicable to any security in which the fund can invest	
Cash in the same currency[49]		0	

152. The standard supervisory haircut for currency risk where exposure and collateral are denominated in different currencies is 8% (also based on a 10-business day holding period and daily mark-to-market)

153. For transactions in which the bank lends non-eligible instruments (e.g. non-investment grade corporate debt securities), the haircut to be applied on the exposure should be the same as the one for equity traded on a recognised exchange that is not part of a main index.

Own estimates for haircuts

154. Supervisors may permit banks to calculate haircuts using their own internal estimates of market price volatility and foreign exchange volatility. Permission to do so will be conditional on the satisfaction of minimum qualitative and quantitative standards stated in paragraphs 156 to 165. When debt securities are rated BBB-/A-3 or higher, supervisors may allow banks to calculate a volatility estimate for each category of security. In determining relevant categories, institutions must take into account (a) the type of issuer of the security, (b) its rating, (c) its residual maturity, and (d) its modified duration. Volatility estimates must be representative of the securities actually included in the category for that bank. For debt securities rated below BBB-/A-3 or for equities eligible as collateral (lightly shaded boxes in the above table), the haircuts must be calculated for each individual security.

155. Banks must estimate the volatility of the collateral instrument or foreign exchange mismatch individually: estimated volatilities for each transaction must not take into account

46 Includes PSEs which are treated as sovereigns by the national supervisor.

47 Multilateral development banks receiving a 0% risk weight will be treated as sovereigns.

48 Includes PSEs which are not treated as sovereigns by the national supervisor.

49 Eligible cash collateral specified in paragraph 145 (a).

the correlations between unsecured exposure, collateral and exchange rates (see paragraphs 202 to 205 for the approach to maturity mismatches).

Quantitative criteria

156. In calculating the haircuts, a 99th percentile, one-tailed confidence interval is to be used.

157. The minimum holding period will be dependent on the type of transaction and the frequency of remargining or marking to market. The minimum holding periods for different types of transactions are presented in paragraph 167. Banks may use haircut numbers calculated according to shorter holding periods, scaled up to the appropriate holding period by the square root of time formula.

158. Banks must take into account the illiquidity of lower-quality assets. The holding period should be adjusted upwards in cases where such a holding period would be inappropriate given the liquidity of the collateral. They should also identify where historical data may understate potential volatility, e.g. a pegged currency. Such cases must be dealt with by subjecting the data to stress testing.

159. The choice of historical observation period (sample period) for calculating haircuts shall be a minimum of one year. For banks that use a weighting scheme or other methods for the historical observation period, the “effective” observation period must be at least one year (that is, the weighted average time lag of the individual observations cannot be less than 6 months).

160. Banks should update their data sets no less frequently than once every three months and should also reassess them whenever market prices are subject to material changes. This implies that haircuts must be computed at least every three months. The supervisor may also require a bank to calculate its haircuts using a shorter observation period if, in the supervisor's judgement, this is justified by a significant upsurge in price volatility.

161. No particular type of model is prescribed. So long as each model used captures all the material risks run by the bank, banks will be free to use models based on, for example, historical simulations and Monte Carlo simulations.

Qualitative criteria

162. The estimated volatility data (and holding period) must be used in the day-to-day risk management process of the bank.

163. Banks should have robust processes in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the risk measurement system.

164. The risk measurement system should be used in conjunction with internal exposure limits.

165. An independent review of the risk measurement system should be carried out regularly in the bank’s own internal auditing process. A review of the overall risk management process should take place at regular intervals (ideally not less than once a year) and should specifically address, at a minimum:

- the integration of risk measures into daily risk management;

- the validation of any significant change in the risk measurement process;
- the accuracy and completeness of position data;
- the verification of the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources; and
- the accuracy and appropriateness of volatility assumptions.

Adjustment for different holding periods and non daily mark-to-market or remargining

166. For some transactions, depending on the nature and frequency of the revaluation and remargining provisions, different holding periods are appropriate. The framework for collateral haircuts distinguishes between repo-style transactions (i.e. repo/reverse repos and securities lending/borrowing), "other capital-market-driven transactions" (i.e. OTC derivatives transactions and margin lending) and secured lending. In capital-market-driven transactions and repo-style transactions, the documentation contains remargining clauses; in secured lending transactions, it generally does not.

167. The minimum holding period for various products is summarised in the following table.

Transaction type	Minimum holding period	Condition
Repo-style transaction	five business days	daily remargining
Other capital market transactions	ten business days	daily remargining
Secured lending	twenty business days	daily revaluation

168. When the frequency of remargining or revaluation is longer than the minimum, the minimum haircut numbers will be scaled up depending on the actual number of business days between remargining or revaluation using the square root of time formula below:

$$H = H_M \sqrt{\frac{N_R + (T_M - 1)}{T_M}}$$

where:

H = haircut

H_M = haircut under the minimum holding period

T_M = minimum holding period for the type of transaction

N_R = actual number of business days between remargining for capital market transactions or revaluation for secured transactions.

When a bank calculates the volatility on a T_N day holding period which is different from the specified minimum holding period T_M, the H_M will be calculated using the square root of time formula:

$$H_M = H_N \sqrt{\frac{T_M}{T_N}}$$

T_N = holding period used by the bank for deriving H_N

H_N = haircut based on the holding period T_N

169. For example, for banks using the standard supervisory haircuts, the 10-business day haircuts provided in paragraph 151 will be the basis and this haircut will be scaled up or down depending on the type of transaction and the frequency of remargining or revaluation using the formula below:

$$H = H_{10} \sqrt{\frac{N_R + (T_M - 1)}{10}}$$

where:

H = haircut

H_{10} = 10-business day standard supervisory haircut for instrument

N_R = actual number of business days between remargining for capital market transactions or revaluation for secured transactions.

T_M = minimum holding period for the type of transaction

Conditions for zero H

170. For repo-style transactions where the following conditions are satisfied, and the counterparty is a *core market participant*, supervisors may choose not to apply the haircuts specified in the comprehensive approach and may instead apply a haircut of zero. This carve-out will not be available for banks using the modelling approaches as described in paragraphs 178 to 181 (i).

(a)	Both the exposure and the collateral are cash or a sovereign security or PSE security qualifying for a 0% risk weight in the standardised approach;[50]
(b)	Both the exposure and the collateral are denominated in the same currency;
(c)	Either the transaction is overnight or both the exposure and the collateral are marked-to-market daily and are subject to daily remargining;
(d)	Following a counterparty's failure to remargin, the time that is required between the last mark-to-market before the failure to remargin and the liquidation[51] of the collateral is considered to be no more than four business days;
(e)	The transaction is settled across a settlement system proven for that type of transaction;
(f)	The documentation covering the agreement is standard market documentation for repo-style transactions in the securities concerned;
(g)	The transaction is governed by documentation specifying that if the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or

[50] Note that where a supervisor has designated domestic-currency claims on its sovereign or central bank to be eligible for a 0% risk weight in the standardised approach, such claims will satisfy this condition.

[51] This does not require the bank to always liquidate the collateral but rather to have the capability to do so within the given time frame.

	otherwise defaults, then the transaction is immediately terminable; and
(h)	Upon any default event, regardless of whether the counterparty is insolvent or bankrupt, the bank has the unfettered, legally enforceable right to immediately seize and liquidate the collateral for its benefit.

171. *Core market participants* may include, at the discretion of the national supervisor, the following entities:

(a)	Sovereigns, central banks and PSEs;
(b)	Banks and securities firms;
(c)	Other financial companies (including insurance companies) eligible for a 20% risk weight in the standardised approach;
(d)	Regulated mutual funds that are subject to capital or leverage requirements;
(e)	Regulated pension funds; and
(f)	Recognised clearing organisations.

172. Where a supervisor applies a specific carve-out to repo-style transactions in securities issued by its domestic government, then other supervisors may choose to allow banks incorporated in their jurisdiction to adopt the same approach to the same transactions.

Treatment of repo-style transactions covered under master netting agreements

173. The effects of bilateral netting agreements covering repo-style transactions will be recognised on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

(a)	provide the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;
(b)	provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;
(c)	allow for the prompt liquidation or setoff of collateral upon the event of default; and
(d)	be, together with the rights arising from the provisions required in (a) to (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of the counterparty's insolvency or bankruptcy.

174. Netting across positions in the banking and trading book will only be recognised when the netted transactions fulfil the following conditions:

(a)	All transactions are marked to market daily;[52] and
(b)	The collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

175. The formula in paragraph 147 will be adapted to calculate the capital requirements for transactions with netting agreements.

176. For banks using the standard supervisory haircuts or own-estimate haircuts, the framework below will apply to take into account the impact of master netting agreements.

$$E^* = \max \{0, [(\sum(E) - \sum(C)) + \sum (Es \times Hs) + \sum (Efx \times Hfx)]\}$$[53]

where:

E* = the exposure value after risk mitigation

E = current value of the exposure

C = the value of the collateral received

Es = absolute value of the net position in a given security

Hs = haircut appropriate to Es

Efx = absolute value of the net position in a currency different from the settlement currency

Hfx = haircut appropriate for currency mismatch

177. The intention here is to obtain a net exposure amount after netting of the exposures and collateral and have an add-on amount reflecting possible price changes for the securities involved in the transactions and for foreign exchange risk if any. The net long or short position of each security included in the netting agreement will be multiplied by the appropriate haircut. All other rules regarding the calculation of haircuts stated in paragraphs 147 to 172 equivalently apply for banks using bilateral netting agreements for repo-style transactions.

Use of models

178. As an alternative to the use of standard or own-estimate haircuts, banks may be permitted to use a VaR models approach to reflect the price volatility of the exposure and collateral for repo-style transactions, taking into account correlation effects between security positions. This approach would apply to repo-style transactions covered by bilateral netting agreements on a counterparty-by-counterparty basis. At the discretion of the national supervisor, firms are also eligible to use the VaR model approach for margin lending transactions, if the transactions are covered under a bilateral master netting agreement that

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52 The holding period for the haircuts will depend as in other repo-style transactions on the frequency of margining.

53 The starting point for this formula is the formula in paragraph 147 which can also be presented as the following: $E^* = \max \{0, [(E - C) + (E \times He) + (C \times Hc) + (C \times Hfx)]\}$.

meets the requirements of paragraphs 173 and 174. The VaR models approach is available to banks that have received supervisory recognition for an internal market risk model according to paragraph 718 (LXX). Banks which have not received supervisory recognition for use of models according to paragraph 718 (LXX) can separately apply for supervisory recognition to use their internal VaR models for calculation of potential price volatility for repo-style transactions. Internal models will only be accepted when a bank can prove the quality of its model to the supervisor through the backtesting of its output using one year of historical data. Banks must meet the model validation requirement of paragraph 43 of Annex 4 to use VaR for repo-style and other SFTs. In addition, other transactions similar to repo-style transactions (like prime brokerage) and that meet the requirements for repo-style transactions, are also eligible to use the VaR models approach provided the model used meets the operational requirements set forth in Section I.F of Annex 4.

179. The quantitative and qualitative criteria for recognition of internal market risk models for repo-style transactions and other similar transactions are in principle the same as in paragraphs 718 (LXXIV) to 718 (LXXVI). With regard to the holding period, the minimum will be 5-business days for repo-style transactions, rather than the 10-business days in paragraph 718 (LXXVI) (c). For other transactions eligible for the VaR models approach, the 10-business day holding period will be retained. The minimum holding period should be adjusted upwards for market instruments where such a holding period would be inappropriate given the liquidity of the instrument concerned.

180. (Deleted)

181. The calculation of the exposure E* for banks using their internal model will be the following:

$$E^* = \max \{0, [(\sum E - \sum C) + \text{VaR output from internal model}]\}$$

In calculating capital requirements banks will use the previous business day's VaR number.

181 (i). Subject to supervisory approval, instead of using the VaR approach, banks may also calculate an expected positive exposure for repo-style and other similar SFTs, in accordance with the Internal Model Method set out in Annex 4 of this Framework.

(iii) The simple approach

Minimum conditions

182. For collateral to be recognised in the simple approach, the collateral must be pledged for at least the life of the exposure and it must be marked to market and revalued with a minimum frequency of six months. Those portions of claims collateralised by the market value of recognised collateral receive the risk weight applicable to the collateral instrument. The risk weight on the collateralised portion will be subject to a floor of 20% except under the conditions specified in paragraphs 183 to 185. The remainder of the claim should be assigned to the risk weight appropriate to the counterparty. A capital requirement will be applied to banks on either side of the collateralised transaction: for example, both repos and reverse repos will be subject to capital requirements.

Exceptions to the risk weight floor

183. Transactions which fulfil the criteria outlined in paragraph 170 and are with a core market participant, as defined in 171, receive a risk weight of 0%. If the counterparty to the transactions is not a core market participant the transaction should receive a risk weight of 10%.

184. OTC derivative transactions subject to daily mark-to-market, collateralised by cash and where there is no currency mismatch should receive a 0% risk weight. Such transactions collateralised by sovereign or PSE securities qualifying for a 0% risk weight in the standardised approach can receive a 10% risk weight.

185. The 20% floor for the risk weight on a collateralised transaction will not be applied and a 0% risk weight can be applied where the exposure and the collateral are denominated in the same currency, and either:

- the collateral is cash on deposit as defined in paragraph 145 (a); or
- the collateral is in the form of sovereign/PSE securities eligible for a 0% risk weight, and its market value has been discounted by 20%.

(iv) Collateralised OTC derivatives transactions

186. Under the Current Exposure Method, the calculation of the counterparty credit risk charge for an individual contract will be as follows:

counterparty charge = [(RC + add-on) – C_A] x r x 8%

where:

RC = the replacement cost,

add-on = the amount for potential future exposure calculated according to paragraph 92(i) and 92(ii) of Annex 4,

C_A = the volatility adjusted collateral amount under the comprehensive approach prescribed in paragraphs 147 to 172, or zero if no eligible collateral is applied to the transaction, and

r = the risk weight of the counterparty.

187. When effective bilateral netting contracts are in place, RC will be the net replacement cost and the add-on will be A_{Net} as calculated according to paragraphs 96(i) to 96(vi) of Annex 4. The haircut for currency risk (Hfx) should be applied when there is a mismatch between the collateral currency and the settlement currency. Even in the case where there are more than two currencies involved in the exposure, collateral and settlement currency, a single haircut assuming a 10-business day holding period scaled up as necessary depending on the frequency of mark-to-market will be applied.

187(i). As an alternative to the Current Exposure Method for the calculation of the counterparty credit risk charge, banks may also use the Standardised Method and, subject to supervisory approval, the Internal Model Method as set out in Annex 4 of this Framework.

4. On-balance sheet netting

188. Where a bank,

(a) has a well-founded legal basis for concluding that the netting or offsetting agreement is enforceable in each relevant jurisdiction regardless of whether the counterparty is insolvent or bankrupt;

(b) is able at any time to determine those assets and liabilities with the same counterparty that are subject to the netting agreement;

(c) monitors and controls its roll-off risks; and

(d) monitors and controls the relevant exposures on a net basis,

it may use the net exposure of loans and deposits as the basis for its capital adequacy calculation in accordance with the formula in paragraph 147. Assets (loans) are treated as exposure and liabilities (deposits) as collateral. The haircuts will be zero except when a currency mismatch exists. A 10-business day holding period will apply when daily mark-to-market is conducted and all the requirements contained in paragraphs 151, 169, and 202 to 205 will apply.

5. Guarantees and credit derivatives

(i) Operational requirements

Operational requirements common to guarantees and credit derivatives

189. A guarantee (counter-guarantee) or credit derivative must represent a direct claim on the protection provider and must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible. Other than non-payment by a protection purchaser of money due in respect of the credit protection contract it must be irrevocable; there must be no clause in the contract that would allow the protection provider unilaterally to cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure.[54] It must also be unconditional; there should be no clause in the protection contract outside the direct control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due.

Additional operational requirements for guarantees

190. In addition to the legal certainty requirements in paragraphs 117 and 118 above, in order for a guarantee to be recognised, the following conditions must be satisfied:

(a)	On the qualifying default/non-payment of the counterparty, the bank may in a timely manner pursue the guarantor for any monies outstanding under the documentation governing the transaction. The guarantor may make one lump sum payment of all monies under such documentation to the bank, or the guarantor may assume the future payment obligations of the counterparty covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal actions in order to pursue the counterparty for payment.
(b)	The guarantee is an explicitly documented obligation assumed by the guarantor.
(c)	Except as noted in the following sentence, the guarantee covers all types of payments the underlying obligor is expected to make under the documentation governing the transaction, for example notional amount, margin payments etc. Where a guarantee covers payment of principal only, interests and other uncovered payments should be treated as an unsecured amount in accordance with paragraph 198.

[54] Note that the irrevocability condition does not require that the credit protection and the exposure be maturity matched; rather that the maturity agreed *ex ante* may not be reduced *ex post* by the protection provider. Paragraph 203 sets forth the treatment of call options in determining remaining maturity for credit protection.

Additional operational requirements for credit derivatives

191. In order for a credit derivative contract to be recognised, the following conditions must be satisfied:

(a)	The credit events specified by the contracting parties must at a minimum cover:
•	failure to pay the amounts due under terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with the grace period in the underlying obligation);
•	bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events; and
•	restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event (i.e. charge-off, specific provision or other similar debit to the profit and loss account). When restructuring is not specified as a credit event, refer to paragraph 192.
(b)	If the credit derivative covers obligations that do not include the underlying obligation, section (g) below governs whether the asset mismatch is permissible.
(c)	The credit derivative shall not terminate prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay, subject to the provisions of paragraph 203.
(d)	Credit derivatives allowing for cash settlement are recognised for capital purposes insofar as a robust valuation process is in place in order to estimate loss reliably. There must be a clearly specified period for obtaining post-credit-event valuations of the underlying obligation. If the reference obligation specified in the credit derivative for purposes of cash settlement is different than the underlying obligation, section (g) below governs whether the asset mismatch is permissible.
(e)	If the protection purchaser's right/ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation must provide that any required consent to such transfer may not be unreasonably withheld.
(f)	The identity of the parties responsible for determining whether a credit event has occurred must be clearly defined. This determination must not be the sole responsibility of the protection seller. The protection buyer must have the right/ability to inform the protection provider of the occurrence of a credit event.
(g)	A mismatch between the underlying obligation and the reference obligation under the credit derivative (i.e. the obligation used for purposes of determining cash settlement value or the deliverable obligation) is permissible if (1) the reference obligation ranks pari passu with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.
(h)	A mismatch between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible if (1) the latter obligation ranks pari passu with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.

192. When the restructuring of the underlying obligation is not covered by the credit derivative, but the other requirements in paragraph 191 are met, partial recognition of the credit derivative will be allowed. If the amount of the credit derivative is less than or equal to the amount of the underlying obligation, 60% of the amount of the hedge can be recognised as covered. If the amount of the credit derivative is larger than that of the underlying obligation, then the amount of eligible hedge is capped at 60% of the amount of the underlying obligation.[55]

193. Only credit default swaps and total return swaps that provide credit protection equivalent to guarantees will be eligible for recognition. The following exception applies. Where a bank buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record offsetting deterioration in the value of the asset that is protected (either through reductions in fair value or by an addition to reserves), the credit protection will not be recognised. The treatment of first-to-default and second-to-default products is covered separately in paragraphs 207 to 210.

194. Other types of credit derivatives will not be eligible for recognition at this time.[56]

(ii) Range of eligible guarantors (counter-guarantors)/protection providers

195. Credit protection given by the following entities will be recognised:

- sovereign entities,[57] PSEs, banks[58] and securities firms with a lower risk weight than the counterparty;
- other entities rated A- or better. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

(iii) Risk weights

196. The protected portion is assigned the risk weight of the protection provider. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty.

197. Materiality thresholds on payments below which no payment is made in the event of loss are equivalent to retained first loss positions and must be deducted in full from the capital of the bank purchasing the credit protection.

Proportional cover

198. Where the amount guaranteed, or against which credit protection is held, is less than the amount of the exposure, and the secured and unsecured portions are of equal seniority, i.e. the bank and the guarantor share losses on a pro-rata basis capital relief will be afforded on a proportional basis: i.e. the protected portion of the exposure will receive the

[55] The 60% recognition factor is provided as an interim treatment, which the Committee intends to refine prior to implementation after considering additional data.

[56] Cash funded credit linked notes issued by the bank against exposures in the banking book which fulfil the criteria for credit derivatives will be treated as cash collateralised transactions.

[57] This includes the Bank for International Settlements, the International Monetary Fund, the European Central Bank and the European Community, as well as those MDBs referred to in footnote 24.

[58] This includes other MDBs.

treatment applicable to eligible guarantees/credit derivatives, with the remainder treated as unsecured.

Tranched cover

199. Where the bank transfers a portion of the risk of an exposure in one or more tranches to a protection seller or sellers and retains some level of risk of the loan and the risk transferred and the risk retained are of different seniority, banks may obtain credit protection for either the senior tranches (e.g. second loss portion) or the junior tranche (e.g. first loss portion). In this case the rules as set out in Section IV (Credit risk – securitisation framework) will apply.

(iv) Currency mismatches

200. Where the credit protection is denominated in a currency different from that in which the exposure is denominated — i.e. there is a currency mismatch — the amount of the exposure deemed to be protected will be reduced by the application of a haircut H_{FX}, i.e.

$$G_A = G \times (1 - H_{FX})$$

where:

G = nominal amount of the credit protection

H_{FX} = haircut appropriate for currency mismatch between the credit protection and underlying obligation.

The appropriate haircut based on a 10-business day holding period (assuming daily marking-to-market) will be applied. If a bank uses the supervisory haircuts it will be 8%. The haircuts must be scaled up using the square root of time formula, depending on the frequency of revaluation of the credit protection as described in paragraph 168.

(v) Sovereign guarantees and counter-guarantees

201. As specified in paragraph 54, a lower risk weight may be applied at national discretion to a bank's exposures to the sovereign (or central bank) where the bank is incorporated and where the exposure is denominated in domestic currency and funded in that currency. National authorities may extend this treatment to portions of claims guaranteed by the sovereign (or central bank), where the guarantee is denominated in the domestic currency and the exposure is funded in that currency. A claim may be covered by a guarantee that is indirectly counter-guaranteed by a sovereign. Such a claim may be treated as covered by a sovereign guarantee provided that:

(a)	the sovereign counter-guarantee covers all credit risk elements of the claim;
(b)	both the original guarantee and the counter-guarantee meet all operational requirements for guarantees, except that the counter-guarantee need not be direct and explicit to the original claim; and
(c)	the supervisor is satisfied that the cover is robust and that no historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct sovereign guarantee.

6. Maturity mismatches

202. For the purposes of calculating risk-weighted assets, a maturity mismatch occurs when the residual maturity of a hedge is less than that of the underlying exposure.

(i) Definition of maturity

203. The maturity of the underlying exposure and the maturity of the hedge should both be defined conservatively. The effective maturity of the underlying should be gauged as the longest possible remaining time before the counterparty is scheduled to fulfil its obligation, taking into account any applicable grace period. For the hedge, embedded options which may reduce the term of the hedge should be taken into account so that the shortest possible effective maturity is used. Where a call is at the discretion of the protection seller, the maturity will always be at the first call date. If the call is at the discretion of the protection buying bank but the terms of the arrangement at origination of the hedge contain a positive incentive for the bank to call the transaction before contractual maturity, the remaining time to the first call date will be deemed to be the effective maturity. For example, where there is a step-up in cost in conjunction with a call feature or where the effective cost of cover increases over time even if credit quality remains the same or increases, the effective maturity will be the remaining time to the first call.

(ii) Risk weights for maturity mismatches

204. As outlined in paragraph 143, hedges with maturity mismatches are only recognised when their original maturities are greater than or equal to one year. As a result, the maturity of hedges for exposures with original maturities of less than one year must be matched to be recognised. In all cases, hedges with maturity mismatches will no longer be recognised when they have a residual maturity of three months or less.

205. When there is a maturity mismatch with recognised credit risk mitigants (collateral, on-balance sheet netting, guarantees and credit derivatives) the following adjustment will be applied.

$$Pa = P \times (t - 0.25) / (T - 0.25)$$

where:

Pa = value of the credit protection adjusted for maturity mismatch

P = credit protection (e.g. collateral amount, guarantee amount) adjusted for any haircuts

t = min (T, residual maturity of the credit protection arrangement) expressed in years

T = min (5, residual maturity of the exposure) expressed in years

7. Other items related to the treatment of CRM techniques

(i) Treatment of pools of CRM techniques

206. In the case where a bank has multiple CRM techniques covering a single exposure (e.g. a bank has both collateral and guarantee partially covering an exposure), the bank will be required to subdivide the exposure into portions covered by each type of CRM technique (e.g. portion covered by collateral, portion covered by guarantee) and the risk-weighted assets of each portion must be calculated separately. When credit protection provided by a

single protection provider has differing maturities, they must be subdivided into separate protection as well.

(ii) First-to-default credit derivatives

207. There are cases where a bank obtains credit protection for a basket of reference names and where the first default among the reference names triggers the credit protection and the credit event also terminates the contract. In this case, the bank may recognise regulatory capital relief for the asset within the basket with the lowest risk-weighted amount, but only if the notional amount is less than or equal to the notional amount of the credit derivative.

208. With regard to the bank providing credit protection through such an instrument, if the product has an external credit assessment from an eligible credit assessment institution, the risk weight in paragraph 567 applied to securitisation tranches will be applied. If the product is not rated by an eligible external credit assessment institution, the risk weights of the assets included in the basket will be aggregated up to a maximum of 1250% and multiplied by the nominal amount of the protection provided by the credit derivative to obtain the risk-weighted asset amount.

(iii) Second-to-default credit derivatives

209. In the case where the second default among the assets within the basket triggers the credit protection, the bank obtaining credit protection through such a product will only be able to recognise any capital relief if first-default-protection has also be obtained or when one of the assets within the basket has already defaulted.

210. For banks providing credit protection through such a product, the capital treatment is the same as in paragraph 208 above with one exception. The exception is that, in aggregating the risk weights, the asset with the lowest risk weighted amount can be excluded from the calculation.

III. Credit Risk – The Internal Ratings-Based Approach

A. Overview

211. This section of the Framework describes the IRB approach to credit risk. Subject to certain minimum conditions and disclosure requirements, banks that have received supervisory approval to use the IRB approach may rely on their own internal estimates of risk components in determining the capital requirement for a given exposure. The risk components include measures of the probability of default (PD), loss given default (LGD), the exposure at default (EAD), and effective maturity (M). In some cases, banks may be required to use a supervisory value as opposed to an internal estimate for one or more of the risk components.

212. The IRB approach is based on measures of unexpected losses (UL) and expected losses (EL). The risk-weight functions produce capital requirements for the UL portion. Expected losses are treated separately, as outlined in paragraph 43 and Section III.G.

213. In this section, the asset classes are defined first. Adoption of the IRB approach across all asset classes is also discussed early in this section, as are transitional arrangements. The risk components, each of which is defined later in this section, serve as inputs to the risk-weight functions that have been developed for separate asset classes. For example, there is a risk-weight function for corporate exposures and another one for qualifying revolving retail exposures. The treatment of each asset class begins with a presentation of the relevant risk-weight function(s) followed by the risk components and other relevant factors, such as the treatment of credit risk mitigants. The legal certainty standards for recognising CRM as set out in Section II.D apply for both the foundation and advanced IRB approaches. The minimum requirements that banks must satisfy to use the IRB approach are presented at the end of this section starting at Section III.H, paragraph 387.

B. Mechanics of the IRB approach

214. In Section III.B.1, the risk components (e.g. PD and LGD) and asset classes (e.g. corporate exposures and retail exposures) of the IRB approach are defined. Section 2 provides a description of the risk components to be used by banks by asset class. Sections 3 and 4 discuss a bank's adoption of the IRB approach and transitional arrangements, respectively. In cases where an IRB treatment is not specified, the risk weight for those other exposures is 100%, except when a 0% risk weight applies under the standardised approach, and the resulting risk-weighted assets are assumed to represent UL only.

1. Categorisation of exposures

215. Under the IRB approach, banks must categorise banking-book exposures into broad classes of assets with different underlying risk characteristics, subject to the definitions set out below. The classes of assets are (a) corporate, (b) sovereign, (c) bank, (d) retail, and (e) equity. Within the corporate asset class, five sub-classes of specialised lending are separately identified. Within the retail asset class, three sub-classes are separately identified. Within the corporate and retail asset classes, a distinct treatment for purchased receivables may also apply provided certain conditions are met.

216. The classification of exposures in this way is broadly consistent with established bank practice. However, some banks may use different definitions in their internal risk management and measurement systems. While it is not the intention of the Committee to require banks to change the way in which they manage their business and risks, banks are required to apply the appropriate treatment to each exposure for the purposes of deriving

their minimum capital requirement. Banks must demonstrate to supervisors that their methodology for assigning exposures to different classes is appropriate and consistent over time.

217. For a discussion of the IRB treatment of securitisation exposures, see Section IV.

(i) Definition of corporate exposures

218. In general, a corporate exposure is defined as a debt obligation of a corporation, partnership, or proprietorship. Banks are permitted to distinguish separately exposures to small- and medium-sized entities (SME), as defined in paragraph 273.

219. Within the corporate asset class, five sub-classes of specialised lending (SL) are identified. Such lending possesses all the following characteristics, either in legal form or economic substance:

- The exposure is typically to an entity (often a special purpose entity (SPE)) which was created specifically to finance and/or operate physical assets;
- The borrowing entity has little or no other material assets or activities, and therefore little or no independent capacity to repay the obligation, apart from the income that it receives from the asset(s) being financed;
- The terms of the obligation give the lender a substantial degree of control over the asset(s) and the income that it generates; and
- As a result of the preceding factors, the primary source of repayment of the obligation is the income generated by the asset(s), rather than the independent capacity of a broader commercial enterprise.

220. The five sub-classes of specialised lending are project finance, object finance, commodities finance, income-producing real estate, and high-volatility commercial real estate. Each of these sub-classes is defined below.

Project finance

221. Project finance (PF) is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements.

222. In such transactions, the lender is usually paid solely or almost exclusively out of the money generated by the contracts for the facility's output, such as the electricity sold by a power plant. The borrower is usually an SPE that is not permitted to perform any function other than developing, owning, and operating the installation. The consequence is that repayment depends primarily on the project's cash flow and on the collateral value of the project's assets. In contrast, if repayment of the exposure depends primarily on a well established, diversified, credit-worthy, contractually obligated end user for repayment, it is considered a secured exposure to that end-user.

Object finance

223. Object finance (OF) refers to a method of funding the acquisition of physical assets (e.g. ships, aircraft, satellites, railcars, and fleets) where the repayment of the exposure is

dependent on the cash flows generated by the specific assets that have been financed and pledged or assigned to the lender. A primary source of these cash flows might be rental or lease contracts with one or several third parties. In contrast, if the exposure is to a borrower whose financial condition and debt-servicing capacity enables it to repay the debt without undue reliance on the specifically pledged assets, the exposure should be treated as a collateralised corporate exposure.

Commodities finance

224. Commodities finance (CF) refers to structured short-term lending to finance reserves, inventories, or receivables of exchange-traded commodities (e.g. crude oil, metals, or crops), where the exposure will be repaid from the proceeds of the sale of the commodity and the borrower has no independent capacity to repay the exposure. This is the case when the borrower has no other activities and no other material assets on its balance sheet. The structured nature of the financing is designed to compensate for the weak credit quality of the borrower. The exposure's rating reflects its self-liquidating nature and the lender's skill in structuring the transaction rather than the credit quality of the borrower.

225. The Committee believes that such lending can be distinguished from exposures financing the reserves, inventories, or receivables of other more diversified corporate borrowers. Banks are able to rate the credit quality of the latter type of borrowers based on their broader ongoing operations. In such cases, the value of the commodity serves as a risk mitigant rather than as the primary source of repayment.

Income-producing real estate

226. Income-producing real estate (IPRE) refers to a method of providing funding to real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, and hotels) where the prospects for repayment and recovery on the exposure depend primarily on the cash flows generated by the asset. The primary source of these cash flows would generally be lease or rental payments or the sale of the asset. The borrower may be, but is not required to be, an SPE, an operating company focused on real estate construction or holdings, or an operating company with sources of revenue other than real estate. The distinguishing characteristic of IPRE versus other corporate exposures that are collateralised by real estate is the strong positive correlation between the prospects for repayment of the exposure and the prospects for recovery in the event of default, with both depending primarily on the cash flows generated by a property.

High-volatility commercial real estate

227. High-volatility commercial real estate (HVCRE) lending is the financing of commercial real estate that exhibits higher loss rate volatility (i.e. higher asset correlation) compared to other types of SL. HVCRE includes:

- Commercial real estate exposures secured by properties of types that are categorised by the national supervisor as sharing higher volatilities in portfolio default rates;
- Loans financing any of the land acquisition, development and construction (ADC) phases for properties of those types in such jurisdictions; and
- Loans financing ADC of any other properties where the source of repayment at origination of the exposure is either the future uncertain sale of the property or cash flows whose source of repayment is substantially uncertain (e.g. the property has not yet been leased to the occupancy rate prevailing in that geographic market for that type of commercial real estate), unless the borrower has substantial equity at

risk. Commercial ADC loans exempted from treatment as HVCRE loans on the basis of certainty of repayment of borrower equity are, however, ineligible for the additional reductions for SL exposures described in paragraph 277.

228. Where supervisors categorise certain types of commercial real estate exposures as HVCRE in their jurisdictions, they are required to make public such determinations. Other supervisors need to ensure that such treatment is then applied equally to banks under their supervision when making such HVCRE loans in that jurisdiction.

(ii) Definition of sovereign exposures

229. This asset class covers all exposures to counterparties treated as sovereigns under the standardised approach. This includes sovereigns (and their central banks), certain PSEs identified as sovereigns in the standardised approach, MDBs that meet the criteria for a 0% risk weight under the standardised approach, and the entities referred to in paragraph 56.

(iii) Definition of bank exposures

230. This asset class covers exposures to banks and those securities firms outlined in paragraph 65. Bank exposures also include claims on domestic PSEs that are treated like claims on banks under the standardised approach, and MDBs that do not meet the criteria for a 0% risk weight under the standardised approach.

(iv) Definition of retail exposures

231. An exposure is categorised as a retail exposure if it meets all of the following criteria:

Nature of borrower or low value of individual exposures

- Exposures to individuals — such as revolving credits and lines of credit (e.g. credit cards, overdrafts, and retail facilities secured by financial instruments) as well as personal term loans and leases (e.g. instalment loans, auto loans and leases, student and educational loans, personal finance, and other exposures with similar characteristics) — are generally eligible for retail treatment regardless of exposure size, although supervisors may wish to establish exposure thresholds to distinguish between retail and corporate exposures.
- Residential mortgage loans (including first and subsequent liens, term loans and revolving home equity lines of credit) are eligible for retail treatment regardless of exposure size so long as the credit is extended to an individual that is an owner-occupier of the property (with the understanding that supervisors exercise reasonable flexibility regarding buildings containing only a few rental units — otherwise they are treated as corporate). Loans secured by a single or small number of condominium or co-operative residential housing units in a single building or complex also fall within the scope of the residential mortgage category. National supervisors may set limits on the maximum number of housing units per exposure.
- Loans extended to small businesses and managed as retail exposures are eligible for retail treatment provided the total exposure of the banking group to a small business borrower (on a consolidated basis where applicable) is less than €1 million. Small business loans extended through or guaranteed by an individual are subject to the same exposure threshold.
- It is expected that supervisors provide flexibility in the practical application of such thresholds such that banks are not forced to develop extensive new information systems simply for the purpose of ensuring perfect compliance. It is, however,

important for supervisors to ensure that such flexibility (and the implied acceptance of exposure amounts in excess of the thresholds that are not treated as violations) is not being abused.

Large number of exposures

232. The exposure must be one of a large pool of exposures, which are managed by the bank on a pooled basis. Supervisors may choose to set a minimum number of exposures within a pool for exposures in that pool to be treated as retail.

- Small business exposures below €1 million may be treated as retail exposures if the bank treats such exposures in its internal risk management systems consistently over time and in the same manner as other retail exposures. This requires that such an exposure be originated in a similar manner to other retail exposures. Furthermore, it must not be managed individually in a way comparable to corporate exposures, but rather as part of a portfolio segment or pool of exposures with similar risk characteristics for purposes of risk assessment and quantification. However, this does not preclude retail exposures from being treated individually at some stages of the risk management process. The fact that an exposure is rated individually does not by itself deny the eligibility as a retail exposure.

233. Within the retail asset class category, banks are required to identify separately three sub-classes of exposures: (a) exposures secured by residential properties as defined above, (b) qualifying revolving retail exposures, as defined in the following paragraph, and (c) all other retail exposures.

(v) Definition of qualifying revolving retail exposures

234. All of the following criteria must be satisfied for a sub-portfolio to be treated as a qualifying revolving retail exposure (QRRE). These criteria must be applied at a sub-portfolio level consistent with the bank's segmentation of its retail activities generally. Segmentation at the national or country level (or below) should be the general rule.

(a) The exposures are revolving, unsecured, and uncommitted (both contractually and in practice). In this context, revolving exposures are defined as those where customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the bank.

(b) The exposures are to individuals.

(c) The maximum exposure to a single individual in the sub-portfolio is €100,000 or less.

(d) Because the asset correlation assumptions for the QRRE risk-weight function are markedly below those for the other retail risk-weight function at low PD values, banks must demonstrate that the use of the QRRE risk-weight function is constrained to portfolios that have exhibited low volatility of loss rates, relative to their average level of loss rates, especially within the low PD bands. Supervisors will review the relative volatility of loss rates across the QRRE subportfolios, as well as the aggregate QRRE portfolio, and intend to share information on the typical characteristics of QRRE loss rates across jurisdictions.

(e) Data on loss rates for the sub-portfolio must be retained in order to allow analysis of the volatility of loss rates.

(f) The supervisor must concur that treatment as a qualifying revolving retail exposure is consistent with the underlying risk characteristics of the sub-portfolio.

(vi) Definition of equity exposures

235. In general, equity exposures are defined on the basis of the economic substance of the instrument. They include both direct and indirect ownership interests,[59] whether voting or non-voting, in the assets and income of a commercial enterprise or of a financial institution that is not consolidated or deducted pursuant to Part 1 of this Framework.[60] An instrument is considered to be an equity exposure if it meets all of the following requirements:

- It is irredeemable in the sense that the return of invested funds can be achieved only by the sale of the investment or sale of the rights to the investment or by the liquidation of the issuer;
- It does not embody an obligation on the part of the issuer; and
- It conveys a residual claim on the assets or income of the issuer.

236. Additionally any of the following instruments must be categorised as an equity exposure:

- An instrument with the same structure as those permitted as Tier 1 capital for banking organisations.
- An instrument that embodies an obligation on the part of the issuer and meets any of the following conditions:
  (1) The issuer may defer indefinitely the settlement of the obligation;
  (2) The obligation requires (or permits at the issuer's discretion) settlement by issuance of a fixed number of the issuer's equity shares;
  (3) The obligation requires (or permits at the issuer's discretion) settlement by issuance of a variable number of the issuer's equity shares and (ceteris paribus) any change in the value of the obligation is attributable to, comparable to, and in the same direction as, the change in the value of a fixed number of the issuer's equity shares;[61] or,
  (4) The holder has the option to require that the obligation be settled in equity shares, unless either (i) in the case of a traded instrument, the supervisor is content that the bank has demonstrated that the instrument trades more like the debt of the issuer than like its equity, or (ii) in the case of non-traded instruments, the supervisor is content that the bank has demonstrated that the instrument should be treated as a debt position. In

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[59] Indirect equity interests include holdings of derivative instruments tied to equity interests, and holdings in corporations, partnerships, limited liability companies or other types of enterprises that issue ownership interests and are engaged principally in the business of investing in equity instruments.

[60] Where some member countries retain their existing treatment as an exception to the deduction approach, such equity investments by IRB banks are to be considered eligible for inclusion in their IRB equity portfolios.

[61] For certain obligations that require or permit settlement by issuance of a variable number of the issuer's equity shares, the change in the monetary value of the obligation is equal to the change in the fair value of a fixed number of equity shares multiplied by a specified factor. Those obligations meet the conditions of item 3 if both the factor and the referenced number of shares are fixed. For example, an issuer may be required to settle an obligation by issuing shares with a value equal to three times the appreciation in the fair value of 1,000 equity shares. That obligation is considered to be the same as an obligation that requires settlement by issuance of shares equal to the appreciation in the fair value of 3,000 equity shares.

cases (i) and (ii), the bank may decompose the risks for regulatory purposes, with the consent of the supervisor.

237. Debt obligations and other securities, partnerships, derivatives or other vehicles structured with the intent of conveying the economic substance of equity ownership are considered an equity holding.[62] This includes liabilities from which the return is linked to that of equities.[63] Conversely, equity investments that are structured with the intent of conveying the economic substance of debt holdings or securitisation exposures would not be considered an equity holding.

238. The national supervisor has the discretion to re-characterise debt holdings as equities for regulatory purposes and to otherwise ensure the proper treatment of holdings under Pillar 2.

(vii) Definition of eligible purchased receivables

239. Eligible purchased receivables are divided into retail and corporate receivables as defined below.

Retail receivables

240. Purchased retail receivables, provided the purchasing bank complies with the IRB rules for retail exposures, are eligible for the top-down approach as permitted within the existing standards for retail exposures. The bank must also apply the minimum operational requirements as set forth in Sections III.F and III.H.

Corporate receivables

241. In general, for purchased corporate receivables, banks are expected to assess the default risk of individual obligors as specified in Section III.C.1 (starting with paragraph 271) consistent with the treatment of other corporate exposures. However, the top-down approach may be used, provided that the purchasing bank's programme for corporate receivables complies with both the criteria for eligible receivables and the minimum operational requirements of this approach. The use of the top-down purchased receivables treatment is limited to situations where it would be an undue burden on a bank to be subjected to the minimum requirements for the IRB approach to corporate exposures that would otherwise apply. Primarily, it is intended for receivables that are purchased for inclusion in asset-backed securitisation structures, but banks may also use this approach, with the approval of national supervisors, for appropriate on-balance sheet exposures that share the same features.

242. Supervisors may deny the use of the top-down approach for purchased corporate receivables depending on the bank's compliance with minimum requirements. In particular, to be eligible for the proposed 'top-down' treatment, purchased corporate receivables must satisfy the following conditions:

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[62] Equities that are recorded as a loan but arise from a debt/equity swap made as part of the orderly realisation or restructuring of the debt are included in the definition of equity holdings. However, these instruments may not attract a lower capital charge than would apply if the holdings remained in the debt portfolio.

[63] Supervisors may decide not to require that such liabilities be included where they are directly hedged by an equity holding, such that the net position does not involve material risk.

- The receivables are purchased from unrelated, third party sellers, and as such the bank has not originated the receivables either directly or indirectly.
- The receivables must be generated on an arm's-length basis between the seller and the obligor. (As such, intercompany accounts receivable and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible.[64])
- The purchasing bank has a claim on all proceeds from the pool of receivables or a *pro-rata* interest in the proceeds.[65]
- National supervisors must also establish concentration limits above which capital charges must be calculated using the minimum requirements for the bottom-up approach for corporate exposures. Such concentration limits may refer to one or a combination of the following measures: the size of one individual exposure relative to the total pool, the size of the pool of receivables as a percentage of regulatory capital, or the maximum size of an individual exposure in the pool.

243. The existence of full or partial recourse to the seller does not automatically disqualify a bank from adopting this top-down approach, as long as the cash flows from the purchased corporate receivables are the primary protection against default risk as determined by the rules in paragraphs 365 to 368 for purchased receivables and the bank meets the eligibility criteria and operational requirements.

2. Foundation and advanced approaches

244. For each of the asset classes covered under the IRB framework, there are three key elements:

- Risk components ─ estimates of risk parameters provided by banks some of which are supervisory estimates.
- Risk-weight functions ─ the means by which risk components are transformed into risk-weighted assets and therefore capital requirements.
- Minimum requirements ─ the minimum standards that must be met in order for a bank to use the IRB approach for a given asset class.

245. For many of the asset classes, the Committee has made available two broad approaches: a foundation and an advanced. Under the foundation approach, as a general rule, banks provide their own estimates of PD and rely on supervisory estimates for other risk components. Under the advanced approach, banks provide more of their own estimates of PD, LGD and EAD, and their own calculation of M, subject to meeting minimum standards. For both the foundation and advanced approaches, banks must always use the risk-weight functions provided in this Framework for the purpose of deriving capital requirements. The full suite of approaches is described below.

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[64] Contra-accounts involve a customer buying from and selling to the same firm. The risk is that debts may be settled through payments in kind rather than cash. Invoices between the companies may be offset against each other instead of being paid. This practice can defeat a security interest when challenged in court.

[65] Claims on tranches of the proceeds (first loss position, second loss position, etc.) would fall under the securitisation treatment.

(i) Corporate, sovereign, and bank exposures

246. Under the foundation approach, banks must provide their own estimates of PD associated with each of their borrower grades, but must use supervisory estimates for the other relevant risk components. The other risk components are LGD, EAD and M.[66]

247. Under the advanced approach, banks must calculate the effective maturity (M)[67] and provide their own estimates of PD, LGD and EAD.

248. There is an exception to this general rule for the five sub-classes of assets identified as SL.

The SL categories: PF, OF, CF, IPRE, and HVCRE

249. Banks that do not meet the requirements for the estimation of PD under the corporate foundation approach for their SL assets are required to map their internal risk grades to five supervisory categories, each of which is associated with a specific risk weight. This version is termed the 'supervisory slotting criteria approach'.

250. Banks that meet the requirements for the estimation of PD are able to use the foundation approach to corporate exposures to derive risk weights for all classes of SL exposures except HVCRE. At national discretion, banks meeting the requirements for HVCRE exposure are able to use a foundation approach that is similar in all respects to the corporate approach, with the exception of a separate risk-weight function as described in paragraph 283.

251. Banks that meet the requirements for the estimation of PD, LGD and EAD are able to use the advanced approach to corporate exposures to derive risk weights for all classes of SL exposures except HVCRE. At national discretion, banks meeting these requirements for HVCRE exposure are able to use an advanced approach that is similar in all respects to the corporate approach, with the exception of a separate risk-weight function as described in paragraph 283.

(ii) Retail exposures

252. For retail exposures, banks must provide their own estimates of PD, LGD and EAD. There is no distinction between a foundation and advanced approach for this asset class.

(iii) Equity exposures

253. There are two broad approaches to calculate risk-weighted assets for equity exposures not held in the trading book: a market-based approach and a PD/LGD approach. These are set out in full in paragraphs 340 to 361.

254. The PD/LGD approach to equity exposures remains available for banks that adopt the advanced approach for other exposure types.

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66 As noted in paragraph 318, some supervisors may require banks using the foundation approach to calculate M using the definition provided in paragraphs 320 to 324.

67 At the discretion of the national supervisor, certain domestic exposures may be exempt from the calculation of M (see paragraph 319).

(iv) Eligible purchased receivables

255. The treatment potentially straddles two asset classes. For eligible corporate receivables, both a foundation and advanced approach are available subject to certain operational requirements being met. For eligible retail receivables, as with the retail asset class, there is no distinction between a foundation and advanced approach.

3. Adoption of the IRB approach across asset classes

256. Once a bank adopts an IRB approach for part of its holdings, it is expected to extend it across the entire banking group. The Committee recognises however, that, for many banks, it may not be practicable for various reasons to implement the IRB approach across all material asset classes and business units at the same time. Furthermore, once on IRB, data limitations may mean that banks can meet the standards for the use of own estimates of LGD and EAD for some but not all of their asset classes/business units at the same time.

257. As such, supervisors may allow banks to adopt a phased rollout of the IRB approach across the banking group. The phased rollout includes (i) adoption of IRB across asset classes within the same business unit (or in the case of retail exposures across individual sub-classes); (ii) adoption of IRB across business units in the same banking group; and (iii) move from the foundation approach to the advanced approach for certain risk components. However, when a bank adopts an IRB approach for an asset class within a particular business unit (or in the case of retail exposures for an individual sub-class), it must apply the IRB approach to all exposures within that asset class (or sub-class) in that unit.

258. A bank must produce an implementation plan, specifying to what extent and when it intends to roll out IRB approaches across significant asset classes (or sub-classes in the case of retail) and business units over time. The plan should be exacting, yet realistic, and must be agreed with the supervisor. It should be driven by the practicality and feasibility of moving to the more advanced approaches, and not motivated by a desire to adopt a Pillar 1 approach that minimises its capital charge. During the roll-out period, supervisors will ensure that no capital relief is granted for intra-group transactions which are designed to reduce a banking group's aggregate capital charge by transferring credit risk among entities on the standardised approach, foundation and advanced IRB approaches. This includes, but is not limited to, asset sales or cross guarantees.

259. Some exposures in non-significant business units as well as asset classes (or sub-classes in the case of retail) that are immaterial in terms of size and perceived risk profile may be exempt from the requirements in the previous two paragraphs, subject to supervisory approval. Capital requirements for such operations will be determined according to the standardised approach, with the national supervisor determining whether a bank should hold more capital under Pillar 2 for such positions.

260. Notwithstanding the above, once a bank has adopted the IRB approach for all or part of any of the corporate, bank, sovereign, or retail asset classes, it will be required to adopt the IRB approach for its equity exposures at the same time, subject to materiality. Supervisors may require a bank to employ one of the IRB equity approaches if its equity exposures are a significant part of the bank's business, even though the bank may not employ an IRB approach in other business lines. Further, once a bank has adopted the general IRB approach for corporate exposures, it will be required to adopt the IRB approach for the SL sub-classes within the corporate exposure class.

261. Banks adopting an IRB approach are expected to continue to employ an IRB approach. A voluntary return to the standardised or foundation approach is permitted only in

extraordinary circumstances, such as divestiture of a large fraction of the bank's credit-related business, and must be approved by the supervisor.

262. Given the data limitations associated with SL exposures, a bank may remain on the supervisory slotting criteria approach for one or more of the PF, OF, CF, IPRE or HVCRE sub-classes, and move to the foundation or advanced approach for other sub-classes within the corporate asset class. However, a bank should not move to the advanced approach for the HVCRE sub-class without also doing so for material IPRE exposures at the same time.

4. Transition arrangements

(i) Parallel calculation

263. Banks adopting the foundation or advanced approaches are required to calculate their capital requirement using these approaches, as well as the 1988 Accord for the time period specified in paragraphs 45 to 49. Parallel calculation for banks adopting the foundation IRB approach to credit risk will start in the year beginning year-end 2005. Banks moving directly from the 1988 Accord to the advanced approaches to credit and/or operational risk will be subject to parallel calculations or impact studies for the year beginning year-end 2005 and to parallel calculations for the year beginning year-end 2006.

(ii) Corporate, sovereign, bank, and retail exposures

264. The transition period starts on the date of implementation of this Framework and will last for 3 years from that date. During the transition period, the following minimum requirements can be relaxed, subject to discretion of the national supervisor:

- For corporate, sovereign, and bank exposures under the foundation approach, paragraph 463, the requirement that, regardless of the data source, banks must use at least five years of data to estimate the PD; and
- For retail exposures, paragraph 466, the requirement that regardless of the data source banks must use at least five years of data to estimate loss characteristics (EAD, and either expected loss (EL) or PD and LGD).
- For corporate, sovereign, bank, and retail exposures, paragraph 445, the requirement that a bank must demonstrate it has been using a rating system that was broadly in line with the minimum requirements articulated in this document for at least three years prior to qualification.
- The applicable aforementioned transitional arrangements also apply to the PD/LGD approach to equity. There are no transitional arrangements for the market-based approach to equity.

265. Under these transitional arrangements banks are required to have a minimum of two years of data at the implementation of this Framework. This requirement will increase by one year for each of three years of transition.

266. Owing to the potential for very long-run cycles in house prices which short-term data may not adequately capture, during this transition period, LGDs for retail exposures secured by residential properties cannot be set below 10% for any sub-segment of exposures to

which the formula in paragraph 328 is applied.[68] During the transition period the Committee will review the potential need for continuation of this floor.

(iii) Equity exposures

267. For a maximum of ten years, supervisors may exempt from the IRB treatment particular equity investments held at the time of the publication of this Framework.[69] The exempted position is measured as the number of shares as of that date and any additional arising directly as a result of owning those holdings, as long as they do not increase the proportional share of ownership in a portfolio company.

268. If an acquisition increases the proportional share of ownership in a specific holding (e.g. due to a change of ownership initiated by the investing company subsequent to the publication of this Framework) the exceeding part of the holding is not subject to the exemption. Nor will the exemption apply to holdings that were originally subject to the exemption, but have been sold and then bought back.

269. Equity holdings covered by these transitional provisions will be subject to the capital requirements of the standardised approach.

C. Rules for corporate, sovereign, and bank exposures

270. Section III.C presents the method of calculating the unexpected loss (UL) capital requirements for corporate, sovereign and bank exposures. As discussed in Section C.1, one risk-weight function is provided for determining the capital requirement for all three asset classes with one exception. Supervisory risk weights are provided for each of the specialised lending sub-classes of corporates, and a separate risk-weight function is also provided for HVCRE. Section C.2 discusses the risk components. The method of calculating expected losses, and for determining the difference between that measure and provisions is described in Section III.G.

1. Risk-weighted assets for corporate, sovereign, and bank exposures

(i) Formula for derivation of risk-weighted assets

271. The derivation of risk-weighted assets is dependent on estimates of the PD, LGD, EAD and, in some cases, effective maturity (M), for a given exposure. Paragraphs 318 to 324 discuss the circumstances in which the maturity adjustment applies.

272. Throughout this section, PD and LGD are measured as decimals, and EAD is measured as currency (e.g. euros), except where explicitly noted otherwise. For exposures not in default, the formula for calculating risk-weighted assets is:[70, 71]

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68 The 10% LGD floor shall not apply, however, to sub-segments that are subject to/benefit from sovereign guarantees. Further, the existence of the floor does not imply any waiver of the requirements of LGD estimation as laid out in the minimum requirements starting with paragraph 468.

69 This exemption does not apply to investments in entities where some countries will retain the existing risk weighting treatment, as referred to in Part 1, see footnote 9.

70 Ln denotes the natural logarithm.

71 N(x) denotes the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x). G(z) denotes the

Correlation (R) = $0.12 \times (1 - EXP(-50 \times PD)) / (1 - EXP(-50)) +$
$0.24 \times [1 - (1 - EXP(-50 \times PD)) / (1 - EXP(-50))]$

Maturity adjustment (b) = $(0.11852 - 0.05478 \times \ln(PD))^2$

Capital requirement[72] (K) = $[LGD \times N[(1 - R)^{-0.5} \times G(PD) + (R / (1 - R))^{0.5} \times G(0.999)] - PD \times LGD] \times (1 - 1.5 \times b)^{-1} \times (1 + (M - 2.5) \times b)$

Risk-weighted assets (RWA) = K x 12.5 x EAD

The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD (described in paragraph 468) and the bank's best estimate of expected loss (described in paragraph 471). The risk-weighted asset amount for the defaulted exposure is the product of K, 12.5, and the EAD.

Illustrative risk weights are shown in Annex 5.

(ii) Firm-size adjustment for small- and medium-sized entities (SME)

273. Under the IRB approach for corporate credits, banks will be permitted to separately distinguish exposures to SME borrowers (defined as corporate exposures where the reported sales for the consolidated group of which the firm is a part is less than €50 million) from those to large firms. A firm-size adjustment (i.e. $0.04 \times (1 - (S - 5) / 45)$) is made to the corporate risk weight formula for exposures to SME borrowers. S is expressed as total annual sales in millions of euros with values of S falling in the range of equal to or less than €50 million or greater than or equal to €5 million. Reported sales of less than €5 million will be treated as if they were equivalent to €5 million for the purposes of the firm-size adjustment for SME borrowers.

Correlation (R) = $0.12 \times (1 - EXP(-50 \times PD)) / (1 - EXP(-50)) +$
$0.24 \times [1 - (1 - EXP(-50 \times PD)) / (1 - EXP(-50))] - 0.04 \times (1 - (S-5) / 45)$

274. Subject to national discretion, supervisors may allow banks, as a failsafe, to substitute total assets of the consolidated group for total sales in calculating the SME threshold and the firm-size adjustment. However, total assets should be used only when total sales are not a meaningful indicator of firm size.

(iii) Risk weights for specialised lending

Risk weights for PF, OF, CF, and IPRE

275. Banks that do not meet the requirements for the estimation of PD under the corporate IRB approach will be required to map their internal grades to five supervisory categories, each of which is associated with a specific risk weight. The slotting criteria on which this mapping must be based are provided in Annex 6. The risk weights for unexpected losses associated with each supervisory category are:

inverse cumulative distribution function for a standard normal random variable (i.e. the value of x such that N(x) = z). The normal cumulative distribution function and the inverse of the normal cumulative distribution function are, for example, available in Excel as the functions NORMSDIST and NORMSINV.

72 If this calculation results in a negative capital charge for any individual sovereign exposure, banks should apply a zero capital charge for that exposure.

Supervisory categories and UL risk weights for other SL exposures

Strong	Good	Satisfactory	Weak	Default
70%	90%	115%	250%	0%

276. Although banks are expected to map their internal ratings to the supervisory categories for specialised lending using the slotting criteria provided in Annex 6, each supervisory category broadly corresponds to a range of external credit assessments as outlined below.

Strong	Good	Satisfactory	Weak	Default
BBB- or better	BB+ or BB	BB- or B+	B to C-	Not applicable

277. At national discretion, supervisors may allow banks to assign preferential risk weights of 50% to “strong” exposures, and 70% to “good” exposures, provided they have a remaining maturity of less than 2.5 years or the supervisor determines that banks’ underwriting and other risk characteristics are substantially stronger than specified in the slotting criteria for the relevant supervisory risk category.

278. Banks that meet the requirements for the estimation of PD will be able to use the general foundation approach for the corporate asset class to derive risk weights for SL sub-classes.

279. Banks that meet the requirements for the estimation of PD and LGD and/or EAD will be able to use the general advanced approach for the corporate asset class to derive risk weights for SL sub-classes.

Risk weights for HVCRE

280. Banks that do not meet the requirements for estimation of PD, or whose supervisor has chosen not to implement the foundation or advanced approaches to HVCRE, must map their internal grades to five supervisory categories, each of which is associated with a specific risk weight. The slotting criteria on which this mapping must be based are the same as those for IPRE, as provided in Annex 6. The risk weights associated with each category are:

Supervisory categories and UL risk weights for high-volatility commercial real estate

Strong	Good	Satisfactory	Weak	Default
95%	120%	140%	250%	0%

281. As indicated in paragraph 276, each supervisory category broadly corresponds to a range of external credit assessments.

282. At national discretion, supervisors may allow banks to assign preferential risk weights of 70% to “strong” exposures, and 95% to “good” exposures, provided they have a remaining maturity of less than 2.5 years or the supervisor determines that banks’

underwriting and other risk characteristics are substantially stronger than specified in the slotting criteria for the relevant supervisory risk category.

283. Banks that meet the requirements for the estimation of PD and whose supervisor has chosen to implement a foundation or advanced approach to HVCRE exposures will use the same formula for the derivation of risk weights that is used for other SL exposures, except that they will apply the following asset correlation formula:

Correlation (R) = 0.12 x (1 – EXP(-50 x PD)) / (1 – EXP(-50)) +
0.30 x [1 – (1 – EXP(-50 x PD)) / (1 – EXP(-50))]

284. Banks that do not meet the requirements for estimation of LGD and EAD for HVCRE exposures must use the supervisory parameters for LGD and EAD for corporate exposures.

(iv) Calculation of risk-weighted assets for exposures subject to the double default framework

284(i). For hedged exposures to be treated within the scope of the double default framework, capital requirements may be calculated according to paragraphs 284 (ii) and 284 (iii).

284(ii). The capital requirement for a hedged exposure subject to the double default treatment (K_{DD}) is calculated by multiplying K_0 as defined below by a multiplier depending on the PD of the protection provider (PD_g):

$$K_{DD} = K_0 \cdot \left(0.15 + 160 \cdot PD_g\right).$$

K_0 is calculated in the same way as a capital requirement for an unhedged corporate exposure (as defined in paragraphs 272 and 273), but using different parameters for LGD and the maturity adjustment.

$$K_0 = LGD_g \cdot \left[N\left(\frac{G\left(PD_o\right) + \sqrt{\rho_{os}} \cdot G\left(0.999\right)}{\sqrt{1-\rho_{os}}} \right) - PD_o \right] \cdot \frac{1 + \left(M - 2.5\right) \cdot b}{1 - 1.5 \cdot b}$$

PD_o and PD_g are the probabilities of default of the obligor and guarantor, respectively, both subject to the PD floor set out in paragraph 285. The correlation ρ_{os} is calculated according to the formula for correlation (R) in paragraph 272 (or, if applicable, paragraph 273), with PD being equal to PD_o, and LGD_g is the LGD of a comparable direct exposure to the guarantor (i.e. consistent with paragraph 301, the LGD associated with an unhedged facility to the guarantor or the unhedged facility to the obligor, depending upon whether in the event both the guarantor and the obligor default during the life of the hedged transaction available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively; in estimating either of these LGDs, a bank may recognise collateral posted exclusively against the exposure or credit protection, respectively, in a manner consistent with paragraphs 303 or 279 and 468 to 473, as applicable). There may be no consideration of double recovery in the LGD estimate. The maturity adjustment coefficient b is calculated according to the formula for maturity adjustment (b) in paragraph 272, with PD being the minimum of PD_o and PD_g. M is the effective maturity of the credit protection, which may under no circumstances be below the one-year floor if the double default framework is to be applied.

284(iii). The risk-weighted asset amount is calculated in the same way as for unhedged exposures, i.e.

$$RWA_{DD} = K_{DD} \cdot 12.5 \cdot EAD_g.$$

2. *Risk components*

(i) Probability of default (PD)

285. For corporate and bank exposures, the PD is the greater of the one-year PD associated with the internal borrower grade to which that exposure is assigned, or 0.03%. For sovereign exposures, the PD is the one-year PD associated with the internal borrower grade to which that exposure is assigned. The PD of borrowers assigned to a default grade(s), consistent with the reference definition of default, is 100%. The minimum requirements for the derivation of the PD estimates associated with each internal borrower grade are outlined in paragraphs 461 to 463.

(ii) Loss given default (LGD)

286. A bank must provide an estimate of the LGD for each corporate, sovereign and bank exposure. There are two approaches for deriving this estimate: a foundation approach and an advanced approach.

LGD under the foundation approach

Treatment of unsecured claims and non-recognised collateral

287. Under the foundation approach, senior claims on corporates, sovereigns and banks not secured by recognised collateral will be assigned a 45% LGD.

288. All subordinated claims on corporates, sovereigns and banks will be assigned a 75% LGD. A subordinated loan is a facility that is expressly subordinated to another facility. At national discretion, supervisors may choose to employ a wider definition of subordination. This might include economic subordination, such as cases where the facility is unsecured and the bulk of the borrower's assets are used to secure other exposures.

Collateral under the foundation approach

289. In addition to the eligible financial collateral recognised in the standardised approach, under the foundation IRB approach some other forms of collateral, known as eligible IRB collateral, are also recognised. These include receivables, specified commercial and residential real estate (CRE/RRE), and other collateral, where they meet the minimum requirements set out in paragraphs 509 to 524.[73] For eligible financial collateral, the requirements are identical to the operational standards as set out in Section II.D beginning with paragraph 111.

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[73] The Committee, however, recognises that, in exceptional circumstances for well-developed and long-established markets, mortgages on office and/or multi-purpose commercial premises and/or multi-tenanted commercial premises may have the potential to receive alternative recognition as collateral in the corporate portfolio. Please refer to footnote 29 of paragraph 74 for a discussion of the eligibility criteria that would apply. The LGD applied to the collateralised portion of such exposures, subject to the limitations set out in paragraphs 119 to 181 (i) of the standardised approach, will be set at 35%. The LGD applied to the remaining portion of this exposure will be set at 45%. In order to ensure consistency with the capital charges in the standardised approach (while providing a small capital incentive in the IRB approach relative to the standardised approach), supervisors may apply a cap on the capital charge associated with such exposures so as to achieve comparable treatment in both approaches.

Methodology for recognition of eligible financial collateral under the foundation approach

290. The methodology for the recognition of eligible financial collateral closely follows that outlined in the comprehensive approach to collateral in the standardised approach in paragraphs 147 to 181(i). The simple approach to collateral presented in the standardised approach will not be available to banks applying the IRB approach.

291. Following the comprehensive approach, the effective loss given default (LGD*) applicable to a collateralised transaction can be expressed as follows, where:

- LGD is that of the senior unsecured exposure before recognition of collateral (45%);
- E is the current value of the exposure (i.e. cash lent or securities lent or posted);
- E* is the exposure value after risk mitigation as determined in paragraphs 147 to 150 of the standardised approach. This concept is only used to calculate LGD*. Banks must continue to calculate EAD without taking into account the presence of any collateral, unless otherwise specified.

$$LGD^* = LGD \times (E^* / E)$$

292. Banks that qualify for the foundation IRB approach may calculate E* using any of the ways specified under the comprehensive approach for collateralised transactions under the standardised approach.

293. Where repo-style transactions are subject to a master netting agreement, a bank may choose not to recognise the netting effects in calculating capital. Banks that want to recognise the effect of master netting agreements on such transactions for capital purposes must satisfy the criteria provided in paragraph 173 and 174 of the standardised approach. The bank must calculate E* in accordance with paragraphs 176 and 177 or 178 to 181 (i) and equate this to EAD. The impact of collateral on these transactions may not be reflected through an adjustment to LGD.

Carve out from the comprehensive approach

294. As in the standardised approach, for transactions where the conditions in paragraph 170 are met, and in addition, the counterparty is a core market participant as specified in paragraph 171, supervisors may choose not to apply the haircuts specified under the comprehensive approach, but instead to apply a zero H.

Methodology for recognition of eligible IRB collateral

295. The methodology for determining the effective LGD under the foundation approach for cases where banks have taken eligible IRB collateral to secure a corporate exposure is as follows.

- Exposures where the minimum eligibility requirements are met, but the ratio of the current value of the collateral received (C) to the current value of the exposure (E) is below a threshold level of C* (i.e. the required minimum collateralisation level for the exposure) would receive the appropriate LGD for unsecured exposures or those secured by collateral which is not eligible financial collateral or eligible IRB collateral.
- Exposures where the ratio of C to E exceeds a second, higher threshold level of C** (i.e. the required level of over-collateralisation for full LGD recognition) would be assigned an LGD according to the following table.

The following table displays the applicable LGD and required over-collateralisation levels for the secured parts of senior exposures:

Minimum LGD for secured portion of senior exposures

	Minimum LGD	Required minimum collateralisation level of the exposure (C*)	Required level of over-collateralisation for full LGD recognition (C**)
Eligible Financial collateral	0%	0%	n.a.
Receivables	35%	0%	125%
CRE/RRE	35%	30%	140%
Other collateral[74]	40%	30%	140%

- Senior exposures are to be divided into fully collateralised and uncollateralised portions.
- The part of the exposure considered to be fully collateralised, C/C**, receives the LGD associated with the type of collateral.
- The remaining part of the exposure is regarded as unsecured and receives an LGD of 45%.

Methodology for the treatment of pools of collateral

296. The methodology for determining the effective LGD of a transaction under the foundation approach where banks have taken both financial collateral and other eligible IRB collateral is aligned to the treatment in the standardised approach and based on the following guidance.

- In the case where a bank has obtained multiple forms of CRM, it will be required to subdivide the adjusted value of the exposure (after the haircut for eligible financial collateral) into portions each covered by only one CRM type. That is, the bank must divide the exposure into the portion covered by eligible financial collateral, the portion covered by receivables, the portion covered by CRE/RRE collateral, a portion covered by other collateral, and an unsecured portion, where relevant.
- Where the ratio of the sum of the value of CRE/RRE and other collateral to the reduced exposure (after recognising the effect of eligible financial collateral and receivables collateral) is below the associated threshold level (i.e. the minimum degree of collateralisation of the exposure), the exposure would receive the appropriate unsecured LGD value of 45%.
- The risk-weighted assets for each fully secured portion of exposure must be calculated separately.

[74] Other collateral excludes physical assets acquired by the bank as a result of a loan default.

LGD under the advanced approach

297. Subject to certain additional minimum requirements specified below, supervisors may permit banks to use their own internal estimates of LGD for corporate, sovereign and bank exposures. LGD must be measured as the loss given default as a percentage of the EAD. Banks eligible for the IRB approach that are unable to meet these additional minimum requirements must utilise the foundation LGD treatment described above.

298. The minimum requirements for the derivation of LGD estimates are outlined in paragraphs 468 to 473.

Treatment of certain repo-style transactions

299. Banks that want to recognise the effects of master netting agreements on repo-style transactions for capital purposes must apply the methodology outlined in paragraph 293 for determining E* for use as the EAD. For banks using the advanced approach, own LGD estimates would be permitted for the unsecured equivalent amount (E*).

Treatment of guarantees and credit derivatives

300. There are two approaches for recognition of CRM in the form of guarantees and credit derivatives in the IRB approach: a foundation approach for banks using supervisory values of LGD, and an advanced approach for those banks using their own internal estimates of LGD.

301. Under either approach, CRM in the form of guarantees and credit derivatives must not reflect the effect of double default (see paragraph 482). As such, to the extent that the CRM is recognised by the bank, the adjusted risk weight will not be less than that of a comparable direct exposure to the protection provider. Consistent with the standardised approach, banks may choose not to recognise credit protection if doing so would result in a higher capital requirement.

Recognition under the foundation approach

302. For banks using the foundation approach for LGD, the approach to guarantees and credit derivatives closely follows the treatment under the standardised approach as specified in paragraphs 189 to 201. The range of eligible guarantors is the same as under the standardised approach except that companies that are internally rated and associated with a PD equivalent to A- or better may also be recognised under the foundation approach. To receive recognition, the requirements outlined in paragraphs 189 to 194 must be met.

303. Eligible guarantees from eligible guarantors will be recognised as follows:

- For the covered portion of the exposure, a risk weight is derived by taking:
  - the risk-weight function appropriate to the type of guarantor, and
  - the PD appropriate to the guarantor's borrower grade, or some grade between the underlying obligor and the guarantor's borrower grade if the bank deems a full substitution treatment not to be warranted.
- The bank may replace the LGD of the underlying transaction with the LGD applicable to the guarantee taking into account seniority and any collateralisation of a guaranteed commitment.

304. The uncovered portion of the exposure is assigned the risk weight associated with the underlying obligor.

305. Where partial coverage exists, or where there is a currency mismatch between the underlying obligation and the credit protection, it is necessary to split the exposure into a covered and an uncovered amount. The treatment in the foundation approach follows that outlined in the standardised approach in paragraphs 198 to 200, and depends upon whether the cover is proportional or tranched.

Recognition under the advanced approach

306. Banks using the advanced approach for estimating LGDs may reflect the risk-mitigating effect of guarantees and credit derivatives through either adjusting PD or LGD estimates. Whether adjustments are done through PD or LGD, they must be done in a consistent manner for a given guarantee or credit derivative type. In doing so, banks must not include the effect of double default in such adjustments. Thus, the adjusted risk weight must not be less than that of a comparable direct exposure to the protection provider.

307. A bank relying on own-estimates of LGD has the option to adopt the treatment outlined above for banks under the foundation IRB approach (paragraphs 302 to 305), or to make an adjustment to its LGD estimate of the exposure to reflect the presence of the guarantee or credit derivative. Under this option, there are no limits to the range of eligible guarantors although the set of minimum requirements provided in paragraphs 483 and 484 concerning the type of guarantee must be satisfied. For credit derivatives, the requirements of paragraphs 488 and 489 must be satisfied.[75]

Operational requirements for recognition of double default

307(i). A bank using an IRB approach has the option of using the substitution approach in determining the appropriate capital requirement for an exposure. However, for exposures hedged by one of the following instruments the double default framework according to paragraphs 284 (i) to 284 (iii) may be applied subject to the additional operational requirements set out in paragraph 307 (ii). A bank may decide separately for each eligible exposure to apply either the double default framework or the substitution approach.

(a)	Single-name, unfunded credit derivatives (e.g. credit default swaps) or single-name guarantees.
(b)	First-to-default basket products — the double default treatment will be applied to the asset within the basket with the lowest risk-weighted amount.
(c)	n^{th}-to-default basket products — the protection obtained is only eligible for consideration under the double default framework if eligible $(n–1)^{th}$ default protection has also been obtained or where $(n–1)$ of the assets within the basket have already defaulted.

[75] When credit derivatives do not cover the restructuring of the underlying obligation, the partial recognition set out in paragraph 192 applies.

307(ii). The double default framework is only applicable where the following conditions are met.

(a)	The risk weight that is associated with the exposure prior to the application of the framework does not already factor in any aspect of the credit protection.
(b)	The entity selling credit protection is a bank[76], investment firm or insurance company (but only those that are in the business of providing credit protection, including mono-lines, re-insurers, and non-sovereign credit export agencies[77]), referred to as a financial firm, that: • is regulated in a manner broadly equivalent to that in this Framework (where there is appropriate supervisory oversight and transparency/ market discipline), or externally rated as at least investment grade by a credit rating agency deemed suitable for this purpose by supervisors; • had an internal rating with a PD equivalent to or lower than that associated with an external A– rating at the time the credit protection for an exposure was first provided or for any period of time thereafter; and • has an internal rating with a PD equivalent to or lower than that associated with an external investment-grade rating.
(c)	The underlying obligation is: • a corporate exposure as defined in paragraphs 218 to 228 (excluding specialised lending exposures for which the supervisory slotting criteria approach described in paragraphs 275 to 282 is being used); or • a claim on a PSE that is not a sovereign exposure as defined in paragraph 229; or • a loan extended to a small business and classified as a retail exposure as defined in paragraph 231.
(d)	The underlying obligor is not: • a financial firm as defined in (b); or • a member of the same group as the protection provider.
(e)	The credit protection meets the minimum operational requirements for such instruments as outlined in paragraphs 189 to 193.

[76] This does not include PSEs and MDBs, even though claims on these may be treated as claims on banks according to paragraph 230.

[77] By non-sovereign it is meant that credit protection in question does not benefit from any explicit sovereign counter-guarantee.

(f)	In keeping with paragraph 190 for guarantees, for any recognition of double default effects for both guarantees and credit derivatives a bank must have the right and expectation to receive payment from the credit protection provider without having to take legal action in order to pursue the counterparty for payment. To the extent possible, a bank should take steps to satisfy itself that the protection provider is willing to pay promptly if a credit event should occur.
(g)	The purchased credit protection absorbs all credit losses incurred on the hedged portion of an exposure that arise due to the credit events outlined in the contract.
(h)	If the payout structure provides for physical settlement, then there must be legal certainty with respect to the deliverability of a loan, bond, or contingent liability. If a bank intends to deliver an obligation other than the underlying exposure, it must ensure that the deliverable obligation is sufficiently liquid so that the bank would have the ability to purchase it for delivery in accordance with the contract.
(i)	The terms and conditions of credit protection arrangements must be legally confirmed in writing by both the credit protection provider and the bank.
(j)	In the case of protection against dilution risk, the seller of purchased receivables must not be a member of the same group as the protection provider.
(k)	There is no excessive correlation between the creditworthiness of a protection provider and the obligor of the underlying exposure due to their performance being dependent on common factors beyond the systematic risk factor. The bank has a process to detect such excessive correlation. An example of a situation in which such excessive correlation would arise is when a protection provider guarantees the debt of a supplier of goods or services and the supplier derives a high proportion of its income or revenue from the protection provider.

(iii) Exposure at default (EAD)

308. The following sections apply to both on and off-balance sheet positions. All exposures are measured gross of specific provisions or partial write-offs. The EAD on drawn amounts should not be less than the sum of (i) the amount by which a bank’s regulatory capital would be reduced if the exposure were written-off fully, and (ii) any specific provisions and partial write-offs. When the difference between the instrument’s EAD and the sum of (i) and (ii) is positive, this amount is termed a discount. The calculation of risk-weighted assets is independent of any discounts. Under the limited circumstances described in paragraph 380, discounts may be included in the measurement of total eligible provisions for purposes of the EL-provision calculation set out in Section III.G.

Exposure measurement for on-balance sheet items

309. On-balance sheet netting of loans and deposits will be recognised subject to the same conditions as under the standardised approach (see paragraph 188). Where currency or maturity mismatched on-balance sheet netting exists, the treatment follows the standardised approach, as set out in paragraphs 200 and 202 to 205.

Exposure measurement for off-balance sheet items (with the exception of FX and interest-rate, equity, and commodity-related derivatives)

310. For off-balance sheet items, exposure is calculated as the committed but undrawn amount multiplied by a CCF. There are two approaches for the estimation of CCFs: a foundation approach and an advanced approach.

EAD under the foundation approach

311. The types of instruments and the CCFs applied to them are the same as those in the standardised approach, as outlined in paragraphs 82 to 89 with the exception of commitments, Note Issuance Facilities (NIFs) and Revolving Underwriting Facilities (RUFs).

312. A CCF of 75% will be applied to commitments, NIFs and RUFs regardless of the maturity of the underlying facility. This does not apply to those facilities which are uncommitted, that are unconditionally cancellable, or that effectively provide for automatic cancellation, for example due to deterioration in a borrower's creditworthiness, at any time by the bank without prior notice. A CCF of 0% will be applied to these facilities.

313. The amount to which the CCF is applied is the lower of the value of the unused committed credit line, and the value that reflects any possible constraining availability of the facility, such as the existence of a ceiling on the potential lending amount which is related to a borrower's reported cash flow. If the facility is constrained in this way, the bank must have sufficient line monitoring and management procedures to support this contention.

314. In order to apply a 0% CCF for unconditionally and immediately cancellable corporate overdrafts and other facilities, banks must demonstrate that they actively monitor the financial condition of the borrower, and that their internal control systems are such that they could cancel the facility upon evidence of a deterioration in the credit quality of the borrower.

315. Where a commitment is obtained on another off-balance sheet exposure, banks under the foundation approach are to apply the lower of the applicable CCFs.

EAD under the advanced approach

316. Banks which meet the minimum requirements for use of their own estimates of EAD (see paragraphs 474 to 478) will be allowed to use their own internal estimates of CCFs across different product types provided the exposure is not subject to a CCF of 100% in the foundation approach (see paragraph 311).

Exposure measurement for transactions that expose banks to counterparty credit risk

317. Measures of exposure for SFTs and OTC derivatives that expose banks to counterparty credit risk under the IRB approach will be calculated as per the rules set forth in Annex 4 of this Framework.

(iv) Effective maturity (M)

318. For banks using the foundation approach for corporate exposures, effective maturity (M) will be 2.5 years except for repo-style transactions where the effective maturity will be 6 months. National supervisors may choose to require all banks in their jurisdiction (those using the foundation and advanced approaches) to measure M for each facility using the definition provided below.

319. Banks using any element of the advanced IRB approach are required to measure effective maturity for each facility as defined below. However, national supervisors may exempt facilities to certain smaller domestic corporate borrowers from the explicit maturity adjustment if the reported sales (i.e. turnover) as well as total assets for the consolidated group of which the firm is a part of are less than €500 million. The consolidated group has to be a domestic company based in the country where the exemption is applied. If adopted, national supervisors must apply such an exemption to all IRB banks using the advanced approach in that country, rather than on a bank-by-bank basis. If the exemption is applied, all exposures to qualifying smaller domestic firms will be assumed to have an average maturity of 2.5 years, as under the foundation IRB approach.

320. Except as noted in paragraph 321, M is defined as the greater of one year and the remaining effective maturity in years as defined below. In all cases, M will be no greater than 5 years.

- For an instrument subject to a determined cash flow schedule, effective maturity M is defined as:

  Effective Maturity (M) = $\sum_t t * CF_t / \sum_t CF_t$

  where CF_t denotes the cash flows (principal, interest payments and fees) contractually payable by the borrower in period t.

- If a bank is not in a position to calculate the effective maturity of the contracted payments as noted above, it is allowed to use a more conservative measure of M such as that it equals the maximum remaining time (in years) that the borrower is permitted to take to fully discharge its contractual obligation (principal, interest, and fees) under the terms of loan agreement. Normally, this will correspond to the nominal maturity of the instrument.
- For derivatives subject to a master netting agreement, the weighted average maturity of the transactions should be used when applying the explicit maturity adjustment. Further, the notional amount of each transaction should be used for weighting the maturity.

321. The one-year floor does not apply to certain short-term exposures, comprising fully or nearly-fully collateralised[78] capital market-driven transactions (i.e. OTC derivatives transactions and margin lending) and repo-style transactions (i.e. repos/reverse repos and securities lending/borrowing) with an original maturity of less then one year, where the documentation contains daily remargining clauses. For all eligible transactions the documentation must require daily revaluation, and must include provisions that must allow for the prompt liquidation or setoff of the collateral in the event of default or failure to re-margin. The maturity of such transactions must be calculated as the greater of one-day, and the effective maturity (M, consistent with the definition above).

322. In addition to the transactions considered in paragraph 321 above, other short-term exposures with an original maturity of less than one year that are not part of a bank's ongoing financing of an obligor may be eligible for exemption from the one-year floor. After a careful review of the particular circumstances in their jurisdictions, national supervisors

[78] The intention is to include both parties of a transaction meeting these conditions where neither of the parties is systematically under-collateralised.

should define the types of short-term exposures that might be considered eligible for this treatment. The results of these reviews might, for example, include transactions such as:

- Some capital market-driven transactions and repo-style transactions that might not fall within the scope of paragraph 321;
- Some short-term self-liquidating trade transactions. Import and export letters of credit and similar transactions could be accounted for at their actual remaining maturity;
- Some exposures arising from settling securities purchases and sales. This could also include overdrafts arising from failed securities settlements provided that such overdrafts do not continue more than a short, fixed number of business days;
- Some exposures arising from cash settlements by wire transfer, including overdrafts arising from failed transfers provided that such overdrafts do not continue more than a short, fixed number of business days;
- Some exposures to banks arising from foreign exchange settlements; and
- Some short-term loans and deposits.

323. For transactions falling within the scope of paragraph 321 subject to a master netting agreement, the weighted average maturity of the transactions should be used when applying the explicit maturity adjustment. A floor equal to the minimum holding period for the transaction type set out in paragraph 167 will apply to the average. Where more than one transaction type is contained in the master netting agreement a floor equal to the highest holding period will apply to the average. Further, the notional amount of each transaction should be used for weighting maturity.

324. Where there is no explicit adjustment, the effective maturity (M) assigned to all exposures is set at 2.5 years unless otherwise specified in paragraph 318.

Treatment of maturity mismatches

325. The treatment of maturity mismatches under IRB is identical to that in the standardised approach ─ see paragraphs 202 to 205.

D. Rules for Retail Exposures

326. Section D presents in detail the method of calculating the UL capital requirements for retail exposures. Section D.1 provides three risk-weight functions, one for residential mortgage exposures, a second for qualifying revolving retail exposures, and a third for other retail exposures. Section D.2 presents the risk components to serve as inputs to the risk-weight functions. The method of calculating expected losses, and for determining the difference between that measure and provisions is described in Section III.G.

1. Risk-weighted assets for retail exposures

327. There are three separate risk-weight functions for retail exposures, as defined in paragraphs 328 to 330. Risk weights for retail exposures are based on separate assessments of PD and LGD as inputs to the risk-weight functions. None of the three retail risk-weight functions contains an explicit maturity adjustment. Throughout this section, PD and LGD are measured as decimals, and EAD is measured as currency (e.g. euros).

(i) Residential mortgage exposures

328. For exposures defined in paragraph 231 that are not in default and are secured or partly secured[79] by residential mortgages, risk weights will be assigned based on the following formula:

Correlation (R) = 0.15

Capital requirement (K) = LGD × N[(1 – R)^-0.5 × G(PD) + (R / (1 – R))^0.5 × G(0.999)] – PD x LGD

Risk-weighted assets = K x 12.5 x EAD

The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD (described in paragraph 468) and the bank's best estimate of expected loss (described in paragraph 471). The risk-weighted asset amount for the defaulted exposure is the product of K, 12.5, and the EAD.

(ii) Qualifying revolving retail exposures

329. For qualifying revolving retail exposures as defined in paragraph 234 that are not in default, risk weights are defined based on the following formula:

Correlation (R) = 0.04

Capital requirement (K) = LGD × N[(1 – R)^-0.5 × G(PD) + (R / (1 – R))^0.5 × G(0.999)] – PD x LGD

Risk-weighted assets = K x 12.5 x EAD

The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD (described in paragraph 468) and the bank's best estimate of expected loss (described in paragraph 471). The risk-weighted asset amount for the defaulted exposure is the product of K, 12.5, and the EAD.

(iii) Other retail exposures

330. For all other retail exposures that are not in default, risk weights are assigned based on the following function, which allows correlation to vary with PD:

Correlation (R) = 0.03 × (1 – EXP(-35 × PD)) / (1 – EXP(-35)) + 0.16 × [1 – (1 – EXP(-35 × PD))/(1 – EXP(-35))]

Capital requirement (K) = LGD × N[(1 – R)^-0.5 × G(PD) + (R / (1 – R))^0.5 × G(0.999)] – PD x LGD

Risk-weighted assets = K x 12.5 x EAD

The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD (described in paragraph 468) and the bank's best estimate of

[79] This means that risk weights for residential mortgages also apply to the unsecured portion of such residential mortgages.

expected loss (described in paragraph 471). The risk-weighted asset amount for the defaulted exposure is the product of K, 12.5, and the EAD.

Illustrative risk weights are shown in Annex 5.

2. Risk components

(i) Probability of default (PD) and loss given default (LGD)

331. For each identified pool of retail exposures, banks are expected to provide an estimate of the PD and LGD associated with the pool, subject to the minimum requirements as set out in Section III.H. Additionally, the PD for retail exposures is the greater of the one-year PD associated with the internal borrower grade to which the pool of retail exposures is assigned or 0.03%.

(ii) Recognition of guarantees and credit derivatives

332. Banks may reflect the risk-reducing effects of guarantees and credit derivatives, either in support of an individual obligation or a pool of exposures, through an adjustment of either the PD or LGD estimate, subject to the minimum requirements in paragraphs 480 to 489. Whether adjustments are done through PD or LGD, they must be done in a consistent manner for a given guarantee or credit derivative type.

333. Consistent with the requirements outlined above for corporate, sovereign, and bank exposures, banks must not include the effect of double default in such adjustments. The adjusted risk weight must not be less than that of a comparable direct exposure to the protection provider. Consistent with the standardised approach, banks may choose not to recognise credit protection if doing so would result in a higher capital requirement.

(iii) Exposure at default (EAD)

334. Both on and off-balance sheet retail exposures are measured gross of specific provisions or partial write-offs. The EAD on drawn amounts should not be less than the sum of (i) the amount by which a bank's regulatory capital would be reduced if the exposure were written-off fully, and (ii) any specific provisions and partial write-offs. When the difference between the instrument's EAD and the sum of (i) and (ii) is positive, this amount is termed a discount. The calculation of risk-weighted assets is independent of any discounts. Under the limited circumstances described in paragraph 380, discounts may be included in the measurement of total eligible provisions for purposes of the EL-provision calculation set out in Section III.G.

335. On-balance sheet netting of loans and deposits of a bank to or from a retail customer will be permitted subject to the same conditions outlined in paragraph 188 of the standardised approach. For retail off-balance sheet items, banks must use their own estimates of CCFs provided the minimum requirements in paragraphs 474 to 477 and 479 are satisfied.

336. For retail exposures with uncertain future drawdown such as credit cards, banks must take into account their history and/or expectation of additional drawings prior to default in their overall calibration of loss estimates. In particular, where a bank does not reflect conversion factors for undrawn lines in its EAD estimates, it must reflect in its LGD estimates the likelihood of additional drawings prior to default. Conversely, if the bank does not incorporate the possibility of additional drawings in its LGD estimates, it must do so in its EAD estimates.

337. When only the drawn balances of retail facilities have been securitised, banks must ensure that they continue to hold required capital against their share (i.e. seller's interest) of undrawn balances related to the securitised exposures using the IRB approach to credit risk. This means that for such facilities, banks must reflect the impact of CCFs in their EAD estimates rather than in the LGD estimates. For determining the EAD associated with the seller's interest in the undrawn lines, the undrawn balances of securitised exposures would be allocated between the seller's and investors' interests on a pro rata basis, based on the proportions of the seller's and investors' shares of the securitised drawn balances. The investors' share of undrawn balances related to the securitised exposures is subject to the treatment in paragraph 643.

338. To the extent that foreign exchange and interest rate commitments exist within a bank's retail portfolio for IRB purposes, banks are not permitted to provide their internal assessments of credit equivalent amounts. Instead, the rules for the standardised approach continue to apply.

E. Rules for Equity Exposures

339. Section E presents the method of calculating the UL capital requirements for equity exposures. Section E.1 discusses (a) the market-based approach (which is further sub-divided into a simple risk weight method and an internal models method), and (b) the PD/LGD approach. The risk components are provided in Section E.2. The method of calculating expected losses, and for determining the difference between that measure and provisions is described in Section III.G.

1. Risk-weighted assets for equity exposures

340. Risk-weighted assets for equity exposures in the trading book are subject to the market risk capital rules.

341. There are two approaches to calculate risk-weighted assets for equity exposures not held in the trading book: a market-based approach and a PD/LGD approach. Supervisors will decide which approach or approaches will be used by banks, and in what circumstances. Certain equity holdings are excluded as defined in paragraphs 356 to 358 and are subject to the capital charges required under the standardised approach.

342. Where supervisors permit both methodologies, banks' choices must be made consistently, and in particular not determined by regulatory arbitrage considerations.

(i) Market-based approach

343. Under the market-based approach, institutions are permitted to calculate the minimum capital requirements for their banking book equity holdings using one or both of two separate and distinct methods: a simple risk weight method or an internal models method. The method used should be consistent with the amount and complexity of the institution's equity holdings and commensurate with the overall size and sophistication of the institution. Supervisors may require the use of either method based on the individual circumstances of an institution.

Simple risk weight method

344. Under the simple risk weight method, a 300% risk weight is to be applied to equity holdings that are publicly traded and a 400% risk weight is to be applied to all other equity

holdings. A publicly traded holding is defined as any equity security traded on a recognised security exchange.

345. Short cash positions and derivative instruments held in the banking book are permitted to offset long positions in the same individual stocks provided that these instruments have been explicitly designated as hedges of specific equity holdings and that they have remaining maturities of at least one year. Other short positions are to be treated as if they are long positions with the relevant risk weight applied to the absolute value of each position. In the context of maturity mismatched positions, the methodology is that for corporate exposures.

Internal models method

346. IRB banks may use, or may be required by their supervisor to use, internal risk measurement models to calculate the risk-based capital requirement. Under this alternative, banks must hold capital equal to the potential loss on the institution's equity holdings as derived using internal value-at-risk models subject to the 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period. The capital charge would be incorporated into an institution's risk-based capital ratio through the calculation of risk-weighted equivalent assets.

347. The risk weight used to convert holdings into risk-weighted equivalent assets would be calculated by multiplying the derived capital charge by 12.5 (i.e. the inverse of the minimum 8% risk-based capital requirement). Capital charges calculated under the internal models method may be no less than the capital charges that would be calculated under the simple risk weight method using a 200% risk weight for publicly traded equity holdings and a 300% risk weight for all other equity holdings. These minimum capital charges would be calculated separately using the methodology of the simple risk weight approach. Further, these minimum risk weights are to apply at the individual exposure level rather than at the portfolio level.

348. A bank may be permitted by its supervisor to employ different market-based approaches to different portfolios based on appropriate considerations and where the bank itself uses different approaches internally.

349. Banks are permitted to recognise guarantees but not collateral obtained on an equity position wherein the capital requirement is determined through use of the market-based approach.

(ii) PD/LGD approach

350. The minimum requirements and methodology for the PD/LGD approach for equity exposures (including equity of companies that are included in the retail asset class) are the same as those for the IRB foundation approach for corporate exposures subject to the following specifications:[80]

- The bank's estimate of the PD of a corporate entity in which it holds an equity position must satisfy the same requirements as the bank's estimate of the PD of a

[80] There is no advanced approach for equity exposures, given the 90% LGD assumption.

corporate entity where the bank holds debt.[81] If a bank does not hold debt of the company in whose equity it has invested, and does not have sufficient information on the position of that company to be able to use the applicable definition of default in practice but meets the other standards, a 1.5 scaling factor will be applied to the risk weights derived from the corporate risk-weight function, given the PD set by the bank. If, however, the bank's equity holdings are material and it is permitted to use a PD/LGD approach for regulatory purposes but the bank has not yet met the relevant standards, the simple risk-weight method under the market-based approach will apply.

- An LGD of 90% would be assumed in deriving the risk weight for equity exposures.
- For these purposes, the risk weight is subject to a five-year maturity adjustment whether or not the bank is using the explicit approach to maturity elsewhere in its IRB portfolio.

351. Under the PD/LGD approach, minimum risk weights as set out in paragraphs 352 and 353 apply. When the sum of UL and EL associated with the equity exposure results in less capital than would be required from application of one of the minimum risk weights, the minimum risk weights must be used. In other words, the minimum risk weights must be applied, if the risk weights calculated according to paragraph 350 plus the EL associated with the equity exposure multiplied by 12.5 are smaller than the applicable minimum risk weights.

352. A minimum risk weight of 100% applies for the following types of equities for as long as the portfolio is managed in the manner outlined below:

- Public equities where the investment is part of a long-term customer relationship, any capital gains are not expected to be realised in the short term and there is no anticipation of (above trend) capital gains in the long term. It is expected that in almost all cases, the institution will have lending and/or general banking relationships with the portfolio company so that the estimated probability of default is readily available. Given their long-term nature, specification of an appropriate holding period for such investments merits careful consideration. In general, it is expected that the bank will hold the equity over the long term (at least five years).
- Private equities where the returns on the investment are based on regular and periodic cash flows not derived from capital gains and there is no expectation of future (above trend) capital gain or of realising any existing gain.

353. For all other equity positions, including net short positions (as defined in paragraph 345), capital charges calculated under the PD/LGD approach may be no less than the capital charges that would be calculated under a simple risk weight method using a 200% risk weight for publicly traded equity holdings and a 300% risk weight for all other equity holdings.

354. The maximum risk weight for the PD/LGD approach for equity exposures is 1250%. This maximum risk weight can be applied, if risk weights calculated according to paragraph 350 plus the EL associated with the equity exposure multiplied by 12.5 exceed the 1250% risk weight. Alternatively, banks may deduct the entire equity exposure amount, assuming it represents the EL amount, 50% from Tier 1 capital and 50% from Tier 2 capital.

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[81] In practice, if there is both an equity exposure and an IRB credit exposure to the same counterparty, a default on the credit exposure would thus trigger a simultaneous default for regulatory purposes on the equity exposure.

355. Hedging for PD/LGD equity exposures is, as for corporate exposures, subject to an LGD of 90% on the exposure to the provider of the hedge. For these purposes equity positions will be treated as having a five-year maturity.

(iii) Exclusions to the market-based and PD/LGD approaches

356. Equity holdings in entities whose debt obligations qualify for a zero risk weight under the standardised approach to credit risk can be excluded from the IRB approaches to equity (including those publicly sponsored entities where a zero risk weight can be applied), at the discretion of the national supervisor. If a national supervisor makes such an exclusion this will be available to all banks.

357. To promote specified sectors of the economy, supervisors may exclude from the IRB capital charges equity holdings made under legislated programmes that provide significant subsidies for the investment to the bank and involve some form of government oversight and restrictions on the equity investments. Example of restrictions are limitations on the size and types of businesses in which the bank is investing, allowable amounts of ownership interests, geographical location and other pertinent factors that limit the potential risk of the investment to the bank. Equity holdings made under legislated programmes can only be excluded from the IRB approaches up to an aggregate of 10% of Tier 1 plus Tier 2 capital.

358. Supervisors may also exclude the equity exposures of a bank from the IRB treatment based on materiality. The equity exposures of a bank are considered material if their aggregate value, excluding all legislative programmes discussed in paragraph 357, exceeds, on average over the prior year, 10% of bank's Tier 1 plus Tier 2 capital. This materiality threshold is lowered to 5% of a bank's Tier 1 plus Tier 2 capital if the equity portfolio consists of less than 10 individual holdings. National supervisors may use lower materiality thresholds.

2. Risk components

359. In general, the measure of an equity exposure on which capital requirements is based is the value presented in the financial statements, which depending on national accounting and regulatory practices may include unrealised revaluation gains. Thus, for example, equity exposure measures will be:

- For investments held at fair value with changes in value flowing directly through income and into regulatory capital, exposure is equal to the fair value presented in the balance sheet.
- For investments held at fair value with changes in value not flowing through income but into a tax-adjusted separate component of equity, exposure is equal to the fair value presented in the balance sheet.
- For investments held at cost or at the lower of cost or market, exposure is equal to the cost or market value presented in the balance sheet.[82]

360. Holdings in funds containing both equity investments and other non-equity types of investments can be either treated, in a consistent manner, as a single investment based on

[82] This does not affect the existing allowance of 45% of unrealised gains to Tier 2 capital in the 1988 Accord.

the majority of the fund's holdings or, where possible, as separate and distinct investments in the fund's component holdings based on a look-through approach.

361. Where only the investment mandate of the fund is known, the fund can still be treated as a single investment. For this purpose, it is assumed that the fund first invests, to the maximum extent allowed under its mandate, in the asset classes attracting the highest capital requirement, and then continues making investments in descending order until the maximum total investment level is reached. The same approach can also be used for the look-through approach, but only where the bank has rated all the potential constituents of such a fund.

F. Rules for Purchased Receivables

362. Section F presents the method of calculating the UL capital requirements for purchased receivables. For such assets, there are IRB capital charges for both default risk and dilution risk. Section III.F.1 discusses the calculation of risk-weighted assets for default risk. The calculation of risk-weighted assets for dilution risk is provided in Section III.F.2. The method of calculating expected losses, and for determining the difference between that measure and provisions, is described in Section III.G.

1. Risk-weighted assets for default risk

363. For receivables belonging unambiguously to one asset class, the IRB risk weight for default risk is based on the risk-weight function applicable to that particular exposure type, as long as the bank can meet the qualification standards for this particular risk-weight function. For example, if banks cannot comply with the standards for qualifying revolving retail exposures (defined in paragraph 234), they should use the risk-weight function for other retail exposures. For hybrid pools containing mixtures of exposure types, if the purchasing bank cannot separate the exposures by type, the risk-weight function producing the highest capital requirements for the exposure types in the receivable pool applies.

(i) Purchased retail receivables

364. For purchased retail receivables, a bank must meet the risk quantification standards for retail exposures but can utilise external and internal reference data to estimate the PDs and LGDs. The estimates for PD and LGD (or EL) must be calculated for the receivables on a stand-alone basis; that is, without regard to any assumption of recourse or guarantees from the seller or other parties.

(ii) Purchased corporate receivables

365. For purchased corporate receivables the purchasing bank is expected to apply the existing IRB risk quantification standards for the bottom-up approach. However, for eligible purchased corporate receivables, and subject to supervisory permission, a bank may employ the following top-down procedure for calculating IRB risk weights for default risk:

- The purchasing bank will estimate the pool's one-year EL for default risk, expressed in percentage of the exposure amount (i.e. the total EAD amount to the bank by all obligors in the receivables pool). The estimated EL must be calculated for the receivables on a stand-alone basis; that is, without regard to any assumption of recourse or guarantees from the seller or other parties. The treatment of recourse or guarantees covering default risk (and/or dilution risk) is discussed separately below.

- Given the EL estimate for the pool's default losses, the risk weight for default risk is determined by the risk-weight function for corporate exposures.[83] As described below, the precise calculation of risk weights for default risk depends on the bank's ability to decompose EL into its PD and LGD components in a reliable manner. Banks can utilise external and internal data to estimate PDs and LGDs. However, the advanced approach will not be available for banks that use the foundation approach for corporate exposures.

Foundation IRB treatment

366. If the purchasing bank is unable to decompose EL into its PD and LGD components in a reliable manner, the risk weight is determined from the corporate risk-weight function using the following specifications: if the bank can demonstrate that the exposures are exclusively senior claims to corporate borrowers, an LGD of 45% can be used. PD will be calculated by dividing the EL using this LGD. EAD will be calculated as the outstanding amount minus the capital charge for dilution prior to credit risk mitigation ($K_{Dilution}$). Otherwise, PD is the bank's estimate of EL; LGD will be 100%; and EAD is the amount outstanding minus $K_{Dilution}$. EAD for a revolving purchase facility is the sum of the current amount of receivables purchased plus 75% of any undrawn purchase commitments minus $K_{Dilution}$. If the purchasing bank is able to estimate PD in a reliable manner, the risk weight is determined from the corporate risk-weight functions according to the specifications for LGD, M and the treatment of guarantees under the foundation approach as given in paragraphs 287 to 296, 299, 300 to 305, and 318.

Advanced IRB treatment

367. If the purchasing bank can estimate either the pool's default-weighted average loss rates given default (as defined in paragraph 468) or average PD in a reliable manner, the bank may estimate the other parameter based on an estimate of the expected long-run loss rate. The bank may (i) use an appropriate PD estimate to infer the long-run default-weighted average loss rate given default, or (ii) use a long-run default-weighted average loss rate given default to infer the appropriate PD. In either case, it is important to recognise that the LGD used for the IRB capital calculation for purchased receivables cannot be less than the long-run default-weighted average loss rate given default and must be consistent with the concepts defined in paragraph 468. The risk weight for the purchased receivables will be determined using the bank's estimated PD and LGD as inputs to the corporate risk-weight function. Similar to the foundation IRB treatment, EAD will be the amount outstanding minus $K_{Dilution}$. EAD for a revolving purchase facility will be the sum of the current amount of receivables purchased plus 75% of any undrawn purchase commitments minus $K_{Dilution}$ (thus, banks using the advanced IRB approach will not be permitted to use their internal EAD estimates for undrawn purchase commitments).

368. For drawn amounts, M will equal the pool's exposure-weighted average effective maturity (as defined in paragraphs 320 to 324). This same value of M will also be used for undrawn amounts under a committed purchase facility provided the facility contains effective covenants, early amortisation triggers, or other features that protect the purchasing bank

[83] The firm-size adjustment for SME, as defined in paragraph 273, will be the weighted average by individual exposure of the pool of purchased corporate receivables. If the bank does not have the information to calculate the average size of the pool, the firm-size adjustment will not apply.

against a significant deterioration in the quality of the future receivables it is required to purchase over the facility's term. Absent such effective protections, the M for undrawn amounts will be calculated as the sum of (a) the longest-dated potential receivable under the purchase agreement and (b) the remaining maturity of the purchase facility.

2. Risk-weighted assets for dilution risk

369. Dilution refers to the possibility that the receivable amount is reduced through cash or non-cash credits to the receivable's obligor.[84] For both corporate and retail receivables, unless the bank can demonstrate to its supervisor that the dilution risk for the purchasing bank is immaterial, the treatment of dilution risk must be the following: at the level of either the pool as a whole (top-down approach) or the individual receivables making up the pool (bottom-up approach), the purchasing bank will estimate the one-year EL for dilution risk, also expressed in percentage of the receivables amount. Banks can utilise external and internal data to estimate EL. As with the treatments of default risk, this estimate must be computed on a stand-alone basis; that is, under the assumption of no recourse or other support from the seller or third-party guarantors. For the purpose of calculating risk weights for dilution risk, the corporate risk-weight function must be used with the following settings: the PD must be set equal to the estimated EL, and the LGD must be set at 100%. An appropriate maturity treatment applies when determining the capital requirement for dilution risk. If a bank can demonstrate that the dilution risk is appropriately monitored and managed to be resolved within one year, the supervisor may allow the bank to apply a one-year maturity.

370. This treatment will be applied regardless of whether the underlying receivables are corporate or retail exposures, and regardless of whether the risk weights for default risk are computed using the standard IRB treatments or, for corporate receivables, the top-down treatment described above.

3. Treatment of purchase price discounts for receivables

371. In many cases, the purchase price of receivables will reflect a discount (not to be confused with the discount concept defined in paragraphs 308 and 334) that provides first loss protection for default losses, dilution losses or both (see paragraph 629). To the extent a portion of such a purchase price discount will be refunded to the seller, this refundable amount may be treated as first loss protection under the IRB securitisation framework. Non-refundable purchase price discounts for receivables do not affect either the EL-provision calculation in Section III.G or the calculation of risk-weighted assets.

372. When collateral or partial guarantees obtained on receivables provide first loss protection (collectively referred to as mitigants in this paragraph), and these mitigants cover default losses, dilution losses, or both, they may also be treated as first loss protection under the IRB securitisation framework (see paragraph 629). When the same mitigant covers both default and dilution risk, banks using the Supervisory Formula that are able to calculate an exposure-weighted LGD must do so as defined in paragraph 634.

[84] Examples include offsets or allowances arising from returns of goods sold, disputes regarding product quality, possible debts of the borrower to a receivables obligor, and any payment or promotional discounts offered by the borrower (e.g. a credit for cash payments within 30 days).

4. Recognition of credit risk mitigants

373. Credit risk mitigants will be recognised generally using the same type of framework as set forth in paragraphs 300 to 307.[85] In particular, a guarantee provided by the seller or a third party will be treated using the existing IRB rules for guarantees, regardless of whether the guarantee covers default risk, dilution risk, or both.

- If the guarantee covers both the pool's default risk *and* dilution risk, the bank will substitute the risk weight for an exposure to the guarantor in place of the pool's total risk weight for default and dilution risk.
- If the guarantee covers only default risk or dilution risk, but not both, the bank will substitute the risk weight for an exposure to the guarantor in place of the pool's risk weight for the corresponding risk component (default or dilution). The capital requirement for the other component will then be added.
- If a guarantee covers only a portion of the default and/or dilution risk, the uncovered portion of the default and/or dilution risk will be treated as per the existing CRM rules for proportional or tranched coverage (i.e. the risk weights of the uncovered risk components will be added to the risk weights of the covered risk components).

373 (i). If protection against dilution risk has been purchased, and the conditions of paragraphs 307 (i) and 307 (ii) are met, the double default framework may be used for the calculation of the risk-weighted asset amount for dilution risk. In this case, paragraphs 284 (i) to 284 (iii) apply with PD_o being equal to the estimated EL, LGD_g being equal to 100 percent, and effective maturity being set according to paragraph 369.

G. Treatment of Expected Losses and Recognition of Provisions

374. Section III.G discusses the method by which the difference between provisions (e.g. specific provisions, portfolio-specific general provisions such as country risk provisions or general provisions) and expected losses may be included in or must be deducted from regulatory capital, as outlined in paragraph 43.

1. Calculation of expected losses

375. A bank must sum the EL amount (defined as EL multiplied by EAD) associated with its exposures (excluding the EL amount associated with equity exposures under the PD/LGD approach and securitisation exposures) to obtain a total EL amount. While the EL amount associated with equity exposures subject to the PD/LGD approach is excluded from the total EL amount, paragraphs 376 and 386 apply to such exposures. The treatment of EL for securitisation exposures is described in paragraph 563.

(i) Expected loss for exposures other than SL subject to the supervisory slotting criteria

376. Banks must calculate an EL as PD x LGD for corporate, sovereign, bank, and retail exposures both not in default and not treated as hedged exposures under the double default treatment. For corporate, sovereign, bank, and retail exposures that are in default, banks must use their best estimate of expected loss as defined in paragraph 471 and banks on the foundation approach must use the supervisory LGD. For SL exposures subject to the

[85] At national supervisory discretion, banks may recognise guarantors that are internally rated and associated with a PD equivalent to less than A- under the foundation IRB approach for purposes of determining capital requirements for dilution risk.

supervisory slotting criteria EL is calculated as described in paragraphs 377 and 378. For equity exposures subject to the PD/LGD approach, the EL is calculated as PD x LGD unless paragraphs 351 to 354 apply. Securitisation exposures do not contribute to the EL amount, as set out in paragraph 563. For all other exposures, including hedged exposures under the double default treatment, the EL is zero.

(ii) Expected loss for SL exposures subject to the supervisory slotting criteria

377. For SL exposures subject to the supervisory slotting criteria, the EL amount is determined by multiplying 8% by the risk-weighted assets produced from the appropriate risk weights, as specified below, multiplied by EAD.

Supervisory categories and EL risk weights for other SL exposures

378. The risk weights for SL, other than HVCRE, are as follows:

Strong	Good	Satisfactory	Weak	Default
5%	10%	35%	100%	625%

Where, at national discretion, supervisors allow banks to assign preferential risk weights to other SL exposures falling into the “strong” and “good” supervisory categories as outlined in paragraph 277, the corresponding EL risk weight is 0% for “strong” exposures, and 5% for “good” exposures.

Supervisory categories and EL risk weights for HVCRE

379. The risk weights for HVCRE are as follows:

Strong	Good	Satisfactory	Weak	Default
5%	5%	35%	100%	625%

Even where, at national discretion, supervisors allow banks to assign preferential risk weights to HVCRE exposures falling into the “strong” and “good” supervisory categories as outlined in paragraph 282, the corresponding EL risk weight will remain at 5% for both “strong” and “good” exposures.

2. Calculation of provisions

(i) Exposures subject to IRB approach

380. Total eligible provisions are defined as the sum of all provisions (e.g. specific provisions, partial write-offs, portfolio-specific general provisions such as country risk provisions or general provisions) that are attributed to exposures treated under the IRB approach. In addition, total eligible provisions may include any discounts on defaulted assets. Specific provisions set aside against equity and securitisation exposures must not be included in total eligible provisions.

(ii) Portion of exposures subject to the standardised approach to credit risk

381. Banks using the standardised approach for a portion of their credit risk exposures, either on a transitional basis (as defined in paragraphs 257 and 258), or on a permanent

basis if the exposures subject to the standardised approach are immaterial (paragraph 259), must determine the portion of general provisions attributed to the standardised or IRB treatment of provisions (see paragraph 42) according to the methods outlined in paragraphs 382 and 383.

382. Banks should generally attribute total general provisions on a pro rata basis according to the proportion of credit risk-weighted assets subject to the standardised and IRB approaches. However, when one approach to determining credit risk-weighted assets (i.e. standardised or IRB approach) is used exclusively within an entity, general provisions booked within the entity using the standardised approach may be attributed to the standardised treatment. Similarly, general provisions booked within entities using the IRB approach may be attributed to the total eligible provisions as defined in paragraph 380.

383. At national supervisory discretion, banks using both the standardised and IRB approaches may rely on their internal methods for allocating general provisions for recognition in capital under either the standardised or IRB approach, subject to the following conditions. Where the internal allocation method is made available, the national supervisor will establish the standards surrounding their use. Banks will need to obtain prior approval from their supervisors to use an internal allocation method for this purpose.

3. Treatment of EL and provisions

384. As specified in paragraph 43, banks using the IRB approach must compare the total amount of total eligible provisions (as defined in paragraph 380) with the total EL amount as calculated within the IRB approach (as defined in paragraph 375). In addition, paragraph 42 outlines the treatment for that portion of a bank that is subject to the standardised approach to credit risk when the bank uses both the standardised and IRB approaches.

385. Where the calculated EL amount is lower than the provisions of the bank, its supervisors must consider whether the EL fully reflects the conditions in the market in which it operates before allowing the difference to be included in Tier 2 capital. If specific provisions exceed the EL amount on defaulted assets this assessment also needs to be made before using the difference to offset the EL amount on non-defaulted assets.

386. The EL amount for equity exposures under the PD/LGD approach is deducted 50% from Tier 1 and 50% from Tier 2. Provisions or write-offs for equity exposures under the PD/LGD approach will not be used in the EL-provision calculation. The treatment of EL and provisions related to securitisation exposures is outlined in paragraph 563.

H. Minimum Requirements for IRB Approach

387. Section III.H presents the minimum requirements for entry and on-going use of the IRB approach. The minimum requirements are set out in 12 separate sections concerning: (a) composition of minimum requirements, (b) compliance with minimum requirements, (c) rating system design, (d) risk rating system operations, (e) corporate governance and oversight, (f) use of internal ratings, (g) risk quantification, (h) validation of internal estimates, (i) supervisory LGD and EAD estimates, (j) requirements for recognition of leasing, (k) calculation of capital charges for equity exposures, and (l) disclosure requirements. It may be helpful to note that the minimum requirements cut across asset classes. Therefore, more than one asset class may be discussed within the context of a given minimum requirement.

1. Composition of minimum requirements

388. To be eligible for the IRB approach a bank must demonstrate to its supervisor that it meets certain minimum requirements at the outset and on an ongoing basis. Many of these requirements are in the form of objectives that a qualifying bank's risk rating systems must fulfil. The focus is on banks' abilities to rank order and quantify risk in a consistent, reliable and valid fashion.

389. The overarching principle behind these requirements is that rating and risk estimation systems and processes provide for a meaningful assessment of borrower and transaction characteristics; a meaningful differentiation of risk; and reasonably accurate and consistent quantitative estimates of risk. Furthermore, the systems and processes must be consistent with internal use of these estimates. The Committee recognises that differences in markets, rating methodologies, banking products, and practices require banks and supervisors to customise their operational procedures. It is not the Committee's intention to dictate the form or operational detail of banks' risk management policies and practices. Each supervisor will develop detailed review procedures to ensure that banks' systems and controls are adequate to serve as the basis for the IRB approach.

390. The minimum requirements set out in this document apply to all asset classes unless noted otherwise. The standards related to the process of assigning exposures to borrower or facility *grades* (and the related oversight, validation, etc.) apply equally to the process of assigning retail exposures to pools of homogenous exposures, unless noted otherwise.

391. The minimum requirements set out in this document apply to both foundation and advanced approaches unless noted otherwise. Generally, all IRB banks must produce their own estimates of PD[86] and must adhere to the overall requirements for rating system design, operations, controls, and corporate governance, as well as the requisite requirements for estimation and validation of PD measures. Banks wishing to use their own estimates of LGD and EAD must also meet the incremental minimum requirements for these risk factors included in paragraphs 468 to 489.

2. Compliance with minimum requirements

392. To be eligible for an IRB approach, a bank must demonstrate to its supervisor that it meets the IRB requirements in this document, at the outset and on an ongoing basis. Banks' overall credit risk management practices must also be consistent with the evolving sound practice guidelines issued by the Committee and national supervisors.

393. There may be circumstances when a bank is not in complete compliance with all the minimum requirements. Where this is the case, the bank must produce a plan for a timely return to compliance, and seek approval from its supervisor, or the bank must demonstrate that the effect of such non-compliance is immaterial in terms of the risk posed to the institution. Failure to produce an acceptable plan or satisfactorily implement the plan or to demonstrate immateriality will lead supervisors to reconsider the bank's eligibility for the IRB approach. Furthermore, for the duration of any non-compliance, supervisors will consider the need for the bank to hold additional capital under Pillar 2 or take other appropriate supervisory action.

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[86] Banks are not required to produce their own estimates of PD for certain equity exposures and certain exposures that fall within the SL sub-class.

3. Rating system design

394. The term "rating system" comprises all of the methods, processes, controls, and data collection and IT systems that support the assessment of credit risk, the assignment of internal risk ratings, and the quantification of default and loss estimates.

395. Within each asset class, a bank may utilise multiple rating methodologies/systems. For example, a bank may have customised rating systems for specific industries or market segments (e.g. middle market, and large corporate). If a bank chooses to use multiple systems, the rationale for assigning a borrower to a rating system must be documented and applied in a manner that best reflects the level of risk of the borrower. Banks must not allocate borrowers across rating systems inappropriately to minimise regulatory capital requirements (i.e. cherry-picking by choice of rating system). Banks must demonstrate that each system used for IRB purposes is in compliance with the minimum requirements at the outset and on an ongoing basis.

(i) Rating dimensions

Standards for corporate, sovereign, and bank exposures

396. A qualifying IRB rating system must have two separate and distinct dimensions: (i) the risk of borrower default, and (ii) transaction-specific factors.

397. The first dimension must be oriented to the risk of borrower default. Separate exposures to the same borrower must be assigned to the same borrower grade, irrespective of any differences in the nature of each specific transaction. There are two exceptions to this. Firstly, in the case of country transfer risk, where a bank may assign different borrower grades depending on whether the facility is denominated in local or foreign currency. Secondly, when the treatment of associated guarantees to a facility may be reflected in an adjusted borrower grade. In either case, separate exposures may result in multiple grades for the same borrower. A bank must articulate in its credit policy the relationship between borrower grades in terms of the level of risk each grade implies. Perceived and measured risk must increase as credit quality declines from one grade to the next. The policy must articulate the risk of each grade in terms of both a description of the probability of default risk typical for borrowers assigned the grade and the criteria used to distinguish that level of credit risk.

398. The second dimension must reflect transaction-specific factors, such as collateral, seniority, product type, etc. For foundation IRB banks, this requirement can be fulfilled by the existence of a facility dimension, which reflects both borrower and transaction-specific factors. For example, a rating dimension that reflects EL by incorporating both borrower strength (PD) and loss severity (LGD) considerations would qualify. Likewise a rating system that exclusively reflects LGD would qualify. Where a rating dimension reflects EL and does not separately quantify LGD, the supervisory estimates of LGD must be used.

399. For banks using the advanced approach, facility ratings must reflect exclusively LGD. These ratings can reflect any and all factors that can influence LGD including, but not limited to, the type of collateral, product, industry, and purpose. Borrower characteristics may be included as LGD rating criteria only to the extent they are predictive of LGD. Banks may alter the factors that influence facility grades across segments of the portfolio as long as they can satisfy their supervisor that it improves the relevance and precision of their estimates.

400. Banks using the supervisory slotting criteria for the SL sub-class are exempt from this two-dimensional requirement for these exposures. Given the interdependence between borrower/transaction characteristics in SL, banks may satisfy the requirements under this heading through a single rating dimension that reflects EL by incorporating both borrower

strength (PD) and loss severity (LGD) considerations. This exemption does not apply to banks using either the general corporate foundation or advanced approach for the SL sub-class.

Standards for retail exposures

401. Rating systems for retail exposures must be oriented to both borrower and transaction risk, and must capture all relevant borrower and transaction characteristics. Banks must assign each exposure that falls within the definition of retail for IRB purposes into a particular pool. Banks must demonstrate that this process provides for a meaningful differentiation of risk, provides for a grouping of sufficiently homogenous exposures, and allows for accurate and consistent estimation of loss characteristics at pool level.

402. For each pool, banks must estimate PD, LGD, and EAD. Multiple pools may share identical PD, LGD and EAD estimates. At a minimum, banks should consider the following risk drivers when assigning exposures to a pool:

- Borrower risk characteristics (e.g. borrower type, demographics such as age/occupation);
- Transaction risk characteristics, including product and/or collateral types (e.g. loan to value measures, seasoning, guarantees; and seniority (first vs. second lien)). Banks must explicitly address cross-collateral provisions where present.
- Delinquency of exposure: Banks are expected to separately identify exposures that are delinquent and those that are not.

(ii) Rating structure

Standards for corporate, sovereign, and bank exposures

403. A bank must have a meaningful distribution of exposures across grades with no excessive concentrations, on both its borrower-rating and its facility-rating scales.

404. To meet this objective, a bank must have a minimum of seven borrower grades for non-defaulted borrowers and one for those that have defaulted. Banks with lending activities focused on a particular market segment may satisfy this requirement with the minimum number of grades; supervisors may require banks, which lend to borrowers of diverse credit quality, to have a greater number of borrower grades.

405. A borrower grade is defined as an assessment of borrower risk on the basis of a specified and distinct set of rating criteria, from which estimates of PD are derived. The grade definition must include both a description of the degree of default risk typical for borrowers assigned the grade and the criteria used to distinguish that level of credit risk. Furthermore, "+" or "-" modifiers to alpha or numeric grades will only qualify as distinct grades if the bank has developed complete rating descriptions and criteria for their assignment, and separately quantifies PDs for these modified grades.

406. Banks with loan portfolios concentrated in a particular market segment and range of default risk must have enough grades within that range to avoid undue concentrations of borrowers in particular grades. Significant concentrations within a single grade or grades must be supported by convincing empirical evidence that the grade or grades cover reasonably narrow PD bands and that the default risk posed by all borrowers in a grade fall within that band.

407. There is no specific minimum number of facility grades for banks using the advanced approach for estimating LGD. A bank must have a sufficient number of facility

grades to avoid grouping facilities with widely varying LGDs into a single grade. The criteria used to define facility grades must be grounded in empirical evidence.

408. Banks using the supervisory slotting criteria for the SL asset classes must have at least four grades for non-defaulted borrowers, and one for defaulted borrowers. The requirements for SL exposures that qualify for the corporate foundation and advanced approaches are the same as those for general corporate exposures.

Standards for retail exposures

409. For each pool identified, the bank must be able to provide quantitative measures of loss characteristics (PD, LGD, and EAD) for that pool. The level of differentiation for IRB purposes must ensure that the number of exposures in a given pool is sufficient so as to allow for meaningful quantification and validation of the loss characteristics at the pool level. There must be a meaningful distribution of borrowers and exposures across pools. A single pool must not include an undue concentration of the bank's total retail exposure.

(iii) Rating criteria

410. A bank must have specific rating definitions, processes and criteria for assigning exposures to grades within a rating system. The rating definitions and criteria must be both plausible and intuitive and must result in a meaningful differentiation of risk.

- The grade descriptions and criteria must be sufficiently detailed to allow those charged with assigning ratings to consistently assign the same grade to borrowers or facilities posing similar risk. This consistency should exist across lines of business, departments and geographic locations. If rating criteria and procedures differ for different types of borrowers or facilities, the bank must monitor for possible inconsistency, and must alter rating criteria to improve consistency when appropriate.
- Written rating definitions must be clear and detailed enough to allow third parties to understand the assignment of ratings, such as internal audit or an equally independent function and supervisors, to replicate rating assignments and evaluate the appropriateness of the grade/pool assignments.
- The criteria must also be consistent with the bank's internal lending standards and its policies for handling troubled borrowers and facilities.

411. To ensure that banks are consistently taking into account available information, they must use all relevant and material information in assigning ratings to borrowers and facilities. Information must be current. The less information a bank has, the more conservative must be its assignments of exposures to borrower and facility grades or pools. An external rating can be the primary factor determining an internal rating assignment; however, the bank must ensure that it considers other relevant information.

SL product lines within the corporate asset class

412. Banks using the supervisory slotting criteria for SL exposures must assign exposures to their internal rating grades based on their own criteria, systems and processes, subject to compliance with the requisite minimum requirements. Banks must then map these internal rating grades into the five supervisory rating categories. Tables 1 to 4 in Annex 6 provide, for each sub-class of SL exposures, the general assessment factors and characteristics exhibited by the exposures that fall under each of the supervisory categories. Each lending activity has a unique table describing the assessment factors and characteristics.

413. The Committee recognises that the criteria that banks use to assign exposures to internal grades will not perfectly align with criteria that define the supervisory categories; however, banks must demonstrate that their mapping process has resulted in an alignment of grades which is consistent with the preponderance of the characteristics in the respective supervisory category. Banks should take special care to ensure that any overrides of their internal criteria do not render the mapping process ineffective.

(iv) Rating assignment horizon

414. Although the time horizon used in PD estimation is one year (as described in paragraph 447), banks are expected to use a longer time horizon in assigning ratings.

415. A borrower rating must represent the bank's assessment of the borrower's ability and willingness to contractually perform despite adverse economic conditions or the occurrence of unexpected events. For example, a bank may base rating assignments on specific, appropriate stress scenarios. Alternatively, a bank may take into account borrower characteristics that are reflective of the borrower's vulnerability to adverse economic conditions or unexpected events, without explicitly specifying a stress scenario. The range of economic conditions that are considered when making assessments must be consistent with current conditions and those that are likely to occur over a business cycle within the respective industry/geographic region.

416. Given the difficulties in forecasting future events and the influence they will have on a particular borrower's financial condition, a bank must take a conservative view of projected information. Furthermore, where limited data are available, a bank must adopt a conservative bias to its analysis.

(v) Use of models

417. The requirements in this section apply to statistical models and other mechanical methods used to assign borrower or facility ratings or in estimation of PDs, LGDs, or EADs. Credit scoring models and other mechanical rating procedures generally use only a subset of available information. Although mechanical rating procedures may sometimes avoid some of the idiosyncratic errors made by rating systems in which human judgement plays a large role, mechanical use of limited information also is a source of rating errors. Credit scoring models and other mechanical procedures are permissible as the primary or partial basis of rating assignments, and may play a role in the estimation of loss characteristics. Sufficient human judgement and human oversight is necessary to ensure that all relevant and material information, including that which is outside the scope of the model, is also taken into consideration, and that the model is used appropriately.

- The burden is on the bank to satisfy its supervisor that a model or procedure has good predictive power and that regulatory capital requirements will not be distorted as a result of its use. The variables that are input to the model must form a reasonable set of predictors. The model must be accurate on average across the range of borrowers or facilities to which the bank is exposed and there must be no known material biases.
- The bank must have in place a process for vetting data inputs into a statistical default or loss prediction model which includes an assessment of the accuracy, completeness and appropriateness of the data specific to the assignment of an approved rating.
- The bank must demonstrate that the data used to build the model are representative of the population of the bank's actual borrowers or facilities.

- When combining model results with human judgement, the judgement must take into account all relevant and material information not considered by the model. The bank must have written guidance describing how human judgement and model results are to be combined.
- The bank must have procedures for human review of model-based rating assignments. Such procedures should focus on finding and limiting errors associated with known model weaknesses and must also include credible ongoing efforts to improve the model's performance.
- The bank must have a regular cycle of model validation that includes monitoring of model performance and stability; review of model relationships; and testing of model outputs against outcomes.

(vi) Documentation of rating system design

418. Banks must document in writing their rating systems' design and operational details. The documentation must evidence banks' compliance with the minimum standards, and must address topics such as portfolio differentiation, rating criteria, responsibilities of parties that rate borrowers and facilities, definition of what constitutes a rating exception, parties that have authority to approve exceptions, frequency of rating reviews, and management oversight of the rating process. A bank must document the rationale for its choice of internal rating criteria and must be able to provide analyses demonstrating that rating criteria and procedures are likely to result in ratings that meaningfully differentiate risk. Rating criteria and procedures must be periodically reviewed to determine whether they remain fully applicable to the current portfolio and to external conditions. In addition, a bank must document a history of major changes in the risk rating process, and such documentation must support identification of changes made to the risk rating process subsequent to the last supervisory review. The organisation of rating assignment, including the internal control structure, must also be documented.

419. Banks must document the specific definitions of default and loss used internally and demonstrate consistency with the reference definitions set out in paragraphs 452 to 460.

420. If the bank employs statistical models in the rating process, the bank must document their methodologies. This material must:

- Provide a detailed outline of the theory, assumptions and/or mathematical and empirical basis of the assignment of estimates to grades, individual obligors, exposures, or pools, and the data source(s) used to estimate the model;
- Establish a rigorous statistical process (including out-of-time and out-of-sample performance tests) for validating the model; and
- Indicate any circumstances under which the model does not work effectively.

421. Use of a model obtained from a third-party vendor that claims proprietary technology is not a justification for exemption from documentation or any other of the requirements for internal rating systems. The burden is on the model's vendor and the bank to satisfy supervisors.

4. Risk rating system operations

(i) Coverage of ratings

422. For corporate, sovereign, and bank exposures, each borrower and all recognised guarantors must be assigned a rating and each exposure must be associated with a facility

rating as part of the loan approval process. Similarly, for retail, each exposure must be assigned to a pool as part of the loan approval process.

423. Each separate legal entity to which the bank is exposed must be separately rated. A bank must have policies acceptable to its supervisor regarding the treatment of individual entities in a connected group including circumstances under which the same rating may or may not be assigned to some or all related entities.

(ii) Integrity of rating process

Standards for corporate, sovereign, and bank exposures

424. Rating assignments and periodic rating reviews must be completed or approved by a party that does not directly stand to benefit from the extension of credit. Independence of the rating assignment process can be achieved through a range of practices that will be carefully reviewed by supervisors. These operational processes must be documented in the bank's procedures and incorporated into bank policies. Credit policies and underwriting procedures must reinforce and foster the independence of the rating process.

425. Borrowers and facilities must have their ratings refreshed at least on an annual basis. Certain credits, especially higher risk borrowers or problem exposures, must be subject to more frequent review. In addition, banks must initiate a new rating if material information on the borrower or facility comes to light.

426. The bank must have an effective process to obtain and update relevant and material information on the borrower's financial condition, and on facility characteristics that affect LGDs and EADs (such as the condition of collateral). Upon receipt, the bank needs to have a procedure to update the borrower's rating in a timely fashion.

Standards for retail exposures

427. A bank must review the loss characteristics and delinquency status of each identified risk pool on at least an annual basis. It must also review the status of individual borrowers within each pool as a means of ensuring that exposures continue to be assigned to the correct pool. This requirement may be satisfied by review of a representative sample of exposures in the pool.

(iii) Overrides

428. For rating assignments based on expert judgement, banks must clearly articulate the situations in which bank officers may override the outputs of the rating process, including how and to what extent such overrides can be used and by whom. For model-based ratings, the bank must have guidelines and processes for monitoring cases where human judgement has overridden the model's rating, variables were excluded or inputs were altered. These guidelines must include identifying personnel that are responsible for approving these overrides. Banks must identify overrides and separately track their performance.

(iv) Data maintenance

429. A bank must collect and store data on key borrower and facility characteristics to provide effective support to its internal credit risk measurement and management process, to enable the bank to meet the other requirements in this document, and to serve as a basis for supervisory reporting. These data should be sufficiently detailed to allow retrospective re-allocation of obligors and facilities to grades, for example if increasing sophistication of the internal rating system suggests that finer segregation of portfolios can be achieved.

Furthermore, banks must collect and retain data on aspects of their internal ratings as required under Pillar 3 of this Framework.

For corporate, sovereign, and bank exposures

430. Banks must maintain rating histories on borrowers and recognised guarantors, including the rating since the borrower/guarantor was assigned an internal grade, the dates the ratings were assigned, the methodology and key data used to derive the rating and the person/model responsible. The identity of borrowers and facilities that default, and the timing and circumstances of such defaults, must be retained. Banks must also retain data on the PDs and realised default rates associated with rating grades and ratings migration in order to track the predictive power of the borrower rating system.

431. Banks using the advanced IRB approach must also collect and store a complete history of data on the LGD and EAD estimates associated with each facility and the key data used to derive the estimate and the person/model responsible. Banks must also collect data on the estimated and realised LGDs and EADs associated with each defaulted facility. Banks that reflect the credit risk mitigating effects of guarantees/credit derivatives through LGD must retain data on the LGD of the facility before and after evaluation of the effects of the guarantee/credit derivative. Information about the components of loss or recovery for each defaulted exposure must be retained, such as amounts recovered, source of recovery (e.g. collateral, liquidation proceeds and guarantees), time period required for recovery, and administrative costs.

432. Banks under the foundation approach which utilise supervisory estimates are encouraged to retain the relevant data (i.e. data on loss and recovery experience for corporate exposures under the foundation approach, data on realised losses for banks using the supervisory slotting criteria for SL).

For retail exposures

433. Banks must retain data used in the process of allocating exposures to pools, including data on borrower and transaction risk characteristics used either directly or through use of a model, as well as data on delinquency. Banks must also retain data on the estimated PDs, LGDs and EADs, associated with pools of exposures. For defaulted exposures, banks must retain the data on the pools to which the exposure was assigned over the year prior to default and the realised outcomes on LGD and EAD.

(v) Stress tests used in assessment of capital adequacy

434. An IRB bank must have in place sound stress testing processes for use in the assessment of capital adequacy. Stress testing must involve identifying possible events or future changes in economic conditions that could have unfavourable effects on a bank's credit exposures and assessment of the bank's ability to withstand such changes. Examples of scenarios that could be used are (i) economic or industry downturns; (ii) market-risk events; and (iii) liquidity conditions.

435. In addition to the more general tests described above, the bank must perform a credit risk stress test to assess the effect of certain specific conditions on its IRB regulatory capital requirements. The test to be employed would be one chosen by the bank, subject to supervisory review. The test to be employed must be meaningful and reasonably conservative. Individual banks may develop different approaches to undertaking this stress test requirement, depending on their circumstances. For this purpose, the objective is not to require banks to consider worst-case scenarios. The bank's stress test in this context should, however, consider at least the effect of mild recession scenarios. In this case, one example

might be to use two consecutive quarters of zero growth to assess the effect on the bank's PDs, LGDs and EADs, taking account — on a conservative basis — of the bank's international diversification.

435(i) Banks using the double default framework must consider as part of their stress testing framework the impact of a deterioration in the credit quality of protection providers, in particular the impact of protection providers falling outside the eligibility criteria due to rating changes. Banks should also consider the impact of the default of one but not both of the obligor and protection provider, and the consequent increase in risk and capital requirements at the time of that default.

436. Whatever method is used, the bank must include a consideration of the following sources of information. First, a bank's own data should allow estimation of the ratings migration of at least some of its exposures. Second, banks should consider information about the impact of smaller deterioration in the credit environment on a bank's ratings, giving some information on the likely effect of bigger, stress circumstances. Third, banks should evaluate evidence of ratings migration in external ratings. This would include the bank broadly matching its buckets to rating categories.

437. National supervisors may wish to issue guidance to their banks on how the tests to be used for this purpose should be designed, bearing in mind conditions in their jurisdiction. The results of the stress test may indicate no difference in the capital calculated under the IRB rules described in this section of this Framework if the bank already uses such an approach for its internal rating purposes. Where a bank operates in several markets, it does not need to test for such conditions in all of those markets, but a bank should stress portfolios containing the vast majority of its total exposures.

5. Corporate governance and oversight

(i) Corporate governance

438. All material aspects of the rating and estimation processes must be approved by the bank's board of directors or a designated committee thereof and senior management.[87] These parties must possess a general understanding of the bank's risk rating system and detailed comprehension of its associated management reports. Senior management must provide notice to the board of directors or a designated committee thereof of material changes or exceptions from established policies that will materially impact the operations of the bank's rating system.

439. Senior management also must have a good understanding of the rating system's design and operation, and must approve material differences between established procedure and actual practice. Management must also ensure, on an ongoing basis, that the rating system is operating properly. Management and staff in the credit control function must meet

[87] This standard refers to a management structure composed of a board of directors and senior management. The Committee is aware that there are significant differences in legislative and regulatory frameworks across countries as regards the functions of the board of directors and senior management. In some countries, the board has the main, if not exclusive, function of supervising the executive body (senior management, general management) so as to ensure that the latter fulfils its tasks. For this reason, in some cases, it is known as a supervisory board. This means that the board has no executive functions. In other countries, by contrast, the board has a broader competence in that it lays down the general framework for the management of the bank. Owing to these differences, the notions of the board of directors and senior management are used in this paper not to identify legal constructs but rather to label two decision-making functions within a bank.

regularly to discuss the performance of the rating process, areas needing improvement, and the status of efforts to improve previously identified deficiencies.

440. Internal ratings must be an essential part of the reporting to these parties. Reporting must include risk profile by grade, migration across grades, estimation of the relevant parameters per grade, and comparison of realised default rates (and LGDs and EADs for banks on advanced approaches) against expectations. Reporting frequencies may vary with the significance and type of information and the level of the recipient.

(ii) Credit risk control

441. Banks must have independent credit risk control units that are responsible for the design or selection, implementation and performance of their internal rating systems. The unit(s) must be functionally independent from the personnel and management functions responsible for originating exposures. Areas of responsibility must include:

- Testing and monitoring internal grades;
- Production and analysis of summary reports from the bank's rating system, to include historical default data sorted by rating at the time of default and one year prior to default, grade migration analyses, and monitoring of trends in key rating criteria;
- Implementing procedures to verify that rating definitions are consistently applied across departments and geographic areas;
- Reviewing and documenting any changes to the rating process, including the reasons for the changes; and
- Reviewing the rating criteria to evaluate if they remain predictive of risk. Changes to the rating process, criteria or individual rating parameters must be documented and retained for supervisors to review.

442. A credit risk control unit must actively participate in the development, selection, implementation and validation of rating models. It must assume oversight and supervision responsibilities for any models used in the rating process, and ultimate responsibility for the ongoing review and alterations to rating models.

(iii) Internal and external audit

443. Internal audit or an equally independent function must review at least annually the bank's rating system and its operations, including the operations of the credit function and the estimation of PDs, LGDs and EADs. Areas of review include adherence to all applicable minimum requirements. Internal audit must document its findings. Some national supervisors may also require an external audit of the bank's rating assignment process and estimation of loss characteristics.

6. Use of internal ratings

444. Internal ratings and default and loss estimates must play an essential role in the credit approval, risk management, internal capital allocations, and corporate governance functions of banks using the IRB approach. Ratings systems and estimates designed and implemented exclusively for the purpose of qualifying for the IRB approach and used only to provide IRB inputs are not acceptable. It is recognised that banks will not necessarily be using exactly the same estimates for both IRB and all internal purposes. For example, pricing models are likely to use PDs and LGDs relevant to the life of the asset. Where there are such

differences, a bank must document them and demonstrate their reasonableness to the supervisor.

445. A bank must have a credible track record in the use of internal ratings information. Thus, the bank must demonstrate that it has been using a rating system that was broadly in line with the minimum requirements articulated in this document for at least the three years prior to qualification. A bank using the advanced IRB approach must demonstrate that it has been estimating and employing LGDs and EADs in a manner that is broadly consistent with the minimum requirements for use of own estimates of LGDs and EADs for at least the three years prior to qualification. Improvements to a bank's rating system will not render a bank non-compliant with the three-year requirement.

7. Risk quantification

(i) Overall requirements for estimation

Structure and intent

446. This section addresses the broad standards for own-estimates of PD, LGD, and EAD. Generally, all banks using the IRB approaches must estimate a PD[88] for each internal borrower grade for corporate, sovereign and bank exposures or for each pool in the case of retail exposures.

447. PD estimates must be a long-run average of one-year default rates for borrowers in the grade, with the exception of retail exposures (see below). Requirements specific to PD estimation are provided in paragraphs 461 to 467. Banks on the advanced approach must estimate an appropriate LGD (as defined in paragraphs 468 to 473) for each of its facilities (or retail pools). Banks on the advanced approach must also estimate an appropriate long-run default-weighted average EAD for each of its facilities as defined in paragraphs 474 and 475. Requirements specific to EAD estimation appear in paragraphs 474 to 479. For corporate, sovereign and bank exposures, banks that do not meet the requirements for own-estimates of EAD or LGD, above, must use the supervisory estimates of these parameters. Standards for use of such estimates are set out in paragraphs 506 to 524.

448. Internal estimates of PD, LGD, and EAD must incorporate all relevant, material and available data, information and methods. A bank may utilise internal data and data from external sources (including pooled data). Where internal or external data is used, the bank must demonstrate that its estimates are representative of long run experience.

449. Estimates must be grounded in historical experience and empirical evidence, and not based purely on subjective or judgmental considerations. Any changes in lending practice or the process for pursuing recoveries over the observation period must be taken into account. A bank's estimates must promptly reflect the implications of technical advances and new data and other information, as it becomes available. Banks must review their estimates on a yearly basis or more frequently.

450. The population of exposures represented in the data used for estimation, and lending standards in use when the data were generated, and other relevant characteristics should be closely matched to or at least comparable with those of the bank's exposures and standards. The bank must also demonstrate that economic or market conditions that underlie

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[88] Banks are not required to produce their own estimates of PD for certain equity exposures and certain exposures that fall within the SL sub-classes.

the data are relevant to current and foreseeable conditions. For estimates of LGD and EAD, banks must take into account paragraphs 468 to 479. The number of exposures in the sample and the data period used for quantification must be sufficient to provide the bank with confidence in the accuracy and robustness of its estimates. The estimation technique must perform well in out-of-sample tests.

451. In general, estimates of PDs, LGDs, and EADs are likely to involve unpredictable errors. In order to avoid over-optimism, a bank must add to its estimates a margin of conservatism that is related to the likely range of errors. Where methods and data are less satisfactory and the likely range of errors is larger, the margin of conservatism must be larger. Supervisors may allow some flexibility in application of the required standards for data that are collected prior to the date of implementation of this Framework. However, in such cases banks must demonstrate to their supervisors that appropriate adjustments have been made to achieve broad equivalence to the data without such flexibility. Data collected beyond the date of implementation must conform to the minimum standards unless otherwise stated.

(ii) Definition of default

452. A default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place.

- The bank considers that the obligor is unlikely to pay its credit obligations to the banking group in full, without recourse by the bank to actions such as realising security (if held).
- The obligor is past due more than 90 days on any material credit obligation to the banking group.[89] Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than current outstandings.

453. The elements to be taken as indications of unlikeliness to pay include:

- The bank puts the credit obligation on non-accrued status.
- The bank makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure.[90]
- The bank sells the credit obligation at a material credit-related economic loss.
- The bank consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or (where relevant) fees.[91]
- The bank has filed for the obligor's bankruptcy or a similar order in respect of the obligor's credit obligation to the banking group.

[89] In the case of retail and PSE obligations, for the 90 days figure, a supervisor may substitute a figure up to 180 days for different products, as it considers appropriate to local conditions. In one member country, local conditions make it appropriate to use a figure of up to 180 days also for lending by its banks to corporates; this applies for a transitional period of 5 years.

[90] In some jurisdictions, specific provisions on equity exposures are set aside for price risk and do not signal default.

[91] Including, in the case of equity holdings assessed under a PD/LGD approach, such distressed restructuring of the equity itself.

- The obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of the credit obligation to the banking group.

454. National supervisors will provide appropriate guidance as to how these elements must be implemented and monitored.

455. For retail exposures, the definition of default can be applied at the level of a particular facility, rather than at the level of the obligor. As such, default by a borrower on one obligation does not require a bank to treat all other obligations to the banking group as defaulted.

456. A bank must record actual defaults on IRB exposure classes using this reference definition. A bank must also use the reference definition for its estimation of PDs, and (where relevant) LGDs and EADs. In arriving at these estimations, a bank may use external data available to it that is not itself consistent with that definition, subject to the requirements set out in paragraph 462. However, in such cases, banks must demonstrate to their supervisors that appropriate adjustments to the data have been made to achieve broad equivalence with the reference definition. This same condition would apply to any internal data used up to implementation of this Framework. Internal data (including that pooled by banks) used in such estimates beyond the date of implementation of this Framework must be consistent with the reference definition.

457. If the bank considers that a previously defaulted exposure's status is such that no trigger of the reference definition any longer applies, the bank must rate the borrower and estimate LGD as they would for a non-defaulted facility. Should the reference definition subsequently be triggered, a second default would be deemed to have occurred.

(iii) Re-ageing

458. The bank must have clearly articulated and documented policies in respect of the counting of days past due, in particular in respect of the re-ageing of the facilities and the granting of extensions, deferrals, renewals and rewrites to existing accounts. At a minimum, the re-ageing policy must include: (a) approval authorities and reporting requirements; (b) minimum age of a facility before it is eligible for re-ageing; (c) delinquency levels of facilities that are eligible for re-ageing; (d) maximum number of re-ageings per facility; and (e) a reassessment of the borrower's capacity to repay. These policies must be applied consistently over time, and must support the 'use test' (i.e. if a bank treats a re-aged exposure in a similar fashion to other delinquent exposures more than the past-due cut off point, this exposure must be recorded as in default for IRB purposes). Some supervisors may choose to establish more specific requirements on re-ageing for banks in their jurisdiction.

(iv) Treatment of overdrafts

459. Authorised overdrafts must be subject to a credit limit set by the bank and brought to the knowledge of the client. Any break of this limit must be monitored; if the account were not brought under the limit after 90 to 180 days (subject to the applicable past-due trigger), it would be considered as defaulted. Non-authorised overdrafts will be associated with a zero limit for IRB purposes. Thus, days past due commence once any credit is granted to an unauthorised customer; if such credit were not repaid within 90 to 180 days, the exposure would be considered in default. Banks must have in place rigorous internal policies for assessing the creditworthiness of customers who are offered overdraft accounts.

(v) Definition of loss for all asset classes

460. The definition of loss used in estimating LGD is economic loss. When measuring economic loss, all relevant factors should be taken into account. This must include material discount effects and material direct and indirect costs associated with collecting on the exposure. Banks must not simply measure the loss recorded in accounting records, although they must be able to compare accounting and economic losses. The bank's own workout and collection expertise significantly influences their recovery rates and must be reflected in their LGD estimates, but adjustments to estimates for such expertise must be conservative until the bank has sufficient internal empirical evidence of the impact of its expertise.

(vi) Requirements specific to PD estimation

Corporate, sovereign, and bank exposures

461. Banks must use information and techniques that take appropriate account of the long-run experience when estimating the average PD for each rating grade. For example, banks may use one or more of the three specific techniques set out below: internal default experience, mapping to external data, and statistical default models.

462. Banks may have a primary technique and use others as a point of comparison and potential adjustment. Supervisors will not be satisfied by mechanical application of a technique without supporting analysis. Banks must recognise the importance of judgmental considerations in combining results of techniques and in making adjustments for limitations of techniques and information.

- A bank may use data on internal default experience for the estimation of PD. A bank must demonstrate in its analysis that the estimates are reflective of underwriting standards and of any differences in the rating system that generated the data and the current rating system. Where only limited data are available, or where underwriting standards or rating systems have changed, the bank must add a greater margin of conservatism in its estimate of PD. The use of pooled data across institutions may also be recognised. A bank must demonstrate that the internal rating systems and criteria of other banks in the pool are comparable with its own.
- Banks may associate or map their internal grades to the scale used by an external credit assessment institution or similar institution and then attribute the default rate observed for the external institution's grades to the bank's grades. Mappings must be based on a comparison of internal rating criteria to the criteria used by the external institution and on a comparison of the internal and external ratings of any common borrowers. Biases or inconsistencies in the mapping approach or underlying data must be avoided. The external institution's criteria underlying the data used for quantification must be oriented to the risk of the borrower and not reflect transaction characteristics. The bank's analysis must include a comparison of the default definitions used, subject to the requirements in paragraph 452 to 457. The bank must document the basis for the mapping.
- A bank is allowed to use a simple average of default-probability estimates for individual borrowers in a given grade, where such estimates are drawn from statistical default prediction models. The bank's use of default probability models for this purpose must meet the standards specified in paragraph 417.

463. Irrespective of whether a bank is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used must be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data are relevant and material, this longer period must be used.

Retail exposures

464. Given the bank-specific basis of assigning exposures to pools, banks must regard internal data as the primary source of information for estimating loss characteristics. Banks are permitted to use external data or statistical models for quantification provided a strong link can be demonstrated between (a) the bank's process of assigning exposures to a pool and the process used by the external data source, and (b) between the bank's internal risk profile and the composition of the external data. In all cases banks must use all relevant and material data sources as points of comparison.

465. One method for deriving long-run average estimates of PD and default-weighted average loss rates given default (as defined in paragraph 468) for retail would be based on an estimate of the expected long-run loss rate. A bank may (i) use an appropriate PD estimate to infer the long-run default-weighted average loss rate given default, or (ii) use a long-run default-weighted average loss rate given default to infer the appropriate PD. In either case, it is important to recognise that the LGD used for the IRB capital calculation cannot be less than the long-run default-weighted average loss rate given default and must be consistent with the concepts defined in paragraph 468.

466. Irrespective of whether banks are using external, internal, pooled data sources, or a combination of the three, for their estimation of loss characteristics, the length of the underlying historical observation period used must be at least five years. If the available observation spans a longer period for any source, and these data are relevant, this longer period must be used. A bank need not give equal importance to historic data if it can convince its supervisor that more recent data are a better predictor of loss rates.

467. The Committee recognises that seasoning can be quite material for some long-term retail exposures characterised by seasoning effects that peak several years after origination. Banks should anticipate the implications of rapid exposure growth and take steps to ensure that their estimation techniques are accurate, and that their current capital level and earnings and funding prospects are adequate to cover their future capital needs. In order to avoid gyrations in their required capital positions arising from short-term PD horizons, banks are also encouraged to adjust PD estimates upward for anticipated seasoning effects, provided such adjustments are applied in a consistent fashion over time. Within some jurisdictions, such adjustments might be made mandatory, subject to supervisory discretion.

(vii) Requirements specific to own-LGD estimates

Standards for all asset classes

468. A bank must estimate an LGD for each facility that aims to reflect economic downturn conditions where necessary to capture the relevant risks. This LGD cannot be less than the long-run default-weighted average loss rate given default calculated based on the average economic loss of all observed defaults within the data source for that type of facility. In addition, a bank must take into account the potential for the LGD of the facility to be higher than the default-weighted average during a period when credit losses are substantially higher than average. For certain types of exposures, loss severities may not exhibit such cyclical variability and LGD estimates may not differ materially (or possibly at all) from the long-run default-weighted average. However, for other exposures, this cyclical variability in loss severities may be important and banks will need to incorporate it into their LGD estimates. For this purpose, banks may use averages of loss severities observed during periods of high credit losses, forecasts based on appropriately conservative assumptions, or other similar methods. Appropriate estimates of LGD during periods of high credit losses might be formed using either internal and/or external data. Supervisors will continue to monitor and encourage the development of appropriate approaches to this issue.

469. In its analysis, the bank must consider the extent of any dependence between the risk of the borrower and that of the collateral or collateral provider. Cases where there is a significant degree of dependence must be addressed in a conservative manner. Any currency mismatch between the underlying obligation and the collateral must also be considered and treated conservatively in the bank's assessment of LGD.

470. LGD estimates must be grounded in historical recovery rates and, when applicable, must not solely be based on the collateral's estimated market value. This requirement recognises the potential inability of banks to gain both control of their collateral and liquidate it expeditiously. To the extent, that LGD estimates take into account the existence of collateral, banks must establish internal requirements for collateral management, operational procedures, legal certainty and risk management process that are generally consistent with those required for the standardised approach.

471. Recognising the principle that realised losses can at times systematically exceed expected levels, the LGD assigned to a defaulted asset should reflect the possibility that the bank would have to recognise additional, unexpected losses during the recovery period. For each defaulted asset, the bank must also construct its best estimate of the expected loss on that asset based on current economic circumstances and facility status. The amount, if any, by which the LGD on a defaulted asset exceeds the bank's best estimate of expected loss on the asset represents the capital requirement for that asset, and should be set by the bank on a risk-sensitive basis in accordance with paragraphs 272 and 328 to 330. Instances where the best estimate of expected loss on a defaulted asset is less than the sum of specific provisions and partial charge-offs on that asset will attract supervisory scrutiny and must be justified by the bank.

Additional standards for corporate, sovereign, and bank exposures

472. Estimates of LGD must be based on a minimum data observation period that should ideally cover at least one complete economic cycle but must in any case be no shorter than a period of seven years for at least one source. If the available observation period spans a longer period for any source, and the data are relevant, this longer period must be used.

Additional standards for retail exposures

473. The minimum data observation period for LGD estimates for retail exposures is five years. The less data a bank has, the more conservative it must be in its estimation. A bank need not give equal importance to historic data if it can demonstrate to its supervisor that more recent data are a better predictor of loss rates.

(viii) Requirements specific to own-EAD estimates

Standards for all asset classes

474. EAD for an on-balance sheet or off-balance sheet item is defined as the expected gross exposure of the facility upon default of the obligor. For on-balance sheet items, banks must estimate EAD at no less than the current drawn amount, subject to recognising the effects of on-balance sheet netting as specified in the foundation approach. The minimum requirements for the recognition of netting are the same as those under the foundation approach. The additional minimum requirements for internal estimation of EAD under the advanced approach, therefore, focus on the estimation of EAD for off-balance sheet items (excluding transactions that expose banks to counterparty credit risk as set out in Annex 4). Advanced approach banks must have established procedures in place for the estimation of EAD for off-balance sheet items. These must specify the estimates of EAD to be used for each facility type. Banks estimates of EAD should reflect the possibility of additional drawings

by the borrower up to and after the time a default event is triggered. Where estimates of EAD differ by facility type, the delineation of these facilities must be clear and unambiguous.

475. Advanced approach banks must assign an estimate of EAD for each facility. It must be an estimate of the long-run default-weighted average EAD for similar facilities and borrowers over a sufficiently long period of time, but with a margin of conservatism appropriate to the likely range of errors in the estimate. If a positive correlation can reasonably be expected between the default frequency and the magnitude of EAD, the EAD estimate must incorporate a larger margin of conservatism. Moreover, for exposures for which EAD estimates are volatile over the economic cycle, the bank must use EAD estimates that are appropriate for an economic downturn, if these are more conservative than the long-run average. For banks that have been able to develop their own EAD models, this could be achieved by considering the cyclical nature, if any, of the drivers of such models. Other banks may have sufficient internal data to examine the impact of previous recession(s). However, some banks may only have the option of making conservative use of external data.

476. The criteria by which estimates of EAD are derived must be plausible and intuitive, and represent what the bank believes to be the material drivers of EAD. The choices must be supported by credible internal analysis by the bank. The bank must be able to provide a breakdown of its EAD experience by the factors it sees as the drivers of EAD. A bank must use all relevant and material information in its derivation of EAD estimates. Across facility types, a bank must review its estimates of EAD when material new information comes to light and at least on an annual basis.

477. Due consideration must be paid by the bank to its specific policies and strategies adopted in respect of account monitoring and payment processing. The bank must also consider its ability and willingness to prevent further drawings in circumstances short of payment default, such as covenant violations or other technical default events. Banks must also have adequate systems and procedures in place to monitor facility amounts, current outstandings against committed lines and changes in outstandings per borrower and per grade. The bank must be able to monitor outstanding balances on a daily basis.

477(i). For transactions that expose banks to counterparty credit risk, estimates of EAD must fulfil the requirements set forth in Annex 4 of this Framework.

Additional standards for corporate, sovereign, and bank exposures

478. Estimates of EAD must be based on a time period that must ideally cover a complete economic cycle but must in any case be no shorter than a period of seven years. If the available observation period spans a longer period for any source, and the data are relevant, this longer period must be used. EAD estimates must be calculated using a default-weighted average and not a time-weighted average.

Additional standards for retail exposures

479. The minimum data observation period for EAD estimates for retail exposures is five years. The less data a bank has, the more conservative it must be in its estimation. A bank need not give equal importance to historic data if it can demonstrate to its supervisor that more recent data are a better predictor of drawdowns.

(ix) Minimum requirements for assessing effect of guarantees and credit derivatives

Standards for corporate, sovereign, and bank exposures where own estimates of LGD are used and standards for retail exposures

Guarantees

480. When a bank uses its own estimates of LGD, it may reflect the risk-mitigating effect of guarantees through an adjustment to PD or LGD estimates. The option to adjust LGDs is available only to those banks that have been approved to use their own internal estimates of LGD. For retail exposures, where guarantees exist, either in support of an individual obligation or a pool of exposures, a bank may reflect the risk-reducing effect either through its estimates of PD or LGD, provided this is done consistently. In adopting one or the other technique, a bank must adopt a consistent approach, both across types of guarantees and over time.

481. In all cases, both the borrower and all recognised guarantors must be assigned a borrower rating at the outset and on an ongoing basis. A bank must follow all minimum requirements for assigning borrower ratings set out in this document, including the regular monitoring of the guarantor's condition and ability and willingness to honour its obligations. Consistent with the requirements in paragraphs 430 and 431, a bank must retain all relevant information on the borrower absent the guarantee and the guarantor. In the case of retail guarantees, these requirements also apply to the assignment of an exposure to a pool, and the estimation of PD.

482. In no case can the bank assign the guaranteed exposure an adjusted PD or LGD such that the adjusted risk weight would be lower than that of a comparable, direct exposure to the guarantor. Neither criteria nor rating processes are permitted to consider possible favourable effects of imperfect expected correlation between default events for the borrower and guarantor for purposes of regulatory minimum capital requirements. As such, the adjusted risk weight must not reflect the risk mitigation of "double default."

Eligible guarantors and guarantees

483. There are no restrictions on the types of eligible guarantors. The bank must, however, have clearly specified criteria for the types of guarantors it will recognise for regulatory capital purposes.

484. The guarantee must be evidenced in writing, non-cancellable on the part of the guarantor, in force until the debt is satisfied in full (to the extent of the amount and tenor of the guarantee) and legally enforceable against the guarantor in a jurisdiction where the guarantor has assets to attach and enforce a judgement. However, in contrast to the foundation approach to corporate, bank, and sovereign exposures, guarantees prescribing conditions under which the guarantor may not be obliged to perform (conditional guarantees) may be recognised under certain conditions. Specifically, the onus is on the bank to demonstrate that the assignment criteria adequately address any potential reduction in the risk mitigation effect.

Adjustment criteria

485. A bank must have clearly specified criteria for adjusting borrower grades or LGD estimates (or in the case of retail and eligible purchased receivables, the process of allocating exposures to pools) to reflect the impact of guarantees for regulatory capital purposes. These criteria must be as detailed as the criteria for assigning exposures to grades consistent with paragraphs 410 and 411, and must follow all minimum requirements for assigning borrower or facility ratings set out in this document.

486. The criteria must be plausible and intuitive, and must address the guarantor's ability and willingness to perform under the guarantee. The criteria must also address the likely timing of any payments and the degree to which the guarantor's ability to perform under the guarantee is correlated with the borrower's ability to repay. The bank's criteria must also consider the extent to which residual risk to the borrower remains, for example a currency mismatch between the guarantee and the underlying exposure.

487. In adjusting borrower grades or LGD estimates (or in the case of retail and eligible purchased receivables, the process of allocating exposures to pools), banks must take all relevant available information into account.

Credit derivatives

488. The minimum requirements for guarantees are relevant also for single-name credit derivatives. Additional considerations arise in respect of asset mismatches. The criteria used for assigning adjusted borrower grades or LGD estimates (or pools) for exposures hedged with credit derivatives must require that the asset on which the protection is based (the reference asset) cannot be different from the underlying asset, unless the conditions outlined in the foundation approach are met.

489. In addition, the criteria must address the payout structure of the credit derivative and conservatively assess the impact this has on the level and timing of recoveries. The bank must also consider the extent to which other forms of residual risk remain.

For banks using foundation LGD estimates

490. The minimum requirements outlined in paragraphs 480 to 489 apply to banks using the foundation LGD estimates with the following exceptions:

(1) The bank is not able to use an 'LGD-adjustment' option; and

(2) The range of eligible guarantees and guarantors is limited to those outlined in paragraph 302.

(x) Requirements specific to estimating PD and LGD (or EL) for qualifying purchased receivables

491. The following minimum requirements for risk quantification must be satisfied for any purchased receivables (corporate or retail) making use of the top-down treatment of default risk and/or the IRB treatments of dilution risk.

492. The purchasing bank will be required to group the receivables into sufficiently homogeneous pools so that accurate and consistent estimates of PD and LGD (or EL) for default losses and EL estimates of dilution losses can be determined. In general, the risk bucketing process will reflect the seller's underwriting practices and the heterogeneity of its customers. In addition, methods and data for estimating PD, LGD, and EL must comply with the existing risk quantification standards for retail exposures. In particular, quantification should reflect all information available to the purchasing bank regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing bank, or by external sources. The purchasing bank must determine whether the data provided by the seller are consistent with expectations agreed upon by both parties concerning, for example, the type, volume and on-going quality of receivables purchased. Where this is not the case, the purchasing bank is expected to obtain and rely upon more relevant data.

Minimum operational requirements

493. A bank purchasing receivables has to justify confidence that current and future advances can be repaid from the liquidation of (or collections against) the receivables pool. To qualify for the top-down treatment of default risk, the receivable pool and overall lending relationship should be closely monitored and controlled. Specifically, a bank will have to demonstrate the following:

Legal certainty

494. The structure of the facility must ensure that under all foreseeable circumstances the bank has effective ownership and control of the cash remittances from the receivables, including incidences of seller or servicer distress and bankruptcy. When the obligor makes payments directly to a seller or servicer, the bank must verify regularly that payments are forwarded completely and within the contractually agreed terms. As well, ownership over the receivables and cash receipts should be protected against bankruptcy 'stays' or legal challenges that could materially delay the lender's ability to liquidate/assign the receivables or retain control over cash receipts.

Effectiveness of monitoring systems

495. The bank must be able to monitor both the quality of the receivables and the financial condition of the seller and servicer. In particular:

- The bank must (a) assess the correlation among the quality of the receivables and the financial condition of both the seller and servicer, and (b) have in place internal policies and procedures that provide adequate safeguards to protect against such contingencies, including the assignment of an internal risk rating for each seller and servicer.
- The bank must have clear and effective policies and procedures for determining seller and servicer eligibility. The bank or its agent must conduct periodic reviews of sellers and servicers in order to verify the accuracy of reports from the seller/servicer, detect fraud or operational weaknesses, and verify the quality of the seller's credit policies and servicer's collection policies and procedures. The findings of these reviews must be well documented.
- The bank must have the ability to assess the characteristics of the receivables pool, including (a) over-advances; (b) history of the seller's arrears, bad debts, and bad debt allowances; (c) payment terms, and (d) potential contra accounts.
- The bank must have effective policies and procedures for monitoring on an aggregate basis single-obligor concentrations both within and across receivables pools.
- The bank must receive timely and sufficiently detailed reports of receivables ageings and dilutions to (a) ensure compliance with the bank's eligibility criteria and advancing policies governing purchased receivables, and (b) provide an effective means with which to monitor and confirm the seller's terms of sale (e.g. invoice date ageing) and dilution.

Effectiveness of work-out systems

496. An effective programme requires systems and procedures not only for detecting deterioration in the seller's financial condition and deterioration in the quality of the receivables at an early stage, but also for addressing emerging problems pro-actively. In particular,

- The bank should have clear and effective policies, procedures, and information systems to monitor compliance with (a) all contractual terms of the facility (including covenants, advancing formulas, concentration limits, early amortisation triggers, etc.) as well as (b) the bank's internal policies governing advance rates and receivables eligibility. The bank's systems should track covenant violations and waivers as well as exceptions to established policies and procedures.
- To limit inappropriate draws, the bank should have effective policies and procedures for detecting, approving, monitoring, and correcting over-advances.
- The bank should have effective policies and procedures for dealing with financially weakened sellers or servicers and/or deterioration in the quality of receivable pools. These include, but are not necessarily limited to, early termination triggers in revolving facilities and other covenant protections, a structured and disciplined approach to dealing with covenant violations, and clear and effective policies and procedures for initiating legal actions and dealing with problem receivables.

Effectiveness of systems for controlling collateral, credit availability, and cash

497. The bank must have clear and effective policies and procedures governing the control of receivables, credit, and cash. In particular,

- Written internal policies must specify all material elements of the receivables purchase programme, including the advancing rates, eligible collateral, necessary documentation, concentration limits, and how cash receipts are to be handled. These elements should take appropriate account of all relevant and material factors, including the seller's/servicer's financial condition, risk concentrations, and trends in the quality of the receivables and the seller's customer base.
- Internal systems must ensure that funds are advanced only against specified supporting collateral and documentation (such as servicer attestations, invoices, shipping documents, etc.).

Compliance with the bank's internal policies and procedures

498. Given the reliance on monitoring and control systems to limit credit risk, the bank should have an effective internal process for assessing compliance with all critical policies and procedures, including

- regular internal and/or external audits of all critical phases of the bank's receivables purchase programme.
- verification of the separation of duties (i) between the assessment of the seller/servicer and the assessment of the obligor and (ii) between the assessment of the seller/servicer and the field audit of the seller/servicer.

499. A bank's effective internal process for assessing compliance with all critical policies and procedures should also include evaluations of back office operations, with particular focus on qualifications, experience, staffing levels, and supporting systems.

8. Validation of internal estimates

500. Banks must have a robust system in place to validate the accuracy and consistency of rating systems, processes, and the estimation of all relevant risk components. A bank must demonstrate to its supervisor that the internal validation process enables it to assess the performance of internal rating and risk estimation systems consistently and meaningfully.

501. Banks must regularly compare realised default rates with estimated PDs for each grade and be able to demonstrate that the realised default rates are within the expected range for that grade. Banks using the advanced IRB approach must complete such analysis for their estimates of LGDs and EADs. Such comparisons must make use of historical data that are over as long a period as possible. The methods and data used in such comparisons by the bank must be clearly documented by the bank. This analysis and documentation must be updated at least annually.

502. Banks must also use other quantitative validation tools and comparisons with relevant external data sources. The analysis must be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. Banks' internal assessments of the performance of their own rating systems must be based on long data histories, covering a range of economic conditions, and ideally one or more complete business cycles.

503. Banks must demonstrate that quantitative testing methods and other validation methods do not vary systematically with the economic cycle. Changes in methods and data (both data sources and periods covered) must be clearly and thoroughly documented.

504. Banks must have well-articulated internal standards for situations where deviations in realised PDs, LGDs and EADs from expectations become significant enough to call the validity of the estimates into question. These standards must take account of business cycles and similar systematic variability in default experiences. Where realised values continue to be higher than expected values, banks must revise estimates upward to reflect their default and loss experience.

505. Where banks rely on supervisory, rather than internal, estimates of risk parameters, they are encouraged to compare realised LGDs and EADs to those set by the supervisors. The information on realised LGDs and EADs should form part of the bank's assessment of economic capital.

9. Supervisory LGD and EAD estimates

506. Banks under the foundation IRB approach, which do not meet the requirements for own-estimates of LGD and EAD, above, must meet the minimum requirements described in the standardised approach to receive recognition for eligible financial collateral (as set out in Section II.D: The standardised approach – credit risk mitigation). They must meet the following additional minimum requirements in order to receive recognition for additional collateral types.

(i) Definition of eligibility of CRE and RRE as collateral

507. Eligible CRE and RRE collateral for corporate, sovereign and bank exposures are defined as:

- Collateral where the risk of the borrower is not materially dependent upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility is not materially dependent on any cash flow generated by the underlying CRE/RRE serving as collateral;[92] and

- Additionally, the value of the collateral pledged must not be materially dependent on the performance of the borrower. This requirement is not intended to preclude situations where purely macro-economic factors affect both the value of the collateral and the performance of the borrower.

508. In light of the generic description above and the definition of corporate exposures, income producing real estate that falls under the SL asset class is specifically excluded from recognition as collateral for corporate exposures.[93]

(ii) Operational requirements for eligible CRE/RRE

509. Subject to meeting the definition above, CRE and RRE will be eligible for recognition as collateral for corporate claims only if all of the following operational requirements are met.

- *Legal enforceability*: any claim on a collateral taken must be legally enforceable in all relevant jurisdictions, and any claim on collateral must be properly filed on a timely basis. Collateral interests must reflect a perfected lien (i.e. all legal requirements for establishing the claim have been fulfilled). Furthermore, the collateral agreement and the legal process underpinning it must be such that they provide for the bank to realise the value of the collateral within a reasonable timeframe.
- *Objective market value of collateral*: the collateral must be valued at or less than the current fair value under which the property could be sold under private contract between a willing seller and an arm's-length buyer on the date of valuation.
- *Frequent revaluation*: the bank is expected to monitor the value of the collateral on a frequent basis and at a minimum once every year. More frequent monitoring is suggested where the market is subject to significant changes in conditions. Statistical methods of evaluation (e.g. reference to house price indices, sampling) may be used to update estimates or to identify collateral that may have declined in value and that may need re-appraisal. A qualified professional must evaluate the property when information indicates that the value of the collateral may have declined materially relative to general market prices or when a credit event, such as default, occurs.
- *Junior liens*: In some member countries, eligible collateral will be restricted to situations where the lender has a first charge over the property.[94] Junior liens may be taken into account where there is no doubt that the claim for collateral is legally

[92] The Committee recognises that in some countries where multifamily housing makes up an important part of the housing market and where public policy is supportive of that sector, including specially established public sector companies as major providers, the risk characteristics of lending secured by mortgage on such residential real estate can be similar to those of traditional corporate exposures. The national supervisor may under such circumstances recognise mortgage on multifamily residential real estate as eligible collateral for corporate exposures.

[93] As noted in footnote 73, in exceptional circumstances for well-developed and long-established markets, mortgages on office and/or multi-purpose commercial premises and/or multi-tenanted commercial premises may have the potential to receive recognition as collateral in the corporate portfolio. Please refer to footnote 29 of paragraph 74 for a discussion of the eligibility criteria that would apply.

[94] In some of these jurisdictions, first liens are subject to the prior right of preferential creditors, such as outstanding tax claims and employees' wages.

enforceable and constitutes an efficient credit risk mitigant. When recognised, junior liens are to be treated using the C*/C** threshold, which is used for senior liens. In such cases, the C* and C** are calculated by taking into account the sum of the junior lien and all more senior liens.

510. Additional collateral management requirements are as follows:

- The types of CRE and RRE collateral accepted by the bank and lending policies (advance rates) when this type of collateral is taken must be clearly documented.
- The bank must take steps to ensure that the property taken as collateral is adequately insured against damage or deterioration.
- The bank must monitor on an ongoing basis the extent of any permissible prior claims (e.g. tax) on the property.
- The bank must appropriately monitor the risk of environmental liability arising in respect of the collateral, such as the presence of toxic material on a property.

(iii) Requirements for recognition of financial receivables

Definition of eligible receivables

511. Eligible financial receivables are claims with an original maturity of less than or equal to one year where repayment will occur through the commercial or financial flows related to the underlying assets of the borrower. This includes both self-liquidating debt arising from the sale of goods or services linked to a commercial transaction and general amounts owed by buyers, suppliers, renters, national and local governmental authorities, or other non-affiliated parties not related to the sale of goods or services linked to a commercial transaction. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives.

Operational requirements

Legal certainty

512. The legal mechanism by which collateral is given must be robust and ensure that the lender has clear rights over the proceeds from the collateral.

513. Banks must take all steps necessary to fulfil local requirements in respect of the enforceability of security interest, e.g. by registering a security interest with a registrar. There should be a framework that allows the potential lender to have a perfected first priority claim over the collateral.

514. All documentation used in collateralised transactions must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review to verify this and have a well founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.

515. The collateral arrangements must be properly documented, with a clear and robust procedure for the timely collection of collateral proceeds. Banks' procedures should ensure that any legal conditions required for declaring the default of the customer and timely collection of collateral are observed. In the event of the obligor's financial distress or default, the bank should have legal authority to sell or assign the receivables to other parties without consent of the receivables' obligors.

Risk management

516. The bank must have a sound process for determining the credit risk in the receivables. Such a process should include, among other things, analyses of the borrower's business and industry (e.g. effects of the business cycle) and the types of customers with whom the borrower does business. Where the bank relies on the borrower to ascertain the credit risk of the customers, the bank must review the borrower's credit policy to ascertain its soundness and credibility.

517. The margin between the amount of the exposure and the value of the receivables must reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual borrower, and potential concentration risk within the bank's total exposures.

518. The bank must maintain a continuous monitoring process that is appropriate for the specific exposures (either immediate or contingent) attributable to the collateral to be utilised as a risk mitigant. This process may include, as appropriate and relevant, ageing reports, control of trade documents, borrowing base certificates, frequent audits of collateral, confirmation of accounts, control of the proceeds of accounts paid, analyses of dilution (credits given by the borrower to the issuers) and regular financial analysis of both the borrower and the issuers of the receivables, especially in the case when a small number of large-sized receivables are taken as collateral. Observance of the bank's overall concentration limits should be monitored. Additionally, compliance with loan covenants, environmental restrictions, and other legal requirements should be reviewed on a regular basis.

519. The receivables pledged by a borrower should be diversified and not be unduly correlated with the borrower. Where the correlation is high, e.g. where some issuers of the receivables are reliant on the borrower for their viability or the borrower and the issuers belong to a common industry, the attendant risks should be taken into account in the setting of margins for the collateral pool as a whole. Receivables from affiliates of the borrower (including subsidiaries and employees) will not be recognised as risk mitigants.

520. The bank should have a documented process for collecting receivable payments in distressed situations. The requisite facilities for collection should be in place, even when the bank normally looks to the borrower for collections.

Requirements for recognition of other collateral

521. Supervisors may allow for recognition of the credit risk mitigating effect of certain other physical collateral. Each supervisor will determine which, if any, collateral types in its jurisdiction meet the following two standards:

- Existence of liquid markets for disposal of collateral in an expeditious and economically efficient manner.
- Existence of well established, publicly available market prices for the collateral. Supervisors will seek to ensure that the amount a bank receives when collateral is realised does not deviate significantly from these market prices.

522. In order for a given bank to receive recognition for additional physical collateral, it must meet all the standards in paragraphs 509 and 510, subject to the following modifications.

- First Claim: With the sole exception of permissible prior claims specified in footnote 94, only first liens on, or charges over, collateral are permissible. As such, the bank must have priority over all other lenders to the realised proceeds of the collateral.

- The loan agreement must include detailed descriptions of the collateral plus detailed specifications of the manner and frequency of revaluation.
- The types of physical collateral accepted by the bank and policies and practices in respect of the appropriate amount of each type of collateral relative to the exposure amount must be clearly documented in internal credit policies and procedures and available for examination and/or audit review.
- Bank credit policies with regard to the transaction structure must address appropriate collateral requirements relative to the exposure amount, the ability to liquidate the collateral readily, the ability to establish objectively a price or market value, the frequency with which the value can readily be obtained (including a professional appraisal or valuation), and the volatility of the value of the collateral. The periodic revaluation process must pay particular attention to "fashion-sensitive" collateral to ensure that valuations are appropriately adjusted downward of fashion, or model-year, obsolescence as well as physical obsolescence or deterioration.
- In cases of inventories (e.g. raw materials, work-in-process, finished goods, dealers' inventories of autos) and equipment, the periodic revaluation process must include physical inspection of the collateral.

10. Requirements for recognition of leasing

523. Leases other than those that expose the bank to residual value risk (see paragraph 524) will be accorded the same treatment as exposures collateralised by the same type of collateral. The minimum requirements for the collateral type must be met (CRE/RRE or other collateral). In addition, the bank must also meet the following standards:

- Robust risk management on the part of the lessor with respect to the location of the asset, the use to which it is put, its age, and planned obsolescence;
- A robust legal framework establishing the lessor's legal ownership of the asset and its ability to exercise its rights as owner in a timely fashion; and
- The difference between the rate of depreciation of the physical asset and the rate of amortisation of the lease payments must not be so large as to overstate the CRM attributed to the leased assets.

524. Leases that expose the bank to residual value risk will be treated in the following manner. Residual value risk is the bank's exposure to potential loss due to the fair value of the equipment declining below its residual estimate at lease inception.

- The discounted lease payment stream will receive a risk weight appropriate for the lessee's financial strength (PD) and supervisory or own-estimate of LGD, which ever is appropriate.
- The residual value will be risk-weighted at 100%.

11. Calculation of capital charges for equity exposures

(i) The internal models market-based approach

525. To be eligible for the internal models market-based approach a bank must demonstrate to its supervisor that it meets certain quantitative and qualitative minimum requirements at the outset and on an ongoing basis. A bank that fails to demonstrate continued compliance with the minimum requirements must develop a plan for rapid return to compliance, obtain its supervisor's approval of the plan, and implement that plan in a timely fashion. In the interim, banks would be expected to compute capital charges using a simple risk weight approach.

526. The Committee recognises that differences in markets, measurement methodologies, equity investments and management practices require banks and supervisors to customise their operational procedures. It is not the Committee's intention to dictate the form or operational detail of banks' risk management policies and measurement practices for their banking book equity holdings. However, some of the minimum requirements are specific. Each supervisor will develop detailed examination procedures to ensure that banks' risk measurement systems and management controls are adequate to serve as the basis for the internal models approach.

(ii) Capital charge and risk quantification

527. The following minimum quantitative standards apply for the purpose of calculating minimum capital charges under the internal models approach.

(a) The capital charge is equivalent to the potential loss on the institution's equity portfolio arising from an assumed instantaneous shock equivalent to the 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period.

(b) The estimated losses should be robust to adverse market movements relevant to the long-term risk profile of the institution's specific holdings. The data used to represent return distributions should reflect the longest sample period for which data are available and meaningful in representing the risk profile of the bank's specific equity holdings. The data used should be sufficient to provide conservative, statistically reliable and robust loss estimates that are not based purely on subjective or judgmental considerations. Institutions must demonstrate to supervisors that the shock employed provides a conservative estimate of potential losses over a relevant long-term market or business cycle. Models estimated using data not reflecting realistic ranges of long-run experience, including a period of reasonably severe declines in equity market values relevant to a bank's holdings, are presumed to produce optimistic results unless there is credible evidence of appropriate adjustments built into the model. In the absence of built-in adjustments, the bank must combine empirical analysis of available data with adjustments based on a variety of factors in order to attain model outputs that achieve appropriate realism and conservatism. In constructing Value at Risk (VaR) models estimating potential quarterly losses, institutions may use quarterly data or convert shorter horizon period data to a quarterly equivalent using an analytically appropriate method supported by empirical evidence. Such adjustments must be applied through a well-developed and well-documented thought process and analysis. In general, adjustments must be applied conservatively and consistently over time. Furthermore, where only limited data are available, or where technical limitations are such that estimates from any single method will be of uncertain quality, banks must add appropriate margins of conservatism in order to avoid over-optimism.

(c) No particular type of VaR model (e.g. variance-covariance, historical simulation, or Monte Carlo) is prescribed. However, the model used must be able to capture adequately all of the material risks embodied in equity returns including both the general market risk and specific risk exposure of the institution's equity portfolio. Internal models must adequately explain historical price variation, capture both the magnitude and changes in the composition of potential concentrations, and be robust to adverse market environments. The population of risk exposures represented in the data used for estimation must be closely matched to or at least comparable with those of the bank's equity exposures.

(d) Banks may also use modelling techniques such as historical scenario analysis to determine minimum capital requirements for banking book equity holdings. The use of such models is conditioned upon the institution demonstrating to its supervisor that the methodology and its output can be quantified in the form of the loss percentile specified under (a).

(e) Institutions must use an internal model that is appropriate for the risk profile and complexity of their equity portfolio. Institutions with material holdings with values that are highly non-linear in nature (e.g. equity derivatives, convertibles) must employ an internal model designed to capture appropriately the risks associated with such instruments.

(f) Subject to supervisory review, equity portfolio correlations can be integrated into a bank's internal risk measures. The use of explicit correlations (e.g. utilisation of a variance/covariance VaR model) must be fully documented and supported using empirical analysis. The appropriateness of implicit correlation assumptions will be evaluated by supervisors in their review of model documentation and estimation techniques.

(g) Mapping of individual positions to proxies, market indices, and risk factors should be plausible, intuitive, and conceptually sound. Mapping techniques and processes should be fully documented, and demonstrated with both theoretical and empirical evidence to be appropriate for the specific holdings. Where professional judgement is combined with quantitative techniques in estimating a holding's return volatility, the judgement must take into account the relevant and material information not considered by the other techniques utilised.

(h) Where factor models are used, either single or multi-factor models are acceptable depending upon the nature of an institution's holdings. Banks are expected to ensure that the factors are sufficient to capture the risks inherent in the equity portfolio. Risk factors should correspond to the appropriate equity market characteristics (for example, public, private, market capitalisation industry sectors and sub-sectors, operational characteristics) in which the bank holds significant positions. While banks will have discretion in choosing the factors, they must demonstrate through empirical analyses the appropriateness of those factors, including their ability to cover both general and specific risk.

(i) Estimates of the return volatility of equity investments must incorporate relevant and material available data, information, and methods. A bank may utilise independently reviewed internal data or data from external sources (including pooled data). The number of risk exposures in the sample, and the data period used for quantification must be sufficient to provide the bank with confidence in the accuracy and robustness of its estimates. Institutions should take appropriate measures to limit the potential of both sampling bias and survivorship bias in estimating return volatilities.

(j) A rigorous and comprehensive stress-testing programme must be in place. Banks are expected to subject their internal model and estimation procedures, including volatility computations, to either hypothetical or historical scenarios that reflect worst-case losses given underlying positions in both public and private equities. At a minimum, stress tests should be employed to provide information about the effect of tail events beyond the level of confidence assumed in the internal models approach.

(iii) Risk management process and controls

528. Banks' overall risk management practices used to manage their banking book equity investments are expected to be consistent with the evolving sound practice guidelines issued by the Committee and national supervisors. With regard to the development and use of internal models for capital purposes, institutions must have established policies, procedures, and controls to ensure the integrity of the model and modelling process used to derive regulatory capital standards. These policies, procedures, and controls should include the following:

(a) Full integration of the internal model into the overall management information systems of the institution and in the management of the banking book equity portfolio. Internal models should be fully integrated into the institution's risk management infrastructure including use in: (i) establishing investment hurdle rates and evaluating alternative investments; (ii) measuring and assessing equity portfolio performance (including the risk-adjusted performance); and (iii) allocating economic capital to equity holdings and evaluating overall capital adequacy as required under Pillar 2. The institution should be able to demonstrate, through for example, investment committee minutes, that internal model output plays an essential role in the investment management process.

(b) Established management systems, procedures, and control functions for ensuring the periodic and independent review of all elements of the internal modelling process, including approval of model revisions, vetting of model inputs, and review of model results, such as direct verification of risk computations. Proxy and mapping techniques and other critical model components should receive special attention. These reviews should assess the accuracy, completeness, and appropriateness of model inputs and results and focus on both finding and limiting potential errors associated with known weaknesses and identifying unknown model weaknesses. Such reviews may be conducted as part of internal or external audit programmes, by an independent risk control unit, or by an external third party.

(c) Adequate systems and procedures for monitoring investment limits and the risk exposures of equity investments.

(d) The units responsible for the design and application of the model must be functionally independent from the units responsible for managing individual investments.

(e) Parties responsible for any aspect of the modelling process must be adequately qualified. Management must allocate sufficient skilled and competent resources to the modelling function.

(iv) Validation and documentation

529. Institutions employing internal models for regulatory capital purposes are expected to have in place a robust system to validate the accuracy and consistency of the model and its inputs. They must also fully document all material elements of their internal models and modelling process. The modelling process itself as well as the systems used to validate internal models including all supporting documentation, validation results, and the findings of internal and external reviews are subject to oversight and review by the bank's supervisor.

Validation

530. Banks must have a robust system in place to validate the accuracy and consistency of their internal models and modelling processes. A bank must demonstrate to its supervisor

that the internal validation process enables it to assess the performance of its internal model and processes consistently and meaningfully.

531. Banks must regularly compare actual return performance (computed using realised and unrealised gains and losses) with modelled estimates and be able to demonstrate that such returns are within the expected range for the portfolio and individual holdings. Such comparisons must make use of historical data that are over as long a period as possible. The methods and data used in such comparisons must be clearly documented by the bank. This analysis and documentation should be updated at least annually.

532. Banks should make use of other quantitative validation tools and comparisons with external data sources. The analysis must be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. Banks' internal assessments of the performance of their own model must be based on long data histories, covering a range of economic conditions, and ideally one or more complete business cycles.

533. Banks must demonstrate that quantitative validation methods and data are consistent through time. Changes in estimation methods and data (both data sources and periods covered) must be clearly and thoroughly documented.

534. Since the evaluation of actual performance to expected performance over time provides a basis for banks to refine and adjust internal models on an ongoing basis, it is expected that banks using internal models will have established well-articulated model review standards. These standards are especially important for situations where actual results significantly deviate from expectations and where the validity of the internal model is called into question. These standards must take account of business cycles and similar systematic variability in equity returns. All adjustments made to internal models in response to model reviews must be well documented and consistent with the bank's model review standards.

535. To facilitate model validation through backtesting on an ongoing basis, institutions using the internal model approach must construct and maintain appropriate databases on the actual quarterly performance of their equity investments as well on the estimates derived using their internal models. Institutions should also backtest the volatility estimates used within their internal models and the appropriateness of the proxies used in the model. Supervisors may ask banks to scale their quarterly forecasts to a different, in particular shorter, time horizon, store performance data for this time horizon and perform backtests on this basis.

Documentation

536. The burden is on the bank to satisfy its supervisor that a model has good predictive power and that regulatory capital requirements will not be distorted as a result of its use. Accordingly, all critical elements of an internal model and the modelling process should be fully and adequately documented. Banks must document in writing their internal model's design and operational details. The documentation should demonstrate banks' compliance with the minimum quantitative and qualitative standards, and should address topics such as the application of the model to different segments of the portfolio, estimation methodologies, responsibilities of parties involved in the modelling, and the model approval and model review processes. In particular, the documentation should address the following points:

(a) A bank must document the rationale for its choice of internal modelling methodology and must be able to provide analyses demonstrating that the model and modelling procedures are likely to result in estimates that meaningfully identify the risk of the bank's equity holdings. Internal models and procedures must be periodically reviewed to determine whether they remain fully applicable to the current portfolio and to external conditions. In addition, a bank must document a history of major changes in the model over time and changes made to the modelling process subsequent to the last supervisory review. If changes have been made in response to the bank's internal review standards, the bank must document that these changes are consistent with its internal model review standards.

(b) In documenting their internal models banks should:

- provide a detailed outline of the theory, assumptions and/or mathematical and empirical basis of the parameters, variables, and data source(s) used to estimate the model;
- establish a rigorous statistical process (including out-of-time and out-of-sample performance tests) for validating the selection of explanatory variables; and
- indicate circumstances under which the model does not work effectively.

(c) Where proxies and mapping are employed, institutions must have performed and documented rigorous analysis demonstrating that all chosen proxies and mappings are sufficiently representative of the risk of the equity holdings to which they correspond. The documentation should show, for instance, the relevant and material factors (e.g. business lines, balance sheet characteristics, geographic location, company age, industry sector and subsector, operating characteristics) used in mapping individual investments into proxies. In summary, institutions must demonstrate that the proxies and mappings employed:

- are adequately comparable to the underlying holding or portfolio;
- are derived using historical economic and market conditions that are relevant and material to the underlying holdings or, where not, that an appropriate adjustment has been made; and,
- are robust estimates of the potential risk of the underlying holding.

12. Disclosure requirements

537. In order to be eligible for the IRB approach, banks must meet the disclosure requirements set out in Pillar 3. These are minimum requirements for use of IRB: failure to meet these will render banks ineligible to use the relevant IRB approach.

IV. Credit Risk — Securitisation Framework

A. Scope and definitions of transactions covered under the securitisation framework

538. Banks must apply the securitisation framework for determining regulatory capital requirements on exposures arising from traditional and synthetic securitisations or similar structures that contain features common to both. Since securitisations may be structured in many different ways, the capital treatment of a securitisation exposure must be determined on the basis of its economic substance rather than its legal form. Similarly, supervisors will look to the economic substance of a transaction to determine whether it should be subject to the securitisation framework for purposes of determining regulatory capital. Banks are encouraged to consult with their national supervisors when there is uncertainty about whether a given transaction should be considered a securitisation. For example, transactions involving cash flows from real estate (e.g. rents) may be considered specialised lending exposures, if warranted.

539. A *traditional securitisation* is a structure where the cash flow from an underlying pool of exposures is used to service at least two different stratified risk positions or tranches reflecting different degrees of credit risk. Payments to the investors depend upon the performance of the specified underlying exposures, as opposed to being derived from an obligation of the entity originating those exposures. The stratified/tranched structures that characterise securitisations differ from ordinary senior/subordinated debt instruments in that junior securitisation tranches can absorb losses without interrupting contractual payments to more senior tranches, whereas subordination in a senior/subordinated debt structure is a matter of priority of rights to the proceeds of liquidation.

540. A *synthetic securitisation* is a structure with at least two different stratified risk positions or tranches that reflect different degrees of credit risk where credit risk of an underlying pool of exposures is transferred, in whole or in part, through the use of funded (e.g. credit-linked notes) or unfunded (e.g. credit default swaps) credit derivatives or guarantees that serve to hedge the credit risk of the portfolio. Accordingly, the investors' potential risk is dependent upon the performance of the underlying pool.

541. Banks' exposures to a securitisation are hereafter referred to as "securitisation exposures". Securitisation exposures can include but are not restricted to the following: asset-backed securities, mortgage-backed securities, credit enhancements, liquidity facilities, interest rate or currency swaps, credit derivatives and tranched cover as described in paragraph 199. Reserve accounts, such as cash collateral accounts, recorded as an asset by the originating bank must also be treated as securitisation exposures.

542. Underlying instruments in the pool being securitised may include but are not restricted to the following: loans, commitments, asset-backed and mortgage-backed securities, corporate bonds, equity securities, and private equity investments. The underlying pool may include one or more exposures.

B. Definitions and general terminology

1. Originating bank

543. For risk-based capital purposes, a bank is considered to be an originator with regard to a certain securitisation if it meets either of the following conditions:

(a) The bank originates directly or indirectly underlying exposures included in the securitisation; or

(b) The bank serves as a sponsor of an asset-backed commercial paper (ABCP) conduit or similar programme that acquires exposures from third-party entities. In the context of such programmes, a bank would generally be considered a sponsor and, in turn, an originator if it, in fact or in substance, manages or advises the programme, places securities into the market, or provides liquidity and/or credit enhancements.

2. Asset-backed commercial paper (ABCP) programme

544. An asset-backed commercial paper (ABCP) programme predominately issues commercial paper with an original maturity of one year or less that is backed by assets or other exposures held in a bankruptcy-remote, special purpose entity.

3. Clean-up call

545. A clean-up call is an option that permits the securitisation exposures (e.g. asset-backed securities) to be called before all of the underlying exposures or securitisation exposures have been repaid. In the case of traditional securitisations, this is generally accomplished by repurchasing the remaining securitisation exposures once the pool balance or outstanding securities have fallen below some specified level. In the case of a synthetic transaction, the clean-up call may take the form of a clause that extinguishes the credit protection.

4. Credit enhancement

546. A credit enhancement is a contractual arrangement in which the bank retains or assumes a securitisation exposure and, in substance, provides some degree of added protection to other parties to the transaction.

5. Credit-enhancing interest-only strip

547. A credit-enhancing interest-only strip *(I/O)* is an on-balance sheet asset that (i) represents a valuation of cash flows related to future margin income, and (ii) is subordinated.

6. Early amortisation

548. Early amortisation provisions are mechanisms that, once triggered, allow investors to be paid out prior to the originally stated maturity of the securities issued. For risk-based capital purposes, an early amortisation provision will be considered either controlled or non-controlled. A controlled early amortisation provision must meet all of the following conditions.

(a) The bank must have an appropriate capital/liquidity plan in place to ensure that it has sufficient capital and liquidity available in the event of an early amortisation.

(b) Throughout the duration of the transaction, including the amortisation period, there is the same pro rata sharing of interest, principal, expenses, losses and recoveries based on the bank's and investors' relative shares of the receivables outstanding at the beginning of each month.

(c) The bank must set a period for amortisation that would be sufficient for at least 90% of the total debt outstanding at the beginning of the early amortisation period to have been repaid or recognised as in default; and

(d) The pace of repayment should not be any more rapid than would be allowed by straight-line amortisation over the period set out in criterion (c).

549. An early amortisation provision that does not satisfy the conditions for a controlled early amortisation provision will be treated as a non-controlled early amortisation provision.

7. Excess spread

550. Excess spread is generally defined as gross finance charge collections and other income received by the trust or special purpose entity (SPE, specified in paragraph 552) minus certificate interest, servicing fees, charge-offs, and other senior trust or SPE expenses.

8. Implicit support

551. Implicit support arises when a bank provides support to a securitisation in excess of its predetermined contractual obligation.

9. Special purpose entity (SPE)

552. An SPE is a corporation, trust, or other entity organised for a specific purpose, the activities of which are limited to those appropriate to accomplish the purpose of the SPE, and the structure of which is intended to isolate the SPE from the credit risk of an originator or seller of exposures. SPEs are commonly used as financing vehicles in which exposures are sold to a trust or similar entity in exchange for cash or other assets funded by debt issued by the trust.

C. Operational requirements for the recognition of risk transference

553. The following operational requirements are applicable to both the standardised and IRB approaches of the securitisation framework.

1. Operational requirements for traditional securitisations

554. An originating bank may exclude securitised exposures from the calculation of risk-weighted assets only if all of the following conditions have been met. Banks meeting these conditions must still hold regulatory capital against any securitisation exposures they retain.

(a) Significant credit risk associated with the securitised exposures has been transferred to third parties.

(b) The transferor does not maintain effective or indirect control over the transferred exposures. The assets are legally isolated from the transferor in such a way (e.g. through the sale of assets or through subparticipation) that the exposures are put beyond the reach of the transferor and its creditors, even in bankruptcy or receivership. These conditions must be supported by an opinion provided by a qualified legal counsel.

The transferor is deemed to have maintained effective control over the transferred credit risk exposures if it: (i) is able to repurchase from the transferee the previously transferred exposures in order to realise their benefits; or (ii) is obligated to retain the risk of the transferred exposures. The transferor's retention of servicing rights to the exposures will not necessarily constitute indirect control of the exposures.

(c) The securities issued are not obligations of the transferor. Thus, investors who purchase the securities only have claim to the underlying pool of exposures.

(d) The transferee is an SPE and the holders of the beneficial interests in that entity have the right to pledge or exchange them without restriction.

(e) Clean-up calls must satisfy the conditions set out in paragraph 557.

(f) The securitisation does not contain clauses that (i) require the originating bank to alter systematically the underlying exposures such that the pool's weighted average credit quality is improved unless this is achieved by selling assets to independent and unaffiliated third parties at market prices; (ii) allow for increases in a retained first loss position or credit enhancement provided by the originating bank after the transaction's inception; or (iii) increase the yield payable to parties other than the originating bank, such as investors and third-party providers of credit enhancements, in response to a deterioration in the credit quality of the underlying pool.

2. Operational requirements for synthetic securitisations

555. For synthetic securitisations, the use of CRM techniques (i.e. collateral, guarantees and credit derivatives) for hedging the underlying exposure may be recognised for risk-based capital purposes only if the conditions outlined below are satisfied:

(a) Credit risk mitigants must comply with the requirements as set out in Section II.D of this Framework.

(b) Eligible collateral is limited to that specified in paragraphs 145 and 146. Eligible collateral pledged by SPEs may be recognised.

(c) Eligible guarantors are defined in paragraph 195. Banks may not recognise SPEs as eligible guarantors in the securitisation framework.

(d) Banks must transfer significant credit risk associated with the underlying exposure to third parties.

(e) The instruments used to transfer credit risk may not contain terms or conditions that limit the amount of credit risk transferred, such as those provided below:

- Clauses that materially limit the credit protection or credit risk transference (e.g. significant materiality thresholds below which credit protection is deemed not to be triggered even if a credit event occurs or those that allow for the termination of the protection due to deterioration in the credit quality of the underlying exposures);
- Clauses that require the originating bank to alter the underlying exposures to improve the pool's weighted average credit quality;
- Clauses that increase the banks' cost of credit protection in response to deterioration in the pool's quality;
- Clauses that increase the yield payable to parties other than the originating bank, such as investors and third-party providers of credit enhancements, in response to a deterioration in the credit quality of the reference pool; and
- Clauses that provide for increases in a retained first loss position or credit enhancement provided by the originating bank after the transaction's inception.

(f) An opinion must be obtained from a qualified legal counsel that confirms the enforceability of the contracts in all relevant jurisdictions.

(g) Clean-up calls must satisfy the conditions set out in paragraph 557.

556. For synthetic securitisations, the effect of applying CRM techniques for hedging the underlying exposure are treated according to paragraphs 109 to 210. In case there is a maturity mismatch, the capital requirement will be determined in accordance with paragraphs 202 to 205. When the exposures in the underlying pool have different maturities, the longest maturity must be taken as the maturity of the pool. Maturity mismatches may arise in the context of synthetic securitisations when, for example, a bank uses credit derivatives to transfer part or all of the credit risk of a specific pool of assets to third parties. When the credit derivatives unwind, the transaction will terminate. This implies that the effective maturity of the tranches of the synthetic securitisation may differ from that of the underlying exposures. Originating banks of synthetic securitisations must treat such maturity mismatches in the following manner. A bank using the standardised approach for securitisation must deduct all retained positions that are unrated or rated below investment grade. A bank using the IRB approach must deduct unrated, retained positions if the treatment of the position is deduction specified in paragraphs 609 to 643. Accordingly, when deduction is required, maturity mismatches are not taken into account. For all other securitisation exposures, the bank must apply the maturity mismatch treatment set forth in paragraphs 202 to 205.

3. Operational requirements and treatment of clean-up calls

557. For securitisation transactions that include a clean-up call, no capital will be required due to the presence of a clean-up call if the following conditions are met: (i) the exercise of the clean-up call must not be mandatory, in form or in substance, but rather must be at the discretion of the originating bank; (ii) the clean-up call must not be structured to avoid allocating losses to credit enhancements or positions held by investors or otherwise structured to provide credit enhancement; and (iii) the clean-up call must only be exercisable when 10% or less of the original underlying portfolio, or securities issued remain, or, for synthetic securitisations, when 10% or less of the original reference portfolio value remains.

558. Securitisation transactions that include a clean-up call that does not meet all of the criteria stated in paragraph 557 result in a capital requirement for the originating bank. For a traditional securitisation, the underlying exposures must be treated as if they were not securitised. Additionally, banks must not recognise in regulatory capital any gain-on-sale, as defined in paragraph 562. For synthetic securitisations, the bank purchasing protection must hold capital against the entire amount of the securitised exposures as if they did not benefit from any credit protection. If a synthetic securitisation incorporates a call (other than a clean-up call) that effectively terminates the transaction and the purchased credit protection on a specific date, the bank must treat the transaction in accordance with paragraph 556 and paragraphs 202 to 205.

559. If a clean-up call, when exercised, is found to serve as a credit enhancement, the exercise of the clean-up call must be considered a form of implicit support provided by the bank and must be treated in accordance with the supervisory guidance pertaining to securitisation transactions.

D. Treatment of securitisation exposures

1. Calculation of capital requirements

560. Banks are required to hold regulatory capital against all of their securitisation exposures, including those arising from the provision of credit risk mitigants to a securitisation transaction, investments in asset-backed securities, retention of a subordinated tranche, and extension of a liquidity facility or credit enhancement, as set forth in the following sections. Repurchased securitisation exposures must be treated as retained securitisation exposures.

(i) Deduction

561. When a bank is required to deduct a securitisation exposure from regulatory capital, the deduction must be taken 50% from Tier 1 and 50% from Tier 2 with the one exception noted in paragraph 562. Credit enhancing I/Os (net of the amount that must be deducted from Tier 1 as in paragraph 562) are deducted 50% from Tier 1 and 50% from Tier 2. Deductions from capital may be calculated net of any specific provisions taken against the relevant securitisation exposures.

562. Banks must deduct from Tier 1 any increase in equity capital resulting from a securitisation transaction, such as that associated with expected future margin income (FMI) resulting in a gain-on-sale that is recognised in regulatory capital. Such an increase in capital is referred to as a "gain-on-sale" for the purposes of the securitisation framework.

563. For the purposes of the EL-provision calculation as set out in Section III.G, securitisation exposures do not contribute to the EL amount. Similarly, any specific provisions against securitisation exposures are not to be included in the measurement of eligible provisions.

(ii) Implicit support

564. When a bank provides implicit support to a securitisation, it must, at a minimum, hold capital against all of the exposures associated with the securitisation transaction as if they had not been securitised. Additionally, banks would not be permitted to recognise in regulatory capital any gain-on-sale, as defined in paragraph 562. Furthermore, the bank is required to disclose publicly that (a) it has provided non-contractual support and (b) the capital impact of doing so.

2. Operational requirements for use of external credit assessments

565. The following operational criteria concerning the use of external credit assessments apply in the standardised and IRB approaches of the securitisation framework:

(a) To be eligible for risk-weighting purposes, the external credit assessment must take into account and reflect the entire amount of credit risk exposure the bank has with regard to all payments owed to it. For example, if a bank is owed both principal and interest, the assessment must fully take into account and reflect the credit risk associated with timely repayment of both principal and interest.

(b) The external credit assessments must be from an eligible ECAI as recognised by the bank's national supervisor in accordance with paragraphs 90 to 108 with the following exception. In contrast with bullet three of paragraph 91, an eligible credit assessment must be publicly available. In other words, a rating must be published in an accessible form and included in the ECAI's transition matrix. Consequently, ratings that are made available only to the parties to a transaction do not satisfy this requirement.

(c) Eligible ECAIs must have a demonstrated expertise in assessing securitisations, which may be evidenced by strong market acceptance.

(d) A bank must apply external credit assessments from eligible ECAIs consistently across a given type of securitisation exposure. Furthermore, a bank cannot use the credit assessments issued by one ECAI for one or more tranches and those of another ECAI for other positions (whether retained or purchased) within the same securitisation structure that may or may not be rated by the first ECAI. Where two or more eligible ECAIs can be used and these assess the credit risk of the same securitisation exposure differently, paragraphs 96 to 98 will apply.

(e) Where CRM is provided directly to an SPE by an eligible guarantor defined in paragraph 195 and is reflected in the external credit assessment assigned to a securitisation exposure(s), the risk weight associated with that external credit assessment should be used. In order to avoid any double counting, no additional capital recognition is permitted. If the CRM provider is not recognised as an eligible guarantor in paragraph 195, the covered securitisation exposures should be treated as unrated.

(f) In the situation where a credit risk mitigant is not obtained by the SPE but rather applied to a specific securitisation exposure within a given structure (e.g. ABS tranche), the bank must treat the exposure as if it is unrated and then use the CRM treatment outlined in Section II.D or in the foundation IRB approach of Section III, to recognise the hedge.

3. Standardised approach for securitisation exposures

(i) Scope

566. Banks that apply the standardised approach to credit risk for the type of underlying exposure(s) securitised must use the standardised approach under the securitisation framework.

(ii) Risk weights

567. The risk-weighted asset amount of a securitisation exposure is computed by multiplying the amount of the position by the appropriate risk weight determined in accordance with the following tables. For off-balance sheet exposures, banks must apply a CCF and then risk weight the resultant credit equivalent amount. If such an exposure is rated, a CCF of 100% must be applied. For positions with long-term ratings of B+ and below and short-term ratings other than A-1/P-1, A-2/P-2, A-3/P-3, deduction from capital as defined in paragraph 561 is required. Deduction is also required for unrated positions with the exception of the circumstances described in paragraphs 571 to 575.

Long-term rating category[95]

External Credit Assessment	**AAA to AA-**	**A+ to A-**	**BBB+ to BBB-**	**BB+ to BB-**	**B+ and below or unrated**
Risk Weight	20%	50%	100%	350%	Deduction

Short-term rating category

External Credit Assessment	**A-1/P-1**	**A-2/P-2**	**A-3/P-3**	**All other ratings or unrated**
Risk Weight	20%	50%	100%	Deduction

568. The capital treatment of positions retained by originators, liquidity facilities, credit risk mitigants, and securitisations of revolving exposures are identified separately. The treatment of clean-up calls is provided in paragraphs 557 to 559.

Investors may recognise ratings on below-investment grade exposures

569. Only third-party investors, as opposed to banks that serve as originators, may recognise external credit assessments that are equivalent to BB+ to BB- for risk weighting purposes of securitisation exposures.

Originators to deduct below-investment grade exposures

570. Originating banks as defined in paragraph 543 must deduct all retained securitisation exposures rated below investment grade (i.e. BBB-).

(iii) Exceptions to general treatment of unrated securitisation exposures

571. As noted in the tables above, unrated securitisation exposures must be deducted with the following exceptions: (i) the most senior exposure in a securitisation, (ii) exposures that are in a second loss position or better in ABCP programmes and meet the requirements outlined in paragraph 574, and (iii) eligible liquidity facilities.

Treatment of unrated most senior securitisation exposures

572. If the most senior exposure in a securitisation of a traditional or synthetic securitisation is unrated, a bank that holds or guarantees such an exposure may determine the risk weight by applying the "look-through" treatment, provided the composition of the underlying pool is known at all times. Banks are not required to consider interest rate or currency swaps when determining whether an exposure is the most senior in a securitisation for the purpose of applying the "look-through" approach.

573. In the look-through treatment, the unrated most senior position receives the average risk weight of the underlying exposures subject to supervisory review. Where the bank is

95 The rating designations used in the following charts are for illustrative purposes only and do not indicate any preference for, or endorsement of, any particular external assessment system.

unable to determine the risk weights assigned to the underlying credit risk exposures, the unrated position must be deducted.

Treatment of exposures in a second loss position or better in ABCP programmes

574. Deduction is not required for those unrated securitisation exposures provided by sponsoring banks to ABCP programmes that satisfy the following requirements:

(a) The exposure is economically in a second loss position or better and the first loss position provides significant credit protection to the second loss position;

(b) The associated credit risk is the equivalent of investment grade or better; and

(c) The bank holding the unrated securitisation exposure does not retain or provide the first loss position.

575. Where these conditions are satisfied, the risk weight is the greater of (i) 100% or (ii) the highest risk weight assigned to any of the underlying individual exposures covered by the facility.

Risk weights for eligible liquidity facilities

576. For eligible liquidity facilities as defined in paragraph 578 and where the conditions for use of external credit assessments in paragraph 565 are not met, the risk weight applied to the exposure's credit equivalent amount is equal to the highest risk weight assigned to any of the underlying individual exposures covered by the facility.

(iv) Credit conversion factors for off-balance sheet exposures

577. For risk-based capital purposes, banks must determine whether, according to the criteria outlined below, an off-balance sheet securitisation exposure qualifies as an 'eligible liquidity facility' or an 'eligible servicer cash advance facility'. All other off-balance sheet securitisation exposures will receive a 100% CCF.

Eligible liquidity facilities

578. Banks are permitted to treat off-balance sheet securitisation exposures as eligible liquidity facilities if the following minimum requirements are satisfied:

(a) The facility documentation must clearly identify and limit the circumstances under which it may be drawn. Draws under the facility must be limited to the amount that is likely to be repaid fully from the liquidation of the underlying exposures and any seller-provided credit enhancements. In addition, the facility must not cover any losses incurred in the underlying pool of exposures prior to a draw, or be structured such that draw-down is certain (as indicated by regular or continuous draws);

(b) The facility must be subject to an asset quality test that precludes it from being drawn to cover credit risk exposures that are in default as defined in paragraphs 452 to 459. In addition, if the exposures that a liquidity facility is required to fund are externally rated securities, the facility can only be used to fund securities that are externally rated investment grade at the time of funding;

(c) The facility cannot be drawn after all applicable (e.g. transaction-specific and programme-wide) credit enhancements from which the liquidity would benefit have been exhausted; and

(d) Repayment of draws on the facility (i.e. assets acquired under a purchase agreement or loans made under a lending agreement) must not be subordinated to any interests of any note holder in the programme (e.g. ABCP programme) or subject to deferral or waiver.

579. Where these conditions are met, the bank may apply a 20% CCF to the amount of eligible liquidity facilities with an original maturity of one year or less, or a 50% CCF if the facility has an original maturity of more than one year. However, if an external rating of the facility itself is used for risk-weighting the facility, a 100% CCF must be applied.

Eligible liquidity facilities available only in the event of market disruption

580. Banks may apply a 0% CCF to eligible liquidity facilities that are only available in the event of a general market disruption (i.e. whereupon more than one SPE across different transactions are unable to roll over maturing commercial paper, and that inability is not the result of an impairment in the SPEs' credit quality or in the credit quality of the underlying exposures). To qualify for this treatment, the conditions provided in paragraph 578 must be satisfied. Additionally, the funds advanced by the bank to pay holders of the capital market instruments (e.g. commercial paper) when there is a general market disruption must be secured by the underlying assets, and must rank at least *pari passu* with the claims of holders of the capital market instruments.

Treatment of overlapping exposures

581. A bank may provide several types of facilities that can be drawn under various conditions. The same bank may be providing two or more of these facilities. Given the different triggers found in these facilities, it may be the case that a bank provides duplicative coverage to the underlying exposures. In other words, the facilities provided by a bank may overlap since a draw on one facility may preclude (in part) a draw under the other facility. In the case of overlapping facilities provided by the same bank, the bank does not need to hold additional capital for the overlap. Rather, it is only required to hold capital once for the position covered by the overlapping facilities (whether they are liquidity facilities or credit enhancements). Where the overlapping facilities are subject to different conversion factors, the bank must attribute the overlapping part to the facility with the highest conversion factor. However, if overlapping facilities are provided by different banks, each bank must hold capital for the maximum amount of the facility.

Eligible servicer cash advance facilities

582. Subject to national discretion, if contractually provided for, servicers may advance cash to ensure an uninterrupted flow of payments to investors so long as the servicer is entitled to full reimbursement and this right is senior to other claims on cash flows from the underlying pool of exposures. At national discretion, such undrawn servicer cash advances or facilities that are unconditionally cancellable without prior notice may be eligible for a 0% CCF.

(v) Treatment of credit risk mitigation for securitisation exposures

583. The treatment below applies to a bank that has obtained a credit risk mitigant on a securitisation exposure. Credit risk mitigants include guarantees, credit derivatives, collateral and on-balance sheet netting. Collateral in this context refers to that used to hedge the credit risk of a securitisation exposure rather than the underlying exposures of the securitisation transaction.

584. When a bank other than the originator provides credit protection to a securitisation exposure, it must calculate a capital requirement on the covered exposure as if it were an investor in that securitisation. If a bank provides protection to an unrated credit enhancement, it must treat the credit protection provided as if it were directly holding the unrated credit enhancement.

Collateral

585. Eligible collateral is limited to that recognised under the standardised approach for CRM (paragraphs 145 and 146). Collateral pledged by SPEs may be recognised.

Guarantees and credit derivatives

586. Credit protection provided by the entities listed in paragraph 195 may be recognised. SPEs cannot be recognised as eligible guarantors.

587. Where guarantees or credit derivatives fulfil the minimum operational conditions as specified in paragraphs 189 to 194, banks can take account of such credit protection in calculating capital requirements for securitisation exposures.

588. Capital requirements for the guaranteed/protected portion will be calculated according to CRM for the standardised approach as specified in paragraphs 196 to 201.

Maturity mismatches

589. For the purpose of setting regulatory capital against a maturity mismatch, the capital requirement will be determined in accordance with paragraphs 202 to 205. When the exposures being hedged have different maturities, the longest maturity must be used.

(vi) Capital requirement for early amortisation provisions

Scope

590. As described below, an originating bank is required to hold capital against all or a portion of the investors' interest (i.e. against both the drawn and undrawn balances related to the securitised exposures) when:

(a) It sells exposures into a structure that contains an early amortisation feature; and

(b) The exposures sold are of a revolving nature. These involve exposures where the borrower is permitted to vary the drawn amount and repayments within an agreed limit under a line of credit (e.g. credit card receivables and corporate loan commitments).

591. The capital requirement should reflect the type of mechanism through which an early amortisation is triggered.

592. For securitisation structures wherein the underlying pool comprises revolving and term exposures, a bank must apply the relevant early amortisation treatment (outlined below in paragraphs 594 to 605) to that portion of the underlying pool containing revolving exposures.

593. Banks are not required to calculate a capital requirement for early amortisations in the following situations:

(a) Replenishment structures where the underlying exposures do not revolve and the early amortisation ends the ability of the bank to add new exposures;

(b) Transactions of revolving assets containing early amortisation features that mimic term structures (i.e. where the risk on the underlying facilities does not return to the originating bank);

(c) Structures where a bank securitises one or more credit line(s) and where investors remain fully exposed to future draws by borrowers even after an early amortisation event has occurred;

(d) The early amortisation clause is solely triggered by events not related to the performance of the securitised assets or the selling bank, such as material changes in tax laws or regulations.

Maximum capital requirement

594. For a bank subject to the early amortisation treatment, the total capital charge for all of its positions will be subject to a maximum capital requirement (i.e. a 'cap') equal to the greater of (i) that required for retained securitisation exposures, or (ii) the capital requirement that would apply had the exposures not been securitised. In addition, banks must deduct the entire amount of any gain-on-sale and credit enhancing I/Os arising from the securitisation transaction in accordance with paragraphs 561 to 563.

Mechanics

595. The originator's capital charge for the investors' interest is determined as the product of (a) the investors' interest, (b) the appropriate CCF (as discussed below), and (c) the risk weight appropriate to the underlying exposure type, as if the exposures had not been securitised. As described below, the CCFs depend upon whether the early amortisation repays investors through a controlled or non-controlled mechanism. They also differ according to whether the securitised exposures are uncommitted retail credit lines (e.g. credit card receivables) or other credit lines (e.g. revolving corporate facilities). A line is considered uncommitted if it is unconditionally cancellable without prior notice.

(vii) Determination of CCFs for controlled early amortisation features

596. An early amortisation feature is considered controlled when the definition as specified in paragraph 548 is satisfied.

Uncommitted retail exposures

597. For uncommitted retail credit lines (e.g. credit card receivables) in securitisations containing controlled early amortisation features, banks must compare the three-month average excess spread defined in paragraph 550 to the point at which the bank is required to trap excess spread as economically required by the structure (i.e. excess spread trapping point).

598. In cases where such a transaction does not require excess spread to be trapped, the trapping point is deemed to be 4.5 percentage points.

599. The bank must divide the excess spread level by the transaction's excess spread trapping point to determine the appropriate segments and apply the corresponding conversion factors, as outlined in the following table.

Controlled early amortisation features

	Uncommitted	**Committed**
Retail credit lines	**3-month average excess spread Credit Conversion Factor (CCF)** 133.33% of trapping point or more 0% CCF less than 133.33% to 100% of trapping point 1% CCF less than 100% to 75% of trapping point 2% CCF less than 75% to 50% of trapping point 10% CCF less than 50% to 25% of trapping point 20% CCF less than 25% 40% CCF	90% CCF
Non-retail credit lines	90% CCF	90% CCF

600. Banks are required to apply the conversion factors set out above for controlled mechanisms to the investors' interest referred to in paragraph 595.

Other exposures

601. All other securitised revolving exposures (i.e. those that are committed and all non-retail exposures) with controlled early amortisation features will be subject to a CCF of 90% against the off-balance sheet exposures.

(viii) Determination of CCFs for non-controlled early amortisation features

602. Early amortisation features that do not satisfy the definition of a controlled early amortisation as specified in paragraph 548 will be considered non-controlled and treated as follows.

Uncommitted retail exposures

603. For uncommitted retail credit lines (e.g. credit card receivables) in securitisations containing non-controlled early amortisation features, banks must make the comparison described in paragraphs 597 and 598:

604. The bank must divide the excess spread level by the transaction's excess spread trapping point to determine the appropriate segments and apply the corresponding conversion factors, as outlined in the following table.

Non-controlled early amortisation features

	Uncommitted	Committed
Retail credit lines	**3-month average excess spread Credit Conversion Factor (CCF)** 133.33% or more of trapping point 0% CCF less than 133.33% to 100% of trapping point 5% CCF less than 100% to 75% of trapping point 15% CCF less than 75% to 50% of trapping point 50% CCF less than 50% of trapping point 100% CCF	100% CCF
Non-retail credit lines	100% CCF	100% CCF

Other exposures

605. All other securitised revolving exposures (i.e. those that are committed and all non-retail exposures) with non-controlled early amortisation features will be subject to a CCF of 100% against the off-balance sheet exposures.

4. Internal ratings-based approach for securitisation exposures

(i) Scope

606. Banks that have received approval to use the IRB approach for the type of underlying exposures securitised (e.g. for their corporate or retail portfolio) must use the IRB approach for securitisations. Conversely, banks may not use the IRB approach to securitisation unless they receive approval to use the IRB approach for the underlying exposures from their national supervisors.

607. If the bank is using the IRB approach for some exposures and the standardised approach for other exposures in the underlying pool, it should generally use the approach corresponding to the predominant share of exposures within the pool. The bank should consult with its national supervisors on which approach to apply to its securitisation exposures. To ensure appropriate capital levels, there may be instances where the supervisor requires a treatment other than this general rule.

608. Where there is no specific IRB treatment for the underlying asset type, originating banks that have received approval to use the IRB approach must calculate capital charges on their securitisation exposures using the standardised approach in the securitisation framework, and investing banks with approval to use the IRB approach must apply the RBA.

(ii) Hierarchy of approaches

609. The Ratings-Based Approach (RBA) must be applied to securitisation exposures that are rated, or where a rating can be inferred as described in paragraph 617. Where an external or an inferred rating is not available, either the Supervisory Formula (SF) or the Internal Assessment Approach (IAA) must be applied. The IAA is only available to exposures (e.g. liquidity facilities and credit enhancements) that banks (including third-party banks) extend to ABCP programmes. Such exposures must satisfy the conditions of paragraphs 619 and 620. For liquidity facilities to which none of these approaches can be applied, banks may apply the treatment specified in paragraph 639. Exceptional treatment for eligible servicer cash advance facilities is specified in paragraph 641. Securitisation exposures to which none of these approaches can be applied must be deducted.

(iii) Maximum capital requirement

610. For a bank using the IRB approach to securitisation, the maximum capital requirement for the securitisation exposures it holds is equal to the IRB capital requirement that would have been assessed against the underlying exposures had they not been securitised and treated under the appropriate sections of the IRB framework including Section III.G. In addition, banks must deduct the entire amount of any gain-on-sale and credit enhancing I/Os arising from the securitisation transaction in accordance with paragraphs 561 to 563.

(iv) Ratings-Based Approach (RBA)

611. Under the RBA, the risk-weighted assets are determined by multiplying the amount of the exposure by the appropriate risk weights, provided in the tables below.

612. The risk weights depend on (i) the external rating grade or an available inferred rating, (ii) whether the credit rating (external or inferred) represents a long-term or a short-term credit rating, (iii) the granularity of the underlying pool and (iv) the seniority of the position.

613. For purposes of the RBA, a securitisation exposure is treated as a senior tranche if it is effectively backed or secured by a first claim on the entire amount of the assets in the underlying securitised pool. While this generally includes only the most senior position within a securitisation transaction, in some instances there may be some other claim that, in a technical sense, may be more senior in the waterfall (e.g. a swap claim) but may be disregarded for the purpose of determining which positions are subject to the “senior tranches” column.

Examples:

(a) In a typical synthetic securitisation, the “super-senior” tranche would be treated as a senior tranche, provided that all of the conditions for inferring a rating from a lower tranche are fulfilled.

(b) In a traditional securitisation where all tranches above the first-loss piece are rated, the most highly rated position would be treated as a senior tranche. However, when there are several tranches that share the same rating, only the most senior one in the waterfall would be treated as senior.

(c) Usually a liquidity facility supporting an ABCP programme would not be the most senior position within the programme; the commercial paper, which benefits from the liquidity support, typically would be the most senior position. However, if the liquidity facility is sized to cover all of the outstanding commercial paper, it can be viewed as covering all losses on the underlying receivables pool that exceed the amount of over-collateralisation/reserves provided by the seller and as being most senior. As a result, the RBA risk weights in the left-most column can be used for such positions. On the other hand, if a liquidity or credit enhancement facility constituted a mezzanine position in economic substance rather than a senior position in the underlying pool, then the "Base risk weights" column is applicable.

614. The risk weights provided in the first table below apply when the external assessment represents a long-term credit rating, as well as when an inferred rating based on a long-term rating is available.

615. Banks may apply the risk weights for senior positions if the effective number of underlying exposures (N, as defined in paragraph 633) is 6 or more and the position is senior as defined above. When N is less than 6, the risk weights in column 4 of the first table below apply. In all other cases, the risk weights in column 3 of the first table below apply.

RBA risk weights when the external assessment represents a long-term credit rating and/or an inferred rating derived from a long-term assessment

<table>
<tr><th>External Rating (Illustrative)</th><th>Risk weights for senior positions and eligible senior IAA exposures</th><th>Base risk weights</th><th>Risk weights for tranches backed by non-granular pools</th></tr>
<tr><td>AAA</td><td>7%</td><td>12%</td><td>20%</td></tr>
<tr><td>AA</td><td>8%</td><td>15%</td><td>25%</td></tr>
<tr><td>A+</td><td>10%</td><td>18%</td><td rowspan="3">35%</td></tr>
<tr><td>A</td><td>12%</td><td>20%</td></tr>
<tr><td>A-</td><td>20%</td><td>35%</td></tr>
<tr><td>BBB+</td><td>35%</td><td colspan="2">50%</td></tr>
<tr><td>BBB</td><td>60%</td><td colspan="2">75%</td></tr>
<tr><td>BBB-</td><td colspan="3">100%</td></tr>
<tr><td>BB+</td><td colspan="3">250%</td></tr>
<tr><td>BB</td><td colspan="3">425%</td></tr>
<tr><td>BB-</td><td colspan="3">650%</td></tr>
<tr><td>Below BB- and unrated</td><td colspan="3">Deduction</td></tr>
</table>

616. The risk weights in the table below apply when the external assessment represents a short-term credit rating, as well as when an inferred rating based on a short-term rating is available. The decision rules outlined in paragraph 615 also apply for short-term credit ratings.

RBA risk weights when the external assessment represents a short-term credit rating and/or an inferred rating derived from a short-term assessment

External Rating (Illustrative)	Risk weights for senior positions and eligible senior IAA exposures	Base risk weights	Risk weights for tranches backed by non-granular pools
A-1/P-1	7%	12%	20%
A-2/P-2	12%	20%	35%
A-3/P-3	60%	75%	75%
All other ratings/unrated	Deduction	Deduction	Deduction

Use of inferred ratings

617. When the following minimum operational requirements are satisfied a bank must attribute an inferred rating to an unrated position. These requirements are intended to ensure that the unrated position is senior in all respects to an externally rated securitisation exposure termed the 'reference securitisation exposure'.

Operational requirements for inferred ratings

618. The following operational requirements must be satisfied to recognise inferred ratings.

(a) The reference securitisation exposure (e.g. ABS) must be subordinate in all respects to the unrated securitisation exposure. Credit enhancements, if any, must be taken into account when assessing the relative subordination of the unrated exposure and the reference securitisation exposure. For example, if the reference securitisation exposure benefits from any third-party guarantees or other credit enhancements that are not available to the unrated exposure, then the latter may not be assigned an inferred rating based on the reference securitisation exposure.

(b) The maturity of the reference securitisation exposure must be equal to or longer than that of the unrated exposure.

(c) On an ongoing basis, any inferred rating must be updated continuously to reflect any changes in the external rating of the reference securitisation exposure.

(d) The external rating of the reference securitisation exposure must satisfy the general requirements for recognition of external ratings as delineated in paragraph 565.

(v) Internal Assessment Approach (IAA)

619. A bank may use its internal assessments of the credit quality of the securitisation exposures the bank extends to ABCP programmes (e.g. liquidity facilities and credit enhancements) if the bank's internal assessment process meets the operational requirements below. Internal assessments of exposures provided to ABCP programmes must be mapped to equivalent external ratings of an ECAI. Those rating equivalents are used to determine the appropriate risk weights under the RBA for purposes of assigning the notional amounts of the exposures.

620. A bank's internal assessment process must meet the following operational requirements in order to use internal assessments in determining the IRB capital requirement

arising from liquidity facilities, credit enhancements, or other exposures extended to an ABCP programme.

(a) For the unrated exposure to qualify for the IAA, the ABCP must be externally rated. The ABCP itself is subject to the RBA.

(b) The internal assessment of the credit quality of a securitisation exposure to the ABCP programme must be based on an ECAI criteria for the asset type purchased and must be the equivalent of at least investment grade when initially assigned to an exposure. In addition, the internal assessment must be used in the bank's internal risk management processes, including management information and economic capital systems, and generally must meet all the relevant requirements of the IRB framework.

(c) In order for banks to use the IAA, their supervisors must be satisfied (i) that the ECAI meets the ECAI eligibility criteria outlined in paragraphs 90 to 108 and (ii) with the ECAI rating methodologies used in the process. In addition, banks have the responsibility to demonstrate to the satisfaction of their supervisors how these internal assessments correspond with the relevant ECAI's standards.

For instance, when calculating the credit enhancement level in the context of the IAA, supervisors may, if warranted, disallow on a full or partial basis any seller-provided recourse guarantees or excess spread, or any other first loss credit enhancements that provide limited protection to the bank.

(d) The bank's internal assessment process must identify gradations of risk. Internal assessments must correspond to the external ratings of ECAIs so that supervisors can determine which internal assessment corresponds to each external rating category of the ECAIs.

(e) The bank's internal assessment process, particularly the stress factors for determining credit enhancement requirements, must be at least as conservative as the publicly available rating criteria of the major ECAIs that are externally rating the ABCP programme's commercial paper for the asset type being purchased by the programme. However, banks should consider, to some extent, all publicly available ECAI ratings methodologies in developing their internal assessments.

- In the case where (i) the commercial paper issued by an ABCP programme is externally rated by two or more ECAIs and (ii) the different ECAIs' benchmark stress factors require different levels of credit enhancement to achieve the same external rating equivalent, the bank must apply the ECAI stress factor that requires the most conservative or highest level of credit protection. For example, if one ECAI required enhancement of 2.5 to 3.5 times historical losses for an asset type to obtain a single A rating equivalent and another required 2 to 3 times historical losses, the bank must use the higher range of stress factors in determining the appropriate level of seller-provided credit enhancement.

- When selecting ECAIs to externally rate an ABCP, a bank must not choose only those ECAIs that generally have relatively less restrictive rating methodologies. In addition, if there are changes in the methodology of one of the selected ECAIs, including the stress factors, that adversely affect the external rating of the programme's commercial paper, then the revised rating methodology must be considered in evaluating whether the internal assessments assigned to ABCP programme exposures are in need of revision.

- A bank cannot utilise an ECAI's rating methodology to derive an internal assessment if the ECAI's process or rating criteria is not publicly available. However, banks should consider the non-publicly available methodology — to the extent that they have access to such information – in developing their internal assessments, particularly if it is more conservative than the publicly available criteria.

- In general, if the ECAI rating methodologies for an asset or exposure are not publicly available, then the IAA may not be used. However, in certain instances, for example, for new or uniquely structured transactions, which are not currently addressed by the rating criteria of an ECAI rating the programme's commercial paper, a bank may discuss the specific transaction with its supervisor to determine whether the IAA may be applied to the related exposures.

(f) Internal or external auditors, an ECAI, or the bank's internal credit review or risk management function must perform regular reviews of the internal assessment process and assess the validity of those internal assessments. If the bank's internal audit, credit review, or risk management functions perform the reviews of the internal assessment process, then these functions must be independent of the ABCP programme business line, as well as the underlying customer relationships.

(g) The bank must track the performance of its internal assessments over time to evaluate the performance of the assigned internal assessments and make adjustments, as necessary, to its assessment process when the performance of the exposures routinely diverges from the assigned internal assessments on those exposures.

(h) The ABCP programme must have credit and investment guidelines, i.e. underwriting standards, for the ABCP programme. In the consideration of an asset purchase, the ABCP programme (i.e. the programme administrator) should develop an outline of the structure of the purchase transaction. Factors that should be discussed include the type of asset being purchased; type and monetary value of the exposures arising from the provision of liquidity facilities and credit enhancements; loss waterfall; and legal and economic isolation of the transferred assets from the entity selling the assets.

(i) A credit analysis of the asset seller's risk profile must be performed and should consider, for example, past and expected future financial performance; current market position; expected future competitiveness; leverage, cash flow, and interest coverage; and debt rating. In addition, a review of the seller's underwriting standards, servicing capabilities, and collection processes should be performed.

(j) The ABCP programme's underwriting policy must establish minimum asset eligibility criteria that, among other things,

- exclude the purchase of assets that are significantly past due or defaulted;

- limit excess concentration to individual obligor or geographic area; and

- limit the tenor of the assets to be purchased.

(k) The ABCP programme should have collections processes established that consider the operational capability and credit quality of the servicer. The programme should mitigate to the extent possible seller/servicer risk through various methods, such as triggers based on current credit quality that would preclude co-mingling of funds and impose lockbox arrangements that would help ensure the continuity of payments to the ABCP programme.

(l) The aggregate estimate of loss on an asset pool that the ABCP programme is considering purchasing must consider all sources of potential risk, such as credit and dilution risk. If the seller-provided credit enhancement is sized based on only credit-related losses, then a separate reserve should be established for dilution risk, if dilution risk is material for the particular exposure pool. In addition, in sizing the required enhancement level, the bank should review several years of historical information, including losses, delinquencies, dilutions, and the turnover rate of the receivables. Furthermore, the bank should evaluate the characteristics of the underlying asset pool, e.g. weighted average credit score, identify any concentrations to an individual obligor or geographic region, and the granularity of the asset pool.

(m) The ABCP programme must incorporate structural features into the purchase of assets in order to mitigate potential credit deterioration of the underlying portfolio. Such features may include wind down triggers specific to a pool of exposures.

621. The notional amount of the securitisation exposure to the ABCP programme must be assigned to the risk weight in the RBA appropriate to the credit rating equivalent assigned to the bank's exposure.

622. If a bank's internal assessment process is no longer considered adequate, the bank's supervisor may preclude the bank from applying the internal assessment approach to its ABCP exposures, both existing and newly originated, for determining the appropriate capital treatment until the bank has remedied the deficiencies. In this instance, the bank must revert to the SF or, if not available, to the method described in paragraph 639.

(vi) Supervisory Formula (SF)

623. As in the IRB approaches, risk-weighted assets generated through the use of the SF are calculated by multiplying the capital charge by 12.5. Under the SF, the capital charge for a securitisation tranche depends on five bank-supplied inputs: the IRB capital charge had the underlying exposures not been securitised (K_{IRB}); the tranche's credit enhancement level (L) and thickness (T); the pool's effective number of exposures (N); and the pool's exposure-weighted average loss-given-default (LGD). The inputs K_{IRB}, L, T and N are defined below. The capital charge is calculated as follows:

(1) *Tranche's IRB capital charge* = the amount of exposures that have been securitised *times* the greater of (a) 0.0056 x T, or (b) (S [L+T] – S [L]),

where the function S[.] (termed the 'Supervisory Formula') is defined in the following paragraph. When the bank holds only a proportional interest in the tranche, that position's capital charge equals the prorated share of the capital charge for the entire tranche.

624. The Supervisory Formula is given by the following expression:

(2)
$$S[L] = \begin{cases} L & \text{when } L \le K_{IRB} \\ K_{IRB} + K[L] - K[K_{IRB}] + (d \cdot K_{IRB}/\omega)\left(1 - e^{\omega(K_{IRB}-L)/K_{IRB}}\right) & \text{when } K_{IRB} < L \end{cases}$$

where

$$h = \left(1 - K_{IRB}/LGD\right)^{N}$$
$$c = K_{IRB}/\left(1 - h\right)$$
$$v = \frac{\left(LGD - K_{IRB}\right)K_{IRB} + 0.25\left(1 - LGD\right)K_{IRB}}{N}$$
$$f = \left(\frac{v + K_{IRB}{}^{2}}{1-h} - c^{2}\right) + \frac{\left(1 - K_{IRB}\right)K_{IRB} - v}{\left(1-h\right)\tau}$$
$$g = \frac{\left(1-c\right)c}{f} - 1$$
$$a = g \cdot c$$
$$b = g \cdot \left(1 - c\right)$$
$$d = 1 - \left(1-h\right) \cdot \left(1 - Beta\left[K_{IRB}; a, b\right]\right)$$
$$K\left[L\right] = \left(1-h\right) \cdot \left(\left(1 - Beta\left[L; a, b\right]\right)L + Beta\left[L; a+1, b\right]c\right).$$

625. In these expressions, Beta[L; a, b] refers to the cumulative beta distribution with parameters a and b evaluated at L.[96]

626. The supervisory-determined parameters in the above expressions are as follows:

$$\tau = 1000, \text{ and } \omega = 20$$

Definition of K_{IRB}

627. K_{IRB} is the ratio of (a) the IRB capital requirement including the EL portion for the underlying exposures in the pool to (b) the exposure amount of the pool (e.g. the sum of drawn amounts related to securitised exposures plus the EAD associated with undrawn commitments related to securitised exposures). Quantity (a) above must be calculated in accordance with the applicable minimum IRB standards (as set out in Section III of this document) as if the exposures in the pool were held directly by the bank. This calculation should reflect the effects of any credit risk mitigant that is applied on the underlying exposures (either individually or to the entire pool), and hence benefits all of the securitisation exposures. K_{IRB} is expressed in decimal form (e.g. a capital charge equal to 15% of the pool would be expressed as 0.15). For structures involving an SPE, all the assets of the SPE that are related to the securitisations are to be treated as exposures in the pool, including assets in which the SPE may have invested a reserve account, such as a cash collateral account.

628. If the risk weight resulting from the SF is 1250%, banks must deduct the securitisation exposure subject to that risk weight in accordance with paragraphs 561 to 563.

629. In cases where a bank has set aside a specific provision or has a non-refundable purchase price discount on an exposure in the pool, quantity (a) defined above and quantity (b) also defined above must be calculated using the gross amount of the exposure without the specific provision and/or non-refundable purchase price discount. In this case, the amount of the non-refundable purchase price discount on a defaulted asset or the specific

96 The cumulative beta distribution function is available, for example, in Excel as the function BETADIST.

provision can be used to reduce the amount of any deduction from capital associated with the securitisation exposure.

Credit enhancement level (L)

630. L is measured (in decimal form) as the ratio of (a) the amount of all securitisation exposures subordinate to the tranche in question to (b) the amount of exposures in the pool. Banks will be required to determine L before considering the effects of any tranche-specific credit enhancements, such as third-party guarantees that benefit only a single tranche. Any gain-on-sale and/or credit enhancing I/Os associated with the securitisation are not to be included in the measurement of L. The size of interest rate or currency swaps that are more junior than the tranche in question may be measured at their current values (without the potential future exposures) in calculating the enhancement level. If the current value of the instrument cannot be measured, the instrument should be ignored in the calculation of L.

631. If there is any reserve account funded by accumulated cash flows from the underlying exposures that is more junior than the tranche in question, this can be included in the calculation of L. Unfunded reserve accounts may not be included if they are to be funded from future receipts from the underlying exposures.

Thickness of exposure (T)

632. T is measured as the ratio of (a) the nominal size of the tranche of interest to (b) the notional amount of exposures in the pool. In the case of an exposure arising from an interest rate or currency swap, the bank must incorporate potential future exposure. If the current value of the instrument is non-negative, the exposure size should be measured by the current value plus the add-on as in Section VII of Annex 4. If the current value is negative, the exposure should be measured by using the potential future exposure only.

Effective number of exposures (N)

633. The effective number of exposures is calculated as:

(3) $$N = \frac{\left(\sum_i EAD_i\right)^2}{\sum_i EAD_i^2}$$

where EAD_i represents the exposure-at-default associated with the i^{th} instrument in the pool. Multiple exposures to the same obligor must be consolidated (i.e. treated as a single instrument). In the case of re-securitisation (securitisation of securitisation exposures), the formula applies to the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools. If the portfolio share associated with the largest exposure, C_1, is available, the bank may compute N as $1/C_1$.

Exposure-weighted average LGD

634. The exposure-weighted average LGD is calculated as follows:

(4) $$LGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where LGD_i represents the average LGD associated with all exposures to the i^{th} obligor. In the case of re-securitisation, an LGD of 100% must be assumed for the underlying securitised exposures. When default and dilution risks for purchased receivables are treated in an aggregate manner (e.g. a single reserve or over-collateralisation is available to cover losses from either source) within a securitisation, the LGD input must be constructed as a weighted-average of the LGD for default risk and the 100% LGD for dilution risk. The weights are the stand-alone IRB capital charges for default risk and dilution risk, respectively.

Simplified method for computing N and LGD

635. For securitisations involving retail exposures, subject to supervisory review, the SF may be implemented using the simplifications: $h = 0$ and $v = 0$.

636. Under the conditions provided below, banks may employ a simplified method for calculating the effective number of exposures and the exposure-weighted average LGD. Let C_m in the simplified calculation denote the share of the pool corresponding to the sum of the largest 'm' exposures (e.g. a 15% share corresponds to a value of 0.15). The level of m is set by each bank.

- If the portfolio share associated with the largest exposure, C_1, is no more than 0.03 (or 3% of the underlying pool), then for purposes of the SF, the bank may set LGD=0.50 and N equal to the following amount

(5) $$N = \left(C_1 C_m + \left(\frac{C_m - C_1}{m-1} \right) \max\{1 - m C_1, 0\} \right)^{-1}$$

- Alternatively, if only C_1 is available and this amount is no more than 0.03, then the bank may set LGD=0.50 and N=1/ C_1.

(vii) Liquidity facilities

637. Liquidity facilities are treated as any other securitisation exposure and receive a CCF of 100% unless specified differently in paragraphs 638 to 641. If the facility is externally rated, the bank may rely on the external rating under the RBA. If the facility is not rated and an inferred rating is not available, the bank must apply the SF, unless the IAA can be applied.

638. An eligible liquidity facility that can only be drawn in the event of a general market disruption as defined in paragraph 580 is assigned a 20% CCF under the SF. That is, an IRB bank is to recognise 20% of the capital charge generated under the SF for the facility. If the eligible facility is externally rated, the bank may rely on the external rating under the RBA provided it assigns a 100% CCF rather than a 20% CCF to the facility.

639. When it is not practical for the bank to use either the bottom-up approach or the top-down approach for calculating K_{IRB}, the bank may, on an exceptional basis and subject to supervisory consent, temporarily be allowed to apply the following method. If the liquidity facility meets the definition in paragraph 578 or 580, the highest risk weight assigned under the standardised approach to any of the underlying individual exposures covered by the liquidity facility can be applied to the liquidity facility. If the liquidity facility meets the definition in paragraph 578, the CCF must be 50% for a facility with an original maturity of one year or less, or 100% if the facility has an original maturity of more than one year. If the liquidity facility meets the definition in paragraph 580, the CCF must be 20%. In all other cases, the notional amount of the liquidity facility must deducted.

(viii) Treatment of overlapping exposures

640. Overlapping exposures are treated as described in paragraph 581.

(ix) Eligible servicer cash advance facilities

641. Eligible servicer cash advance facilities are treated as specified in paragraph 582.

(x) Treatment of credit risk mitigation for securitisation exposures

642. As with the RBA, banks are required to apply the CRM techniques as specified in the foundation IRB approach of Section III when applying the SF. The bank may reduce the capital charge proportionally when the credit risk mitigant covers first losses or losses on a proportional basis. For all other cases, the bank must assume that the credit risk mitigant covers the most senior portion of the securitisation exposure (i.e. that the most junior portion of the securitisation exposure is uncovered). Examples for recognising collateral and guarantees under the SF are provided in Annex 7.

(xi) Capital requirement for early amortisation provisions

643. An originating bank must use the methodology and treatment described in paragraphs 590 to 605 for determining if any capital must be held against the investors' interest. For banks using the IRB approach to securitisation, investors' interest is defined as investors' drawn balances related to securitisation exposures and EAD associated with investors' undrawn lines related to securitisation exposures. For determining the EAD, the undrawn balances of securitised exposures would be allocated between the seller's and investors' interests on a pro rata basis, based on the proportions of the seller's and investors' shares of the securitised drawn balances. For IRB purposes, the capital charge attributed to the investors' interest is determined by the product of (a) the investors' interest, (b) the appropriate CCF, and (c) K_{IRB}.

V. Operational Risk

A. Definition of operational risk

644. Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk,[97] but excludes strategic and reputational risk.

B. The measurement methodologies

645. The framework outlined below presents three methods for calculating operational risk capital charges in a continuum of increasing sophistication and risk sensitivity: (i) the Basic Indicator Approach; (ii) the Standardised Approach; and (iii) Advanced Measurement Approaches (AMA).

646. Banks are encouraged to move along the spectrum of available approaches as they develop more sophisticated operational risk measurement systems and practices. Qualifying criteria for the Standardised Approach and AMA are presented below.

647. Internationally active banks and banks with significant operational risk exposures (for example, specialised processing banks) are expected to use an approach that is more sophisticated than the Basic Indicator Approach and that is appropriate for the risk profile of the institution.[98] A bank will be permitted to use the Basic Indicator or Standardised Approach for some parts of its operations and an AMA for others provided certain minimum criteria are met, see paragraphs 680 to 683.

648. A bank will not be allowed to choose to revert to a simpler approach once it has been approved for a more advanced approach without supervisory approval. However, if a supervisor determines that a bank using a more advanced approach no longer meets the qualifying criteria for this approach, it may require the bank to revert to a simpler approach for some or all of its operations, until it meets the conditions specified by the supervisor for returning to a more advanced approach.

1. The Basic Indicator Approach

649. Banks using the Basic Indicator Approach must hold capital for operational risk equal to the average over the previous three years of a fixed percentage (denoted alpha) of positive annual gross income. Figures for any year in which annual gross income is negative or zero should be excluded from both the numerator and denominator when calculating the average.[99] The charge may be expressed as follows:

$$K_{BIA} = \left[\sum\left(GI_{1\ldots n} \times \alpha\right)\right]/n$$

[97] Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

[98] Supervisors will review the capital requirement produced by the operational risk approach used by a bank (whether Basic Indicator Approach, Standardised Approach or AMA) for general credibility, especially in relation to a firm's peers. In the event that credibility is lacking, appropriate supervisory action under Pillar 2 will be considered.

[99] If negative gross income distorts a bank's Pillar 1 capital charge, supervisors will consider appropriate supervisory action under Pillar 2.

where:

K_{BIA} = the capital charge under the Basic Indicator Approach

GI = annual gross income, where positive, over the previous three years

N = number of the previous three years for which gross income is positive

α = 15%, which is set by the Committee, relating the industry wide level of required capital to the industry wide level of the indicator.

650. Gross income is defined as net interest income plus net non-interest income.[100] It is intended that this measure should: (i) be gross of any provisions (e.g. for unpaid interest); (ii) be gross of operating expenses, including fees paid to outsourcing service providers;[101] (iii) exclude realised profits/losses from the sale of securities in the banking book;[102] and (iv) exclude extraordinary or irregular items as well as income derived from insurance.

651. As a point of entry for capital calculation, no specific criteria for use of the Basic Indicator Approach are set out in this Framework. Nevertheless, banks using this approach are encouraged to comply with the Committee's guidance on *Sound Practices for the Management and Supervision of Operational Risk*, February 2003.

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[100] As defined by national supervisors and/or national accounting standards.

[101] In contrast to fees paid for services that are outsourced, fees received by banks that provide outsourcing services shall be included in the definition of gross income.

[102] Realised profits/losses from securities classified as "held to maturity" and "available for sale", which typically constitute items of the banking book (e.g. under certain accounting standards), are also excluded from the definition of gross income.

2. The Standardised Approach[103,104]

652. In the Standardised Approach, banks' activities are divided into eight business lines: corporate finance, trading & sales, retail banking, commercial banking, payment & settlement, agency services, asset management, and retail brokerage. The business lines are defined in detail in Annex 8.

653. Within each business line, gross income is a broad indicator that serves as a proxy for the scale of business operations and thus the likely scale of operational risk exposure within each of these business lines. The capital charge for each business line is calculated by multiplying gross income by a factor (denoted beta) assigned to that business line. Beta serves as a proxy for the industry-wide relationship between the operational risk loss experience for a given business line and the aggregate level of gross income for that business line. It should be noted that in the Standardised Approach gross income is measured for each business line, not the whole institution, i.e. in corporate finance, the indicator is the gross income generated in the corporate finance business line.

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[103] The Committee intends to reconsider the calibration of the Basic Indicator and Standardised Approaches when more risk-sensitive data are available to carry out this recalibration. Any such recalibration would not be intended to affect significantly the overall calibration of the operational risk component of the Pillar 1 capital charge.

[104] **The Alternative Standardised Approach**

At national supervisory discretion a supervisor can choose to allow a bank to use the Alternative Standardised Approach (ASA) provided the bank is able to satisfy its supervisor that this alternative approach provides an improved basis by, for example, avoiding double counting of risks. Once a bank has been allowed to use the ASA, it will not be allowed to revert to use of the Standardised Approach without the permission of its supervisor. It is not envisaged that large diversified banks in major markets would use the ASA.

Under the ASA, the operational risk capital charge/methodology is the same as for the Standardised Approach except for two business lines — retail banking and commercial banking. For these business lines, loans and advances — multiplied by a fixed factor 'm' — replaces gross income as the exposure indicator. The betas for retail and commercial banking are unchanged from the Standardised Approach. The ASA operational risk capital charge for retail banking (with the same basic formula for commercial banking) can be expressed as:

$$\mathbf{K_{RB} = \beta_{RB} \times m \times LA_{RB}}$$

where

K_{RB} is the capital charge for the retail banking business line

β_{RB} is the beta for the retail banking business line

LA_{RB} is total outstanding retail loans and advances (non-risk weighted and gross of provisions), averaged over the past three years

m is 0.035

For the purposes of the ASA, total loans and advances in the retail banking business line consists of the total drawn amounts in the following credit portfolios: retail, SMEs treated as retail, and purchased retail receivables. For commercial banking, total loans and advances consists of the drawn amounts in the following credit portfolios: corporate, sovereign, bank, specialised lending, SMEs treated as corporate and purchased corporate receivables. The book value of securities held in the banking book should also be included.

Under the ASA, banks may aggregate retail and commercial banking (if they wish to) using a beta of 15%. Similarly, those banks that are unable to disaggregate their gross income into the other six business lines can aggregate the total gross income for these six business lines using a beta of 18%, with negative gross income treated as described in paragraph 654.

As under the Standardised Approach, the total capital charge for the ASA is calculated as the simple summation of the regulatory capital charges across each of the eight business lines.

654. The total capital charge is calculated as the three-year average of the simple summation of the regulatory capital charges across each of the business lines in each year. In any given year, negative capital charges (resulting from negative gross income) in any business line may offset positive capital charges in other business lines without limit.[105] However, where the aggregate capital charge across all business lines within a given year is negative, then the input to the numerator for that year will be zero.[106] The total capital charge may be expressed as:

$$K_{TSA} = \left\{ \sum_{\text{years } 1\text{-}3} \max\left[\sum \left(GI_{1\text{-}8} \times \beta_{1-8} \right), 0 \right] \right\} / 3$$

where:

K_{TSA} = the capital charge under the Standardised Approach

$GI_{1\text{-}8}$ = annual gross income in a given year, as defined above in the Basic Indicator Approach, for each of the eight business lines

$\beta_{1\text{-}8}$ = a fixed percentage, set by the Committee, relating the level of required capital to the level of the gross income for each of the eight business lines. The values of the betas are detailed below.

Business Lines	Beta Factors
Corporate finance (β_1)	18%
Trading and sales (β_2)	18%
Retail banking (β_3)	12%
Commercial banking (β_4)	15%
Payment and settlement (β_5)	18%
Agency services (β_6)	15%
Asset management (β_7)	12%
Retail brokerage (β_8)	12%

3. *Advanced Measurement Approaches (AMA)*

655. Under the AMA, the regulatory capital requirement will equal the risk measure generated by the bank's internal operational risk measurement system using the quantitative and qualitative criteria for the AMA discussed below. Use of the AMA is subject to supervisory approval.

656. A bank adopting the AMA may, with the approval of its host supervisors and the support of its home supervisor, use an allocation mechanism for the purpose of determining the regulatory capital requirement for internationally active banking subsidiaries that are not deemed to be significant relative to the overall banking group but are themselves subject to this Framework in accordance with Part 1. Supervisory approval would be conditional on the bank demonstrating to the satisfaction of the relevant supervisors that the allocation

[105] At national discretion, supervisors may adopt a more conservative treatment of negative gross income.

[106] As under the Basic Indicator Approach, if negative gross income distorts a bank's Pillar 1 capital charge under the Standardised Approach, supervisors will consider appropriate supervisory action under Pillar 2.

mechanism for these subsidiaries is appropriate and can be supported empirically. The board of directors and senior management of each subsidiary are responsible for conducting their own assessment of the subsidiary's operational risks and controls and ensuring the subsidiary is adequately capitalised in respect of those risks.

657. Subject to supervisory approval as discussed in paragraph 669(d), the incorporation of a well-reasoned estimate of diversification benefits may be factored in at the group-wide level or at the banking subsidiary level. However, any banking subsidiaries whose host supervisors determine that they must calculate stand-alone capital requirements (see Part 1) may not incorporate group-wide diversification benefits in their AMA calculations (e.g. where an internationally active banking subsidiary is deemed to be significant, the banking subsidiary may incorporate the diversification benefits of its own operations — those arising at the sub-consolidated level — but may not incorporate the diversification benefits of the parent).

658. The appropriateness of the allocation methodology will be reviewed with consideration given to the stage of development of risk-sensitive allocation techniques and the extent to which it reflects the level of operational risk in the legal entities and across the banking group. Supervisors expect that AMA banking groups will continue efforts to develop increasingly risk-sensitive operational risk allocation techniques, notwithstanding initial approval of techniques based on gross income or other proxies for operational risk.

659. Banks adopting the AMA will be required to calculate their capital requirement using this approach as well as the 1988 Accord as outlined in paragraph 46.

C. Qualifying criteria

1. The Standardised Approach[107]

660. In order to qualify for use of the Standardised Approach, a bank must satisfy its supervisor that, at a minimum:

- Its board of directors and senior management, as appropriate, are actively involved in the oversight of the operational risk management framework;
- It has an operational risk management system that is conceptually sound and is implemented with integrity; and
- It has sufficient resources in the use of the approach in the major business lines as well as the control and audit areas.

661. Supervisors will have the right to insist on a period of initial monitoring of a bank's Standardised Approach before it is used for regulatory capital purposes.

662. A bank must develop specific policies and have documented criteria for mapping gross income for current business lines and activities into the standardised framework. The criteria must be reviewed and adjusted for new or changing business activities as appropriate. The principles for business line mapping are set out in Annex 8.

[107] Supervisors allowing banks to use the Alternative Standardised Approach must decide on the appropriate qualifying criteria for that approach, as the criteria set forth in paragraphs 662 and 663 of this section may not be appropriate.

663. As some internationally active banks will wish to use the Standardised Approach, it is important that such banks have adequate operational risk management systems. Consequently, an internationally active bank using the Standardised Approach must meet the following additional criteria:[108]

(a) The bank must have an operational risk management system with clear responsibilities assigned to an operational risk management function. The operational risk management function is responsible for developing strategies to identify, assess, monitor and control/mitigate operational risk; for codifying firm-level policies and procedures concerning operational risk management and controls; for the design and implementation of the firm's operational risk assessment methodology; and for the design and implementation of a risk-reporting system for operational risk.

(b) As part of the bank's internal operational risk assessment system, the bank must systematically track relevant operational risk data including material losses by business line. Its operational risk assessment system must be closely integrated into the risk management processes of the bank. Its output must be an integral part of the process of monitoring and controlling the banks operational risk profile. For instance, this information must play a prominent role in risk reporting, management reporting, and risk analysis. The bank must have techniques for creating incentives to improve the management of operational risk throughout the firm.

(c) There must be regular reporting of operational risk exposures, including material operational losses, to business unit management, senior management, and to the board of directors. The bank must have procedures for taking appropriate action according to the information within the management reports.

(d) The bank's operational risk management system must be well documented. The bank must have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operational risk management system, which must include policies for the treatment of non-compliance issues.

(e) The bank's operational risk management processes and assessment system must be subject to validation and regular independent review. These reviews must include both the activities of the business units and of the operational risk management function.

(f) The bank's operational risk assessment system (including the internal validation processes) must be subject to regular review by external auditors and/or supervisors.

2. Advanced Measurement Approaches (AMA)

(i) General standards

664. In order to qualify for use of the AMA a bank must satisfy its supervisor that, at a minimum:

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[108] For other banks, these criteria are recommended, with national discretion to impose them as requirements.

- Its board of directors and senior management, as appropriate, are actively involved in the oversight of the operational risk management framework;
- It has an operational risk management system that is conceptually sound and is implemented with integrity; and
- It has sufficient resources in the use of the approach in the major business lines as well as the control and audit areas.

665. A bank's AMA will be subject to a period of initial monitoring by its supervisor before it can be used for regulatory purposes. This period will allow the supervisor to determine whether the approach is credible and appropriate. As discussed below, a bank's internal measurement system must reasonably estimate unexpected losses based on the combined use of internal and relevant external loss data, scenario analysis and bank-specific business environment and internal control factors. The bank's measurement system must also be capable of supporting an allocation of economic capital for operational risk across business lines in a manner that creates incentives to improve business line operational risk management.

(ii) Qualitative standards

666. A bank must meet the following qualitative standards before it is permitted to use an AMA for operational risk capital:

(a) The bank must have an independent operational risk management function that is responsible for the design and implementation of the bank's operational risk management framework. The operational risk management function is responsible for codifying firm-level policies and procedures concerning operational risk management and controls; for the design and implementation of the firm's operational risk measurement methodology; for the design and implementation of a risk-reporting system for operational risk; and for developing strategies to identify, measure, monitor and control/mitigate operational risk.

(b) The bank's internal operational risk measurement system must be closely integrated into the day-to-day risk management processes of the bank. Its output must be an integral part of the process of monitoring and controlling the bank's operational risk profile. For instance, this information must play a prominent role in risk reporting, management reporting, internal capital allocation, and risk analysis. The bank must have techniques for allocating operational risk capital to major business lines and for creating incentives to improve the management of operational risk throughout the firm.

(c) There must be regular reporting of operational risk exposures and loss experience to business unit management, senior management, and to the board of directors. The bank must have procedures for taking appropriate action according to the information within the management reports.

(d) The bank's operational risk management system must be well documented. The bank must have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operational risk management system, which must include policies for the treatment of non-compliance issues.

(e) Internal and/or external auditors must perform regular reviews of the operational risk management processes and measurement systems. This review must include both the activities of the business units and of the independent operational risk management function.

(f) The validation of the operational risk measurement system by external auditors and/or supervisory authorities must include the following:

- Verifying that the internal validation processes are operating in a satisfactory manner; and
- Making sure that data flows and processes associated with the risk measurement system are transparent and accessible. In particular, it is necessary that auditors and supervisory authorities are in a position to have easy access, whenever they judge it necessary and under appropriate procedures, to the system's specifications and parameters.

(iii) Quantitative standards

AMA soundness standard

667. Given the continuing evolution of analytical approaches for operational risk, the Committee is not specifying the approach or distributional assumptions used to generate the operational risk measure for regulatory capital purposes. However, a bank must be able to demonstrate that its approach captures potentially severe 'tail' loss events. Whatever approach is used, a bank must demonstrate that its operational risk measure meets a soundness standard comparable to that of the internal ratings-based approach for credit risk, (i.e. comparable to a one year holding period and a 99.9^{th} percentile confidence interval).

668. The Committee recognises that the AMA soundness standard provides significant flexibility to banks in the development of an operational risk measurement and management system. However, in the development of these systems, banks must have and maintain rigorous procedures for operational risk model development and independent model validation. Prior to implementation, the Committee will review evolving industry practices regarding credible and consistent estimates of potential operational losses. It will also review accumulated data, and the level of capital requirements estimated by the AMA, and may refine its proposals if appropriate.

Detailed criteria

669. This section describes a series of quantitative standards that will apply to internally-generated operational risk measures for purposes of calculating the regulatory minimum capital charge.

(a) Any internal operational risk measurement system must be consistent with the scope of operational risk defined by the Committee in paragraph 644 and the loss event types defined in Annex 9.

(b) Supervisors will require the bank to calculate its regulatory capital requirement as the sum of expected loss (EL) and unexpected loss (UL), unless the bank can demonstrate that it is adequately capturing EL in its internal business practices. That is, to base the minimum regulatory capital requirement on UL alone, the bank must be able to demonstrate to the satisfaction of its national supervisor that it has measured and accounted for its EL exposure.

(c) A bank's risk measurement system must be sufficiently 'granular' to capture the major drivers of operational risk affecting the shape of the tail of the loss estimates.

(d) Risk measures for different operational risk estimates must be added for purposes of calculating the regulatory minimum capital requirement. However, the bank may be permitted to use internally determined correlations in operational risk losses across individual operational risk estimates, provided it can demonstrate to the satisfaction of the national supervisor that its systems for determining correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates (particularly in periods of stress). The bank must validate its correlation assumptions using appropriate quantitative and qualitative techniques.

(e) Any operational risk measurement system must have certain key features to meet the supervisory soundness standard set out in this section. These elements must include the use of internal data, relevant external data, scenario analysis and factors reflecting the business environment and internal control systems.

(f) A bank needs to have a credible, transparent, well-documented and verifiable approach for weighting these fundamental elements in its overall operational risk measurement system. For example, there may be cases where estimates of the 99.9^{th} percentile confidence interval based primarily on internal and external loss event data would be unreliable for business lines with a heavy-tailed loss distribution and a small number of observed losses. In such cases, scenario analysis, and business environment and control factors, may play a more dominant role in the risk measurement system. Conversely, operational loss event data may play a more dominant role in the risk measurement system for business lines where estimates of the 99.9^{th} percentile confidence interval based primarily on such data are deemed reliable. In all cases, the bank's approach for weighting the four fundamental elements should be internally consistent and avoid the double counting of qualitative assessments or risk mitigants already recognised in other elements of the framework.

Internal data

670. Banks must track internal loss data according to the criteria set out in this section. The tracking of internal loss event data is an essential prerequisite to the development and functioning of a credible operational risk measurement system. Internal loss data is crucial for tying a bank's risk estimates to its actual loss experience. This can be achieved in a number of ways, including using internal loss data as the foundation of empirical risk estimates, as a means of validating the inputs and outputs of the bank's risk measurement system, or as the link between loss experience and risk management and control decisions.

671. Internal loss data is most relevant when it is clearly linked to a bank's current business activities, technological processes and risk management procedures. Therefore, a bank must have documented procedures for assessing the on-going relevance of historical loss data, including those situations in which judgement overrides, scaling, or other adjustments may be used, to what extent they may be used and who is authorised to make such decisions.

672. Internally generated operational risk measures used for regulatory capital purposes must be based on a minimum five-year observation period of internal loss data, whether the internal loss data is used directly to build the loss measure or to validate it. When the bank first moves to the AMA, a three-year historical data window is acceptable (this includes the parallel calculations in paragraph 46).

673. To qualify for regulatory capital purposes, a bank's internal loss collection processes must meet the following standards:

- To assist in supervisory validation, a bank must be able to map its historical internal loss data into the relevant level 1 supervisory categories defined in Annexes 8 and 9 and to provide these data to supervisors upon request. It must have documented, objective criteria for allocating losses to the specified business lines and event types. However, it is left to the bank to decide the extent to which it applies these categorisations in its internal operational risk measurement system.
- A bank's internal loss data must be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. A bank must be able to justify that any excluded activities or exposures, both individually and in combination, would not have a material impact on the overall risk estimates. A bank must have an appropriate *de minimis* gross loss threshold for internal loss data collection, for example €10,000. The appropriate threshold may vary somewhat between banks, and within a bank across business lines and/or event types. However, particular thresholds should be broadly consistent with those used by peer banks.
- Aside from information on gross loss amounts, a bank should collect information about the date of the event, any recoveries of gross loss amounts, as well as some descriptive information about the drivers or causes of the loss event. The level of detail of any descriptive information should be commensurate with the size of the gross loss amount.
- A bank must develop specific criteria for assigning loss data arising from an event in a centralised function (e.g. an information technology department) or an activity that spans more than one business line, as well as from related events over time.
- Operational risk losses that are related to credit risk and have historically been included in banks' credit risk databases (e.g. collateral management failures) will continue to be treated as credit risk for the purposes of calculating minimum regulatory capital under this Framework. Therefore, such losses will not be subject to the operational risk capital charge.[109] Nevertheless, for the purposes of internal operational risk management, banks must identify all material operational risk losses consistent with the scope of the definition of operational risk (as set out in paragraph 644 and the loss event types outlined in Annex 9), including those related to credit risk. Such material operational risk-related credit risk losses should be flagged separately within a bank's internal operational risk database. The materiality of these losses may vary between banks, and within a bank across business lines and/or event types. Materiality thresholds should be broadly consistent with those used by peer banks.
- Operational risk losses that are related to market risk are treated as operational risk for the purposes of calculating minimum regulatory capital under this Framework and will therefore be subject to the operational risk capital charge.

External data

674. A bank's operational risk measurement system must use relevant external data (either public data and/or pooled industry data), especially when there is reason to believe that the bank is exposed to infrequent, yet potentially severe, losses. These external data should include data on actual loss amounts, information on the scale of business operations where the event occurred, information on the causes and circumstances of the loss events,

[109] This applies to all banks, including those that may only now be designing their credit risk and operational risk databases.

or other information that would help in assessing the relevance of the loss event for other banks. A bank must have a systematic process for determining the situations for which external data must be used and the methodologies used to incorporate the data (e.g. scaling, qualitative adjustments, or informing the development of improved scenario analysis). The conditions and practices for external data use must be regularly reviewed, documented, and subject to periodic independent review.

Scenario analysis

675. A bank must use scenario analysis of expert opinion in conjunction with external data to evaluate its exposure to high-severity events. This approach draws on the knowledge of experienced business managers and risk management experts to derive reasoned assessments of plausible severe losses. For instance, these expert assessments could be expressed as parameters of an assumed statistical loss distribution. In addition, scenario analysis should be used to assess the impact of deviations from the correlation assumptions embedded in the bank's operational risk measurement framework, in particular, to evaluate potential losses arising from multiple simultaneous operational risk loss events. Over time, such assessments need to be validated and re-assessed through comparison to actual loss experience to ensure their reasonableness.

Business environment and internal control factors

676. In addition to using loss data, whether actual or scenario-based, a bank's firm-wide risk assessment methodology must capture key business environment and internal control factors that can change its operational risk profile. These factors will make a bank's risk assessments more forward-looking, more directly reflect the quality of the bank's control and operating environments, help align capital assessments with risk management objectives, and recognise both improvements and deterioration in operational risk profiles in a more immediate fashion. To qualify for regulatory capital purposes, the use of these factors in a bank's risk measurement framework must meet the following standards:

- The choice of each factor needs to be justified as a meaningful driver of risk, based on experience and involving the expert judgment of the affected business areas. Whenever possible, the factors should be translatable into quantitative measures that lend themselves to verification.
- The sensitivity of a bank's risk estimates to changes in the factors and the relative weighting of the various factors need to be well reasoned. In addition to capturing changes in risk due to improvements in risk controls, the framework must also capture potential increases in risk due to greater complexity of activities or increased business volume.
- The framework and each instance of its application, including the supporting rationale for any adjustments to empirical estimates, must be documented and subject to independent review within the bank and by supervisors.
- Over time, the process and the outcomes need to be validated through comparison to actual internal loss experience, relevant external data, and appropriate adjustments made.

(iv) Risk mitigation[110]

677. Under the AMA, a bank will be allowed to recognise the risk mitigating impact of insurance in the measures of operational risk used for regulatory minimum capital requirements. The recognition of insurance mitigation will be limited to 20% of the total operational risk capital charge calculated under the AMA.

678. A bank's ability to take advantage of such risk mitigation will depend on compliance with the following criteria:

- The insurance provider has a minimum claims paying ability rating of A (or equivalent).
- The insurance policy must have an initial term of no less than one year. For policies with a residual term of less than one year, the bank must make appropriate haircuts reflecting the declining residual term of the policy, up to a full 100% haircut for policies with a residual term of 90 days or less.
- The insurance policy has a minimum notice period for cancellation of 90 days.
- The insurance policy has no exclusions or limitations triggered by supervisory actions or, in the case of a failed bank, that preclude the bank, receiver or liquidator from recovering for damages suffered or expenses incurred by the bank, except in respect of events occurring after the initiation of receivership or liquidation proceedings in respect of the bank, provided that the insurance policy may exclude any fine, penalty, or punitive damages resulting from supervisory actions.
- The risk mitigation calculations must reflect the bank's insurance coverage in a manner that is transparent in its relationship to, and consistent with, the actual likelihood and impact of loss used in the bank's overall determination of its operational risk capital.
- The insurance is provided by a third-party entity. In the case of insurance through captives and affiliates, the exposure has to be laid off to an independent third-party entity, for example through re-insurance, that meets the eligibility criteria.
- The framework for recognising insurance is well reasoned and documented.
- The bank discloses a description of its use of insurance for the purpose of mitigating operational risk.

679. A bank's methodology for recognising insurance under the AMA also needs to capture the following elements through appropriate discounts or haircuts in the amount of insurance recognition:

- The residual term of a policy, where less than one year, as noted above;
- A policy's cancellation terms, where less than one year; and
- The uncertainty of payment as well as mismatches in coverage of insurance policies.

[110] The Committee intends to continue an ongoing dialogue with the industry on the use of risk mitigants for operational risk and, in due course, may consider revising the criteria for and limits on the recognition of operational risk mitigants on the basis of growing experience.

D. Partial use

680. A bank will be permitted to use an AMA for some parts of its operations and the Basic Indicator Approach or Standardised Approach for the balance (partial use), provided that the following conditions are met:

- All operational risks of the bank's global, consolidated operations are captured;
- All of the bank's operations that are covered by the AMA meet the qualitative criteria for using an AMA, while those parts of its operations that are using one of the simpler approaches meet the qualifying criteria for that approach;
- On the date of implementation of an AMA, a significant part of the bank's operational risks are captured by the AMA; and
- The bank provides its supervisor with a plan specifying the timetable to which it intends to roll out the AMA across all but an immaterial part of its operations. The plan should be driven by the practicality and feasibility of moving to the AMA over time, and not for other reasons.

681. Subject to the approval of its supervisor, a bank opting for partial use may determine which parts of its operations will use an AMA on the basis of business line, legal structure, geography, or other internally determined basis.

682. Subject to the approval of its supervisor, where a bank intends to implement an approach other than the AMA on a global, consolidated basis and it does not meet the third and/or fourth conditions in paragraph 680, the bank may, in limited circumstances:

- Implement an AMA on a permanent partial basis; and
- Include in its global, consolidated operational risk capital requirements the results of an AMA calculation at a subsidiary where the AMA has been approved by the relevant host supervisor and is acceptable to the bank's home supervisor.

683. Approvals of the nature described in paragraph 682 should be granted only on an exceptional basis. Such exceptional approvals should generally be limited to circumstances where a bank is prevented from meeting these conditions due to implementation decisions of supervisors of the bank's subsidiary operations in foreign jurisdictions.

VI. Market Risk

A. The risk measurement framework

683(i). Market risk is defined as the risk of losses in on and off-balance-sheet positions arising from movements in market prices. The risks subject to this requirement are:

- The risks pertaining to interest rate related instruments and equities in the trading book;
- Foreign exchange risk and commodities risk throughout the bank.

1. Scope and coverage of the capital charges

683(ii). The capital charges for interest rate related instruments and equities will apply to the current trading book items prudently valued by banks, alongside paragraphs 690 to 701 below. The definition of trading book is set out in paragraphs 685 to 689(iii) below.

683(iii). The capital charges for foreign exchange risk and for commodities risk will apply to banks' total currency and commodity positions, subject to some discretion to exclude structural foreign exchange positions. It is understood that some of these positions will be reported and hence evaluated at market value, but some may be reported and evaluated at book value.

683(iv). For the time being, the Committee does not believe that it is necessary to allow any de minimis exemptions from the capital requirements for market risk, except for those for foreign exchange risk set out in paragraph 718(xLii) below, because this Framework applies only to internationally active banks, and then essentially on a consolidated basis; all of these banks are likely to be involved in trading to some extent.

683(v). In the same way as for credit risk, the capital requirements for market risk are to apply on a worldwide consolidated basis. Where appropriate, national authorities may permit banking and financial entities in a group which is running a global consolidated book and whose capital is being assessed on a global basis to report short and long positions in exactly the same instrument (e.g. currencies, commodities, equities or bonds), on a net basis, no matter where they are booked.[111] Moreover, the offsetting rules as set out in this section may also be applied on a consolidated basis. Nonetheless, there will be circumstances in which supervisory authorities demand that the individual positions be taken into the measurement system without any offsetting or netting against positions in the remainder of the group. This may be needed, for example, where there are obstacles to the quick repatriation of profits from a foreign subsidiary or where there are legal and procedural difficulties in carrying out the timely management of risks on a consolidated basis. Moreover, all national authorities will retain the right to continue to monitor the market risks of individual entities on a non-consolidated basis to ensure that significant imbalances within a group do not escape supervision. Supervisory authorities will be especially vigilant in ensuring that banks do not pass positions on reporting dates in such a way as to escape measurement.

684. (Deleted)

[111] The positions of less than wholly-owned subsidiaries would be subject to the generally accepted accounting principles in the country where the parent company is supervised.

685. A trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any restrictive covenants on their tradability or able to be hedged completely. In addition, positions should be frequently and accurately valued, and the portfolio should be actively managed.

686. A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments include both primary financial instruments (or cash instruments) and derivative financial instruments. A financial asset is any asset that is cash, the right to receive cash or another financial asset; or the contractual right to exchange financial assets on potentially favourable terms, or an equity instrument. A financial liability is the contractual obligation to deliver cash or another financial asset or to exchange financial liabilities under conditions that are potentially unfavourable.

687. Positions held with trading intent are those held intentionally for short-term resale and/or with the intent of benefiting from actual or expected short-term price movements or to lock in arbitrage profits, and may include for example proprietary positions, positions arising from client servicing (e.g. matched principal broking) and market making.

687(i). Banks must have clearly defined policies and procedures for determining which exposures to include in, and to exclude from, the trading book for purposes of calculating their regulatory capital, to ensure compliance with the criteria for trading book set forth in this Section and taking into account the bank's risk management capabilities and practices. Compliance with these policies and procedures must be fully documented and subject to periodic internal audit.

687(ii). These policies and procedures should, at a minimum, address the general considerations listed below. The list below is not intended to provide a series of tests that a product or group of related products must pass to be eligible for inclusion in the trading book. Rather, the list provides a minimum set of key points that must be addressed by the policies and procedures for overall management of a firm's trading book:

- The activities the bank considers to be trading and as constituting part of the trading book for regulatory capital purposes;
- The extent to which an exposure can be marked-to-market daily by reference to an active, liquid two-way market;
- For exposures that are marked-to-model, the extent to which the bank can:
  - (i) Identify the material risks of the exposure;
  - (ii) Hedge the material risks of the exposure and the extent to which hedging instruments would have an active, liquid two-way market;
  - (iii) Derive reliable estimates for the key assumptions and parameters used in the model.
- The extent to which the bank can and is required to generate valuations for the exposure that can be validated externally in a consistent manner;
- The extent to which legal restrictions or other operational requirements would impede the bank's ability to effect an immediate liquidation of the exposure;
- The extent to which the bank is required to, and can, actively risk manage the exposure within its trading operations; and

- The extent to which the bank may transfer risk or exposures between the banking and the trading books and criteria for such transfers.

688. The following will be the basic requirements for positions eligible to receive trading book capital treatment.

- Clearly documented trading strategy for the position/instrument or portfolios, approved by senior management (which would include expected holding horizon).
- Clearly defined policies and procedures for the active management of the position, which must include:
  - positions are managed on a trading desk;
  - position limits are set and monitored for appropriateness;
  - dealers have the autonomy to enter into/manage the position within agreed limits and according to the agreed strategy;
  - positions are marked to market at least daily and when marking to model the parameters must be assessed on a daily basis;
  - positions are reported to senior management as an integral part of the institution's risk management process; and
  - positions are actively monitored with reference to market information sources (assessment should be made of the market liquidity or the ability to hedge positions or the portfolio risk profiles). This would include assessing the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market, etc.
- Clearly defined policy and procedures to monitor the positions against the bank's trading strategy including the monitoring of turnover and stale positions in the bank's trading book.

689. (deleted)

689(i). When a bank hedges a banking book credit risk exposure using a credit derivative booked in its trading book (i.e. using an internal hedge), the banking book exposure is not deemed to be hedged for capital purposes unless the bank purchases from an eligible third party protection provider a credit derivative meeting the requirements of paragraph 191 vis-à-vis the banking book exposure. Where such third party protection is purchased and is recognised as a hedge of a banking book exposure for regulatory capital purposes, neither the internal nor external credit derivative hedge would be included in the trading book for regulatory capital purposes.

689(ii). Positions in the bank's own eligible regulatory capital instruments are deducted from capital. Positions in other banks', securities firms', and other financial entities' eligible regulatory capital instruments, as well as intangible assets, will receive the same treatment as that set down by the national supervisor for such assets held in the banking book, which in many cases is deduction from capital. Where a bank demonstrates that it is an active market maker then a national supervisor may establish a dealer exception for holdings of other banks', securities firms', and other financial entities' capital instruments in the trading book. In order to qualify for the dealer exception, the bank must have adequate systems and controls surrounding the trading of financial institutions' eligible regulatory capital instruments.

689(iii). Term trading-related repo-style transactions that a bank accounts for in its banking book may be included in the bank's trading book for regulatory capital purposes so long as all such repo-style transactions are included. For this purpose, trading-related repo-style transactions are defined as only those that meet the requirements of paragraphs 687 and 688 and both legs are in the form of either cash or securities includable in the trading book. Regardless of where they are booked, all repo-style transactions are subject to a banking book counterparty credit risk charge.

2. Prudent valuation guidance

690. This section provides banks with guidance on prudent valuation for positions in the trading book. This guidance is especially important for less liquid positions which, although they will not be excluded from the trading book solely on grounds of lesser liquidity, raise supervisory concerns about prudent valuation.

691. A framework for prudent valuation practices should at a minimum include the following:

(i). Systems and controls

692. Banks must establish and maintain adequate systems and controls sufficient to give management and supervisors the confidence that their valuation estimates are prudent and reliable. These systems must be integrated with other risk management systems within the organisation (such as credit analysis). Such systems must include:

- Documented policies and procedures for the process of valuation. This includes clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, end of the month and ad-hoc verification procedures; and
- Clear and independent (i.e. independent of front office) reporting lines for the department accountable for the valuation process. The reporting line should ultimately be to a main board executive director.

(ii). Valuation methodologies

Marking to market

693. Marking-to-market is at least the daily valuation of positions at readily available close out prices that are sourced independently. Examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.

694. Banks must mark-to-market as much as possible. The more prudent side of bid/offer must be used unless the institution is a significant market maker in a particular position type and it can close out at mid-market.

Marking to model

695. Where marking-to-market is not possible, banks may mark-to-model, where this can be demonstrated to be prudent. Marking-to-model is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. When marking to model, an extra degree of conservatism is appropriate. Supervisory authorities will consider the following in assessing whether a mark-to-model valuation is prudent:

- Senior management should be aware of the elements of the trading book which are subject to mark to model and should understand the materiality of the uncertainty this creates in the reporting of the risk/performance of the business.
- Market inputs should be sourced, to the extent possible, in line with market prices (as discussed above). The appropriateness of the market inputs for the particular position being valued should be reviewed regularly.
- Where available, generally accepted valuation methodologies for particular products should be used as far as possible.
- Where the model is developed by the institution itself, it should be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process. The model should be developed or approved independently of the front office. It should be independently tested. This includes validating the mathematics, the assumptions and the software implementation.
- There should be formal change control procedures in place and a secure copy of the model should be held and periodically used to check valuations.
- Risk management should be aware of the weaknesses of the models used and how best to reflect those in the valuation output.
- The model should be subject to periodic review to determine the accuracy of its performance (e.g. assessing continued appropriateness of the assumptions, analysis of P&L versus risk factors, comparison of actual close out values to model outputs).
- Valuation adjustments should be made as appropriate, for example, to cover the uncertainty of the model valuation (see also valuation adjustments in 698 to 701).

Independent price verification

696. Independent price verification is distinct from daily mark-to-market. It is the process by which market prices or model inputs are regularly verified for accuracy. While daily marking-to-market may be performed by dealers, verification of market prices or model inputs should be performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market/trading activity, more frequently). It need not be performed as frequently as daily mark-to-market, since the objective, i.e. independent, marking of positions, should reveal any error or bias in pricing, which should result in the elimination of inaccurate daily marks.

697. Independent price verification entails a higher standard of accuracy in that the market prices or model inputs are used to determine profit and loss figures, whereas daily marks are used primarily for management reporting in between reporting dates. For independent price verification, where pricing sources are more subjective, e.g. only one available broker quote, prudent measures such as valuation adjustments may be appropriate.

(iii). Valuation adjustments or reserves

698. Banks must establish and maintain procedures for considering valuation adjustments/reserves. Supervisory authorities expect banks using third-party valuations to consider whether valuation adjustments are necessary. Such considerations are also necessary when marking to model.

699. Supervisory authorities expect the following valuation adjustments/reserves to be formally considered at a minimum: unearned credit spreads, close-out costs, operational risks, early termination, investing and funding costs, and future administrative costs and, where appropriate, model risk.

700. Bearing in mind that the underlying 10-day assumption in paragraph 718 (LXXVI) (c) may not be consistent with the bank's ability to sell or hedge out positions under normal market conditions, banks must make downward valuation adjustments/reserves for these less liquid positions, and to review their continued appropriateness on an on-going basis. Reduced liquidity could arise from market events. Additionally, close-out prices for concentrated positions and/or stale positions should be considered in establishing those valuation adjustments/reserves. Banks must consider all relevant factors when determining the appropriateness of valuation adjustments/reserves for less liquid positions. These factors may include, but are not limited to, the amount of time it would take to hedge out the position/risks within the position, the average volatility of bid/offer spreads, the availability of independent market quotes (number and identity of market makers), the average and volatility of trading volumes, market concentrations, the aging of positions, the extent to which valuation relies on marking-to-model, and the impact of other model risks.

701. Valuation adjustments/reserves made under paragraph 700 must impact Tier 1 regulatory capital and may exceed those made under financial accounting standards.

3. Methods of measuring market risks

701(i). In measuring their market risks, a choice between two broad methodologies (described in paragraphs 709 to 718(LXIX) and 718(LXX) to 718(XCIX), respectively) will be permitted, subject to the approval of the national authorities. One alternative will be to measure the risks in a standardised manner, using the measurement frameworks described in paragraphs 709 to 718(LXIX) below. Paragraphs 709 to 718(LV) deal with the four risks addressed in this section, i.e. interest rate, equity position, foreign exchange and commodities risk. Paragraphs 718(LVI) to 718(LXIX) set out a number of possible methods for measuring the price risk in options of all kinds. The capital charge under the standardised measurement method will be the measures of risk obtained from paragraphs 709 to 718(LXIX), summed arithmetically.

701(ii). The alternative methodology, which is subject to the fulfilment of certain conditions and the use of which is therefore conditional upon the explicit approval of the bank's supervisory authority, is set out in 718(LXX) to 718(XCIX). This method allows banks to use risk measures derived from their own internal risk management models, subject to seven sets of conditions, namely:

- certain general criteria concerning the adequacy of the risk management system;
- qualitative standards for internal oversight of the use of models, notably by management;
- guidelines for specifying an appropriate set of market risk factors (i.e. the market rates and prices that affect the value of banks' positions);
- quantitative standards setting out the use of common minimum statistical parameters for measuring risk;
- guidelines for stress testing;
- validation procedures for external oversight of the use of models;
- rules for banks which use a mixture of models and the standardised approach.

701(iii). The standardised methodology uses a "building-block" approach in which specific risk and the general market risk arising from debt and equity positions are calculated separately. The focus of most internal models is a bank's general market risk exposure, typically leaving specific risk (i.e. exposures to specific issuers of debt securities or equities[112]) to be measured largely through separate credit risk measurement systems. Banks using models should be subject to capital charges for the specific risk not captured by their models. Accordingly, a separate capital charge for specific risk will apply to each bank using a model to the extent that the model does not capture specific risk. The capital charge for banks which are modelling specific risk is set out in paragraphs 718(Lxxxvii) to 718(XCviii) of this Framework.[113]

701(iv). In measuring the price risk in options under the standardised approach, where a number of alternatives with varying degrees of sophistication are provided (see paragraphs 718(Lvi) to 718(Lxix)), supervisory authorities will apply the rule that the more a bank is engaged in writing options, the more sophisticated its measurement method needs to be. In the longer term, banks which are significant traders in options will be expected to move to comprehensive value-at-risk models and become subject to the full range of quantitative and qualitative standards set out in paragraphs 718(Lxx) to 718(XCIX).

701(v). Each bank subject to capital charges for market risk will be expected to monitor and report the level of risk against which a capital requirement is to be applied. The bank's overall minimum capital requirement will be:

(a) the credit risk requirements laid down in this Framework, excluding debt and equity securities in the trading book and all positions in commodities, but including the credit counterparty risk on all over-the-counter derivatives whether in the trading or the banking books; plus

(b) the capital charges for operational risk described in paragraphs 644 to 683 of this Framework; plus

(c) either the capital charges for market risks described in paragraphs 709 to 718(Lxix), summed arithmetically; or

(d) the measure of market risk derived from the models approach set out in paragraphs 718(Lxx) to 718(XCix); or

(e) a mixture of (c) and (d) summed arithmetically.

701(vi). All transactions, including forward sales and purchases, shall be included in the calculation of capital requirements as from the date on which they were entered into. Although regular reporting will in principle take place only at intervals (in most countries quarterly), banks are expected to manage the market risk in their trading book in such a way

[112] Specific risk includes the risk that an individual debt or equity security moves by more or less than the general market in day-to-day trading (including periods when the whole market is volatile) and event risk (where the price of an individual debt or equity security moves precipitously relative to the general market, e.g. on a take-over bid or some other shock event; such events would also include the risk of "default").

[113] Banks that already have received specific risk model recognition for particular portfolios or lines of business according to the original version of the 1996 Market Risk Amendment should agree a timetable with their supervisors to bring their model in line with the new standards in a timely manner as is practicable, with an end date of 1 January 2010. Following that transition period, banks that have been unable to develop an acceptable methodology will have to use the standardised rules for specific risk.

that the capital requirements are being met on a continuous basis, i.e. at the close of each business day. Supervisory authorities have at their disposal a number of effective measures to ensure that banks do not "window-dress" by showing significantly lower market risk positions on reporting dates. Banks will also, of course, be expected to maintain strict risk management systems to ensure that intra-day exposures are not excessive. If a bank fails to meet the capital requirements, the national authority shall ensure that the bank takes immediate measures to rectify the situation.

4. Treatment of counterparty credit risk in the trading book

702. Banks will be required to calculate the counterparty credit risk charge for OTC derivatives, repo-style and other transactions booked in the trading book, separate from the capital charge for general market risk and specific risk.[114] The risk weights to be used in this calculation must be consistent with those used for calculating the capital requirements in the banking book. Thus, banks using the standardised approach in the banking book will use the standardised approach risk weights in the trading book and banks using the IRB approach in the banking book will use the IRB risk weights in the trading book in a manner consistent with the IRB roll out situation in the banking book as described in paragraphs 256 to 262. For counterparties included in portfolios where the IRB approach is being used the IRB risk weights will have to be applied.

703. In the trading book, for repo-style transactions, all instruments, which are included in the trading book, may be used as eligible collateral. Those instruments which fall outside the banking book definition of eligible collateral shall be subject to a haircut at the level applicable to non-main index equities listed on recognised exchanges (as noted in paragraph 151). However, where banks are using the own estimates approach to haircutting they may also apply it in the trading book in accordance with paragraphs 154 and 155. Consequently, for instruments that count as eligible collateral in the trading book, but not in the banking book, the haircuts must be calculated for each individual security. Where banks are using a VaR approach to measuring exposure for repo-style transactions, they also may apply this approach in the trading book in accordance with paragraphs 178 to 181 (i) and Annex 4.

704. The calculation of the counterparty credit risk charge for collateralised OTC derivative transactions is the same as the rules prescribed for such transactions booked in the banking book.

705. The calculation of the counterparty charge for repo-style transactions will be conducted using the rules in paragraphs 147 to 181 (i) and Annex 4 spelt out for such transactions booked in the banking book. The firm-size adjustment for SMEs as set out in paragraph 273 shall also be applicable in the trading book.

Credit derivatives

706. (deleted)

707. The counterparty credit risk charge for single name credit derivative transactions in the trading book will be calculated using the following potential future exposure add-on factors:

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[114] The treatment for unsettled foreign exchange and securities trades is set forth in paragraph 88.

	Protection buyer	Protection seller
Total Return Swap		
"qualifying" reference obligation	5%	5%
"Non-qualifying" reference obligation	10%	10%
Credit Default Swap		
"qualifying" reference obligation	5%	5%**
"Non-qualifying" reference obligation	10%	10%**

There will be no difference depending on residual maturity.

The definition of "qualifying" is the same as for the "qualifying" category for the treatment of specific risk under the standardised measurement method in paragraph 711(i) and 711(ii).

** The protection seller of a credit default swap shall only be subject to the add-on factor where it is subject to closeout upon the insolvency of the protection buyer while the underlying is still solvent. Add-on should then be capped to the amount of unpaid premiums.

708. Where the credit derivative is a first to default transaction, the add-on will be determined by the lowest credit quality underlying in the basket, i.e. if there are any non-qualifying items in the basket, the non-qualifying reference obligation add-on should be used. For second and subsequent to default transactions, underlying assets should continue to be allocated according to the credit quality, i.e. the second lowest credit quality will determine the add-on for a second to default transaction etc.

5. Transitional arrangements

708(i). Banks will on a transitional basis be free to use a combination of the standardised measurement method and the internal models approach to measure their market risks. As a general rule, any such "partial" models should cover a complete risk category (e.g. interest rate risk or foreign exchange risk), i.e. a combination of the two methods will not be permitted within the same risk category.[115] However, as most banks are at present still implementing or further improving their risk management models, the Committee believes that the banks should be given – even within risk categories – some flexibility in including all their operations on a worldwide basis; this flexibility will be subject to approval by the national authority and reviewed by the Committee in the future (supervisory authorities will take precautions against "cherry-picking" between the standardised approach and the models approach within a risk factor category). Banks which adopt the modelling alternative for any single risk category will be expected over time to include all their operations, subject to the exceptions mentioned below, and to move towards a comprehensive model (i.e. one which captures all market risk categories). Banks which adopt a model will not be permitted, save in exceptional circumstances, to revert to the standardised approach. Notwithstanding these general principles, even banks using comprehensive models to measure their market risk may still incur risks in positions which are not captured by their internal trading risk management models, for example, in remote locations, in minor currencies or in negligible business

[115] This does not, however, apply to pre-processing techniques which are used to simplify the calculation and whose results become subject to the standardised methodology.

areas.[116] Any such risks that are not included in a model should be separately measured and reported using the methodologies described in paragraphs 709 to 718(xviii) below.

B. The capital requirement

1. Definition of capital

708(ii). The definition of capital to be used for market risk purposes is set out in paragraphs 49(xiii) and 49(xiv) of this Framework.

708(iii). In calculating eligible capital, it will be necessary first to calculate the bank's minimum capital requirement for credit and operational risks, and only afterwards its market risk requirement, to establish how much Tier 1 and Tier 2 capital is available to support market risk. Eligible capital will be the sum of the whole of the bank's Tier 1 capital, plus all of its Tier 2 capital under the limits imposed in paragraph 49(iii) of this Framework. Tier 3 capital will be regarded as eligible only if it can be used to support market risks under the conditions set out in paragraphs 49(xxi) and 49(xxii) above. The quoted capital ratio will thus represent capital that is available to meet credit risk, operational risk, and market risk. Where a bank has Tier 3 capital, within the limits set out in paragraph 49(xxi), which is not at present supporting market risks, it may report that excess as unused but eligible Tier 3 alongside its standard ratio.

C. Market risk – The standardised measurement method

1. Interest rate risk

709. (Deleted)

709(i). This section describes the standard framework for measuring the risk of holding or taking positions in debt securities and other interest rate related instruments in the trading book. The instruments covered include all fixed-rate and floating-rate debt securities and instruments that behave like them, including non-convertible preference shares.[117] Convertible bonds, i.e. debt issues or preference shares that are convertible, at a stated price, into common shares of the issuer, will be treated as debt securities if they trade like debt securities and as equities if they trade like equities. The basis for dealing with derivative products is considered in paragraphs 718(ix) to 718(xviii) below.

709(ii). The minimum capital requirement is expressed in terms of two separately calculated charges, one applying to the *"specific risk"* of each security, whether it is a short or a long position, and the other to the interest rate risk in the portfolio (termed *"general market risk"*) where long and short positions in different securities or instruments can be offset.

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[116] For example, if a bank is hardly at all engaged in commodities it would not necessarily be expected to model its commodities risk.

[117] Traded mortgage securities and mortgage derivative products possess unique characteristics because of the risk of pre-payment. Accordingly, for the time being, no common treatment will apply to these securities, which will be dealt with at national discretion. A security which is the subject of a repurchase or securities lending agreement will be treated as if it were still owned by the lender of the security, i.e. it will be treated in the same manner as other securities positions.

(i) Specific risk

709(iii). The capital charge for specific risk is designed to protect against an adverse movement in the price of an individual security owing to factors related to the individual issuer. In measuring the risk, offsetting will be restricted to matched positions in the identical issue (including positions in derivatives). Even if the issuer is the same, no offsetting will be permitted between different issues since differences in coupon rates, liquidity, call features, etc. mean that prices may diverge in the short run.

Specific risk capital charges for issuer risk

710. The new capital charges for "government" and "other" categories will be as follows.

Categories	External credit assessment	Specific risk capital charge
Government	AAA to AA-	0%
	A+ to BBB-	0.25% (residual term to final maturity 6 months or less)
		1.00% (residual term to final maturity greater than 6 and up to and including 24 months)
		1.60% (residual term to final maturity exceeding 24 months)
	BB+ to B-	8.00%
	Below B-	12.00%
	Unrated	8.00%
Qualifying		0.25% (residual term to final maturity 6 months or less)
		1.00% (residual term to final maturity greater than 6 and up to and including 24 months)
		1.60% (residual term to final maturity exceeding 24 months)
Other	Similar to credit risk charges under the standardised approach of this Framework, e.g.:	
	BB+ to BB-	8.00%
	Below BB-	12.00%
	Unrated	8.00%

710(i). The category "government" will include all forms of government[118] paper including bonds, Treasury bills and other short-term instruments, but national authorities reserve the right to apply a specific risk weight to securities issued by certain foreign governments, especially to securities denominated in a currency other than that of the issuing government.

711. When the government paper is denominated in the domestic currency and funded by the bank in the same currency, at national discretion a lower specific risk charge may be applied.

[118] Including, at national discretion, local and regional governments subject to a zero credit risk weight in this Framework.

711(i). The *"qualifying"* category includes securities issued by public sector entities and multilateral development banks, plus other securities that are:

- rated investment-grade[119] by at least two credit rating agencies specified by the national authority; or
- rated investment-grade by one rating agency and not less than investment-grade by any other rating agency specified by the national authority (subject to supervisory oversight); or
- subject to supervisory approval, unrated, but deemed to be of comparable investment quality by the reporting bank, *and* the issuer has securities listed on a recognised stock exchange.

Each supervisory authority will be responsible for monitoring the application of these qualifying criteria, particularly in relation to the last criterion where the initial classification is essentially left to the reporting banks. National authorities will also have discretion to include within the qualifying category debt securities issued by banks in countries which have implemented this Framework, subject to the express understanding that supervisory authorities in such countries undertake prompt remedial action if a bank fails to meet the capital standards set forth in this Framework. Similarly, national authorities will have discretion to include within the qualifying category debt securities issued by securities firms that are subject to equivalent rules.

711(ii). Furthermore, the "qualifying" category shall include securities issued by institutions that are deemed to be equivalent to investment grade quality and subject to supervisory and regulatory arrangements comparable to those under this Framework.

Specific risk rules for unrated debt securities

712. Unrated securities may be included in the "qualifying" category when they are subject to supervisory approval, unrated, but deemed to be of comparable investment quality by the reporting bank, and the issuer has securities listed on a recognised stock exchange. This will remain unchanged for banks using the standardised approach. For banks using the IRB approach for a portfolio, unrated securities can be included in the "qualifying" category if both of the following conditions are met:

- the securities are rated equivalent[120] to investment grade under the reporting bank's internal rating system, which the national supervisor has confirmed complies with the requirements for an IRB approach; and
- the issuer has securities listed on a recognised stock exchange.

Specific risk rules for non-qualifying issuers

712(i). Instruments issued by a non-qualifying issuer will receive the same specific risk charge as a non-investment grade corporate borrower under the standardised approach for credit risk under this Framework.

[119] E.g. rated Baa or higher by Moody's and BBB or higher by Standard and Poor's.

[120] Equivalent means the debt security has a one-year PD equal to or less than the one year PD implied by the long-run average one-year PD of a security rated investment grade or better by a qualifying rating agency.

712(ii). However, since this may in certain cases considerably underestimate the specific risk for debt instruments which have a high yield to redemption relative to government debt securities, each national supervisor will have the discretion:

- To apply a higher specific risk charge to such instruments; and/or
- To disallow offsetting for the purposes of defining the extent of general market risk between such instruments and any other debt instruments.

In that respect, securitisation exposures that would be subject to a deduction treatment under the securitisation framework set forth in this Framework (e.g. equity tranches that absorb first loss), as well as securitisation exposures that are unrated liquidity lines or letters of credit should be subject to a capital charge that is no less than the charge set forth in the securitisation framework.

Specific risk capital charges for positions hedged by credit derivatives

713. Full allowance will be recognised when the values of two legs (i.e. long and short) always move in the opposite direction and broadly to the same extent. This would be the case in the following situations:

(a) the two legs consist of completely identical instruments, or

(b) a long cash position is hedged by a total rate of return swap (or vice versa) and there is an exact match between the reference obligation and the underlying exposure (i.e. the cash position).[121]

In these cases, no specific risk capital requirement applies to both sides of the position.

714. An 80% offset will be recognised when the value of two legs (i.e. long and short) always moves in the opposite direction but not broadly to the same extent. This would be the case when a long cash position is hedged by a credit default swap or a credit linked note (or vice versa) and there is an exact match in terms of the reference obligation, the maturity of both the reference obligation and the credit derivative, and the currency of the underlying exposure. In addition, key features of the credit derivative contract (e.g. credit event definitions, settlement mechanisms) should not cause the price movement of the credit derivative to materially deviate from the price movements of the cash position. To the extent that the transaction transfers risk (i.e. taking account of restrictive payout provisions such as fixed payouts and materiality thresholds), an 80% specific risk offset will be applied to the side of the transaction with the higher capital charge, while the specific risk requirement on the other side will be zero.

715. Partial allowance will be recognised when the value of the two legs (i.e. long and short) usually moves in the opposite direction. This would be the case in the following situations:

(a) the position is captured in paragraph 713 under (b), but there is an asset mismatch between the reference obligation and the underlying exposure. Nonetheless, the position meets the requirements in paragraph 191 (g).

[121] The maturity of the swap itself may be different from that of the underlying exposure.

(b) The position is captured in paragraph 713 under (a) or 714 but there is a currency or maturity mismatch[122] between the credit protection and the underlying asset.

(c) The position is captured in paragraph 714 but there is an asset mismatch between the cash position and the credit derivative. However, the underlying asset is included in the (deliverable) obligations in the credit derivative documentation.

716. In each of these cases in paragraphs 713 to 715, the following rule applies. Rather than adding the specific risk capital requirements for each side of the transaction (i.e. the credit protection and the underlying asset) only the higher of the two capital requirements will apply.

717. In cases not captured in paragraphs 713 to 715, a specific risk capital charge will be assessed against both sides of the position.

718. With regard to banks' first-to-default and second-to-default products in the trading book, the basic concepts developed for the banking book will also apply. Banks holding long positions in these products (e.g. buyers of basket credit linked notes) would be treated as if they were protection sellers and would be required to add the specific risk charges or use the external rating if available. Issuers of these notes would be treated as if they were protection buyers and are therefore allowed to off-set specific risk for one of the underlyings, i.e. the asset with the lowest specific risk charge.

(ii) General market risk

718(i). The capital requirements for general market risk are designed to capture the risk of loss arising from changes in market interest rates. A choice between two principal methods of measuring the risk is permitted, a "maturity" method and a "duration" method. In each method, the capital charge is the sum of four components:

- The net short or long position in the whole trading book;
- A small proportion of the matched positions in each time-band (the *"vertical disallowance"*);
- A larger proportion of the matched positions across different time-bands (the *"horizontal disallowance"*);
- A net charge for positions in options, where appropriate (see paragraphs 718(Lxvi) to 718(Lxix)).

718(ii). Separate maturity ladders should be used for each currency and capital charges should be calculated for each currency separately and then summed with no offsetting between positions of opposite sign. In the case of those currencies in which business is insignificant, separate maturity ladders for each currency are not required. Rather, the bank may construct a single maturity ladder and slot, within each appropriate time-band, the net long or short position for each currency. However, these individual net positions are to be summed within each time-band, irrespective of whether they are long or short positions, to produce a gross position figure.

[122] Currency mismatches should feed into the normal reporting of foreign exchange risk.

718(iii). In the **maturity method** (see paragraph 718(vii) for the duration method), long or short positions in debt securities and other sources of interest rate exposures including derivative instruments are slotted into a maturity ladder comprising thirteen time-bands (or fifteen time-bands in case of low coupon instruments). Fixed rate instruments should be allocated according to the residual term to maturity and floating-rate instruments according to the residual term to the next repricing date. Opposite positions of the same amount in the same issues (but not different issues by the same issuer), whether actual or notional, can be omitted from the interest rate maturity framework, as well as closely matched swaps, forwards, futures and FRAs which meet the conditions set out in paragraphs 718(xiii) and 718(xiv) below.

718(iv). The first step in the calculation is to weight the positions in each time-band by a factor designed to reflect the price sensitivity of those positions to assumed changes in interest rates. The weights for each time-band are set out in the table below. Zero-coupon bonds and deep-discount bonds (defined as bonds with a coupon of less than 3%) should be slotted according to the time-bands set out in the second column of the table.

Maturity method: time-bands and weights

Coupon 3% or more	Coupon less than 3%	Risk weight	Assumed changes in yield
1 month or less	1 month or less	0.00%	1.00
1 to 3 months	1 to 3 months	0.20%	1.00
3 to 6 months	3 to 6 months	0.40%	1.00
6 to 12 months	6 to 12 months	0.70%	1.00
1 to 2 years	1.0 to 1.9 years	1.25%	0.90
2 to 3 years	1.9 to 2.8 years	1.75%	0.80
3 to 4 years	2.8 to 3.6 years	2.25%	0.75
4 to 5 years	3.6 to 4.3 years	2.75%	0.75
5 to 7 years	4.3 to 5.7 years	3.25%	0.70
7 to 10 years	5.7 to 7.3 years	3.75%	0.65
10 to 15 years	7.3 to 9.3 years	4.50%	0.60
15 to 20 years	9.3 to 10.6 years	5.25%	0.60
over 20years	10.6 to 12 years	6.00%	0.60
	12 to 20 years	8.00%	0.60
	over 20 years	12.50%	0.60

718(v). The next step in the calculation is to offset the weighted longs and shorts in each time-band, resulting in a single short or long position for each band. Since, however, each band would include different instruments and different maturities, a 10% capital charge to reflect basis risk and gap risk will be levied on the smaller of the offsetting positions, be it long or short. Thus, if the sum of the weighted longs in a time-band is $100 million and the sum of the weighted shorts $90 million, the so-called “vertical disallowance” for that time-band would be 10% of $90 million (i.e. $9.0 million).

718(vi). The result of the above calculations is to produce two sets of weighted positions, the net long or short positions in each time-band ($10 million long in the example above) and the vertical disallowances, which have no sign. In addition, however, banks will be allowed to conduct two rounds of "horizontal offsetting", first between the net positions in each of three zones (zero to one year, one year to four years and four years and over),[123] and subsequently between the net positions in the three different zones. The offsetting will be subject to a scale of disallowances expressed as a fraction of the matched positions, as set out in the table below. The weighted long and short positions in each of three zones may be offset, subject to the matched portion attracting a disallowance factor that is part of the capital charge. The residual net position in each zone may be carried over and offset against opposite positions in other zones, subject to a second set of disallowance factors.

Horizontal disallowances

Zones[124]	Time-band	within the zone	between adjacent zones	between zones 1 and 3
Zone 1	0 - 1 month 1 - 3 months 3 - 6 months 6 - 12 months	40%	40%	100%
Zone 2	1 - 2 years 2 - 3 years 3 - 4 years 4 - 5 years	30%	40%	
Zone 3	5 - 7 years 7 - 10 years 10 - 15 years 15 - 20 years over 20 years	30%		

718(vii). Under the alternative **duration method**, banks with the necessary capability may, with their supervisors' consent, use a more accurate method of measuring all of their general market risk by calculating the price sensitivity of each position separately. Banks must elect and use the method on a continuous basis (unless a change in method is approved by the national authority) and will be subject to supervisory monitoring of the systems used. The mechanics of this method are as follows:

- First calculate the price sensitivity of each instrument in terms of a change in interest rates of between 0.6 and 1.0 percentage points depending on the maturity of the instrument (see the table below);

- Slot the resulting sensitivity measures into a duration-based ladder with the fifteen time-bands set out in the table below;

[123] The zones for coupons less than 3% are 0 to 1 year, 1 to 3.6 years, and 3.6 years and over.

[124] The zones for coupons less than 3% are 0 to 1 year, 1 to 3.6 years, and 3.6 years and over.

- Subject long and short positions in each time-band to a 5% vertical disallowance designed to capture basis risk;
- Carry forward the net positions in each time-band for horizontal offsetting subject to the disallowances set out in table paragraph 718(vi) above.

Duration method: time-bands and assumed changes in yield

	Assumed change in yield		Assumed change in yield
Zone 1		**Zone 3**	
1 month or less	1.00	3.6 to 4.3 years	0.75
1 to 3 months	1.00	4.3 to 5.7 years	0.70
3 to 6 months	1.00	5.7 to 7.3 years	0.65
6 to 12 months	1.00	7.3 to 9.3 years	0.60
		9.3 to 10.6 years	0.60
Zone 2		10.6 to 12 years	0.60
1.0 to 1.9 years	0.90	12 to 20 years	0.60
1.9 to 2.8 years	0.80	over 20 years	0.60
2.8 to 3.6 years	0.75		

718(viii). In the case of **residual currencies** (see paragraph 718(ii) above) the gross positions in each time-band will be subject to either the risk weightings set out in paragraph 718(iv), if positions are reported using the maturity method, or the assumed change in yield set out in paragraph 718(vii), if positions are reported using the duration method, with no further offsets.

(iii) Interest rate derivatives

718(ix). The measurement system should include all interest rate derivatives and off-balance-sheet instruments in the trading book which react to changes in interest rates, (e.g. forward rate agreements (FRAs), other forward contracts, bond futures, interest rate and cross-currency swaps and forward foreign exchange positions). Options can be treated in a variety of ways as described in paragraphs 718(Lvi) to 718(Lxix) below. A summary of the rules for dealing with interest rate derivatives is set out in paragraph 718(xviii) below.

Calculation of positions

718(x). The derivatives should be converted into positions in the relevant underlying and become subject to specific and general market risk charges as described above. In order to calculate the standard formula described above, the amounts reported should be the market value of the principal amount of the underlying or of the notional underlying resulting from the prudent valuation guidance set out in paragraphs 690 to 701 above.[125]

Futures and forward contracts, including forward rate agreements

718(xi). These instruments are treated as a combination of a long and a short position in a notional government security. The maturity of a future or a FRA will be the period until delivery or exercise of the contract, plus - where applicable - the life of the underlying

[125] For instruments where the apparent notional amount differs from the effective notional amount, banks must use the effective notional amount.

instrument. For example, a long position in a June three month interest rate future (taken in April) is to be reported as a long position in a government security with a maturity of five months and a short position in a government security with a maturity of two months. Where a range of deliverable instruments may be delivered to fulfil the contract, the bank has flexibility to elect which deliverable security goes into the maturity or duration ladder but should take account of any conversion factor defined by the exchange. In the case of a future on a corporate bond index, positions will be included at the market value of the notional underlying portfolio of securities.

Swaps

718(xii). Swaps will be treated as two notional positions in government securities with relevant maturities. For example, an interest rate swap under which a bank is receiving floating rate interest and paying fixed will be treated as a long position in a floating rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument of maturity equivalent to the residual life of the swap. For swaps that pay or receive a fixed or floating interest rate against some other reference price, e.g. a stock index, the interest rate component should be slotted into the appropriate repricing maturity category, with the equity component being included in the equity framework. The separate legs of cross-currency swaps are to be reported in the relevant maturity ladders for the currencies concerned.

Calculation of capital charges for derivatives under the standardised methodology

Allowable offsetting of matched positions

718(xiii). Banks may exclude from the interest rate maturity framework altogether (for both specific and general market risk) long and short positions (both actual and notional) in identical instruments with exactly the same issuer, coupon, currency and maturity. A matched position in a future or forward and its corresponding underlying may also be fully offset,[126] and thus excluded from the calculation. When the future or the forward comprises a range of deliverable instruments offsetting of positions in the future or forward contract and its underlying is only permissible in cases where there is a readily identifiable underlying security which is most profitable for the trader with a short position to deliver. The price of this security, sometimes called the "cheapest-to-deliver", and the price of the future or forward contract should in such cases move in close alignment. No offsetting will be allowed between positions in different currencies; the separate legs of cross-currency swaps or forward foreign exchange deals are to be treated as notional positions in the relevant instruments and included in the appropriate calculation for each currency.

718(xiv). In addition, opposite positions in the same category of instruments[127] can in certain circumstances be regarded as matched and allowed to offset fully. To qualify for this treatment the positions must relate to the same underlying instruments, be of the same nominal value and be denominated in the same currency.[128] In addition:

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[126] The leg representing the time to expiry of the future should, however, be reported.

[127] This includes the delta-equivalent value of options. The delta equivalent of the legs arising out of the treatment of caps and floors as set out in paragraph 718(LX) can also be offset against each other under the rules laid down in this paragraph.

[128] The separate legs of different swaps may also be "matched" subject to the same conditions.

(i) **for futures**: offsetting positions in the notional or underlying instruments to which the futures contract relates must be for identical products and mature within seven days of each other;

(ii) **for swaps and FRAs**: the reference rate (for floating rate positions) must be identical and the coupon closely matched (i.e. within 15 basis points); and

(iii) **for swaps, FRAs and forwards**: the next interest fixing date or, for fixed coupon positions or forwards, the residual maturity must correspond within the following limits:

- less than one month hence: same day;
- between one month and one year hence: within seven days;
- over one year hence: within thirty days.

718(xv). Banks with large swap books may use alternative formulae for these swaps to calculate the positions to be included in the maturity or duration ladder. One method would be to first convert the payments required by the swap into their present values. For that purpose, each payment should be discounted using zero coupon yields, and a single net figure for the present value of the cash flows entered into the appropriate time-band using procedures that apply to zero (or low) coupon bonds; these figures should be slotted into the general market risk framework as set out above. An alternative method would be to calculate the sensitivity of the net present value implied by the change in yield used in the maturity or duration method and allocate these sensitivities into the time-bands set out in paragraph 718(iv) or paragraph 718(vii). Other methods which produce similar results could also be used. Such alternative treatments will, however, only be allowed if:

- the supervisory authority is fully satisfied with the accuracy of the systems being used;
- the positions calculated fully reflect the sensitivity of the cash flows to interest rate changes and are entered into the appropriate time-bands;
- the positions are denominated in the same currency.

Specific risk

718(xvi). Interest rate and currency swaps, FRAs, forward foreign exchange contracts and interest rate futures will not be subject to a specific risk charge. This exemption also applies to futures on an interest rate index (e.g. LIBOR). However, in the case of futures contracts where the underlying is a debt security, or an index representing a basket of debt securities, a specific risk charge will apply according to the credit risk of the issuer as set out in paragraphs 709(iii) to 718 above.

General market risk

718(xvii). General market risk applies to positions in all derivative products in the same manner as for cash positions, subject only to an exemption for fully or very closely matched positions in identical instruments as defined in paragraphs 718(xiii) and 718(xiv). The various categories of instruments should be slotted into the maturity ladder and treated according to the rules identified earlier.

718(xviii). The table below presents a summary of the regulatory treatment for interest rate derivatives, for market risk purposes.

Summary of treatment of interest rate derivatives

Instrument	Specific risk charge[129]	General market risk charge
Exchange-traded future		
- Government debt security	Yes[130]	Yes, as two positions
- Corporate debt security	Yes	Yes, as two positions
- Index on interest rates (e.g. LIBOR)	No	Yes, as two positions
OTC forward		
- Government debt security	Yes[130]	Yes, as two positions
- Corporate debt security	Yes	Yes, as two positions
- Index on interest rates	No	Yes, as two positions
FRAs, Swaps	No	Yes, as two positions
Forward foreign exchange	No	Yes, as one position in each currency
Options		Either
- Government debt security	Yes[130]	(a) Carve out together with the associated hedging positions - simplified approach - scenario analysis - internal models (Part B)
- Corporate debt security	Yes	(b) General market risk charge according to the delta-plus method (gamma and vega should receive separate capital charges)
- Index on interest rates	No	
- FRAs, Swaps	No	

2. *Equity position risk*

718(xix).This section sets out a minimum capital standard to cover the risk of holding or taking positions in equities in the trading book. It applies to long and short positions in all instruments that exhibit market behaviour similar to equities, but not to non-convertible preference shares (which are covered by the interest rate risk requirements described in paragraphs 709 to 718(xviii)). Long and short positions in the same issue may be reported on a net basis. The instruments covered include common stocks, whether voting or non-voting, convertible securities that behave like equities, and commitments to buy or sell equity securities. The treatment of derivative products, stock indices and index arbitrage is described in paragraphs 718(xxii) to 718(xxix) below.

[129] This is the specific risk charge relating to the issuer of the instrument. Under the existing credit risk rules, there remains a separate capital charge for the counterparty risk.

[130] The specific risk capital charge only applies to government debt securities that are rated below AA- (see paragraphs 710 and 710 (i)).

(i). Specific and general market risk

718(xx). As with debt securities, the minimum capital standard for equities is expressed in terms of two separately calculated charges for the "specific risk" of holding a long or short position in an individual equity and for the "general market risk" of holding a long or short position in the market as a whole. Specific risk is defined as the bank's gross equity positions (i.e. the sum of all long equity positions and of all short equity positions) and general market risk as the difference between the sum of the longs and the sum of the shorts (i.e. the overall net position in an equity market).The long or short position in the market must be calculated on a market-by-market basis, i.e. a separate calculation has to be carried out for each national market in which the bank holds equities.

718(xxi). The capital charge for *specific* risk will be 8%, unless the portfolio is both liquid and well-diversified, in which case the charge will be 4%. Given the different characteristics of national markets in terms of marketability and concentration, national authorities will have discretion to determine the criteria for liquid and diversified portfolios. The *general market risk* charge will be 8%.

(ii). Equity derivatives

718(xxii). Except for options, which are dealt with in paragraphs 718(Lvi) to 718(Lxix), equity derivatives and off-balance-sheet positions which are affected by changes in equity prices should be included in the measurement system.[131] This includes futures and swaps on both individual equities and on stock indices. The derivatives are to be converted into positions in the relevant underlying. The treatment of equity derivatives is summarised in paragraph 718(xxix) below.

Calculation of positions

718(xxiii). In order to calculate the standard formula for specific and general market risk, positions in derivatives should be converted into notional equity positions:

- Futures and forward contracts relating to individual equities should in principle be reported at current market prices;
- Futures relating to stock indices should be reported as the marked-to-market value of the notional underlying equity portfolio;
- Equity swaps are to be treated as two notional positions;[132]
- Equity options and stock index options should be either "carved out" together with the associated underlyings or be incorporated in the measure of general market risk described in this section according to the delta-plus method.

[131] Where equities are part of a forward contract, a future or an option (quantity of equities to be received or to be delivered), any interest rate or foreign currency exposure from the other leg of the contract should be reported as set out in paragraphs 709 to 718(xviii) and 718(xxx) to 718(xLii).

[132] For example, an equity swap in which a bank is receiving an amount based on the change in value of one particular equity or stock index and paying a different index will be treated as a long position in the former and a short position in the latter. Where one of the legs involves receiving/paying a fixed or floating interest rate, that exposure should be slotted into the appropriate repricing time-band for interest rate related instruments as set out in paragraphs 709 to 718(xviii). The stock index should be covered by the equity treatment.

Calculation of capital charges

Measurement of specific and general market risk

718(xxiv). Matched positions in each identical equity or stock index in each market may be fully offset, resulting in a single net short or long position to which the specific and general market risk charges will apply. For example, a future in a given equity may be offset against an opposite cash position in the same equity.[133]

Risk in relation to an index

718(xxv). Besides general market risk, a further capital charge of 2% will apply to the net long or short position in an index contract comprising a diversified portfolio of equities. This capital charge is intended to cover factors such as execution risk. National supervisory authorities will take care to ensure that this 2% risk weight applies only to well-diversified indices and not, for example, to sectoral indices.

Arbitrage

718(xxvi). In the case of the futures-related arbitrage strategies described below, the additional 2% capital charge described above may be applied to only one index with the opposite position exempt from a capital charge. The strategies are:

- When the bank takes an opposite position in exactly the same index at different dates or in different market centres;
- When the bank has an opposite position in contracts at the same date in different but similar indices, subject to supervisory oversight that the two indices contain sufficient common components to justify offsetting.

718(xxvii). Where a bank engages in a deliberate arbitrage strategy, in which a futures contract on a broadly-based index matches a basket of stocks, it will be allowed to carve out both positions from the standardised methodology on condition that:

- The trade has been deliberately entered into and separately controlled;
- The composition of the basket of stocks represents at least 90% of the index when broken down into its notional components.

In such a case the minimum capital requirement will be 4% (i.e. 2% of the gross value of the positions on each side) to reflect divergence and execution risks. This applies even if all of the stocks comprising the index are held in identical proportions. Any excess value of the stocks comprising the basket over the value of the futures contract or excess value of the futures contract over the value of the basket is to be treated as an open long or short position.

718(xxviii). If a bank takes a position in depository receipts against an opposite position in the underlying equity or identical equities in different markets, it may offset the position (i.e.

[133] The interest rate risk arising out of the future, however, should be reported as set out in paragraphs 709 to 718(xviii).

bear no capital charge) but only on condition that any costs on conversion are fully taken into account.[134]

718(xxix). The table below summarises the regulatory treatment of equity derivatives for market risk purposes.

Summary of treatment of equity derivatives

Instrument	Specific risk[135]	General market risk
Exchange-traded or OTC-Future		
- Individual equity	Yes	Yes, as underlying
- Index	2%	Yes, as underlying
Options		
- Individual equity	Yes	Either (a) Carve out together with the associated hedging positions - simplified approach - scenario analysis - internal models (Part B) (b) General market risk charge according to the delta-plus method (gamma and vega should receive separate capital charges)
- Index	2%	

3. *Foreign exchange risk*

718(xxx). This section sets out a minimum capital standard to cover the risk of holding or taking positions in foreign currencies, including gold.[136]

718(xxxi). Two processes are needed to calculate the capital requirement for foreign exchange risk. The first is to measure the exposure in a single currency position. The second is to measure the risks inherent in a bank's mix of long and short positions in different currencies.

(i). Measuring the exposure in a single currency

718(xxxii). The bank's net open position in each currency should be calculated by summing:

[134] Any foreign exchange risk arising out of these positions has to be reported as set out in paragraphs 718(xxx) to 718(xLvii).

[135] This is the specific risk charge relating to the issuer of the instrument. Under the existing credit risk rules, there remains a separate capital charge for the counterparty risk.

[136] Gold is to be dealt with as a foreign exchange position rather than a commodity because its volatility is more in line with foreign currencies and banks manage it in a similar manner to foreign currencies.

- The net spot position (i.e. all asset items less all liability items, including accrued interest, denominated in the currency in question);
- The net forward position (i.e. all amounts to be received less all amounts to be paid under forward foreign exchange transactions, including currency futures and the principal on currency swaps not included in the spot position);
- Guarantees (and similar instruments) that are certain to be called and are likely to be irrecoverable;
- Net future income/expenses not yet accrued but already fully hedged (at the discretion of the reporting bank);
- Depending on particular accounting conventions in different countries, any other item representing a profit or loss in foreign currencies;
- The net delta-based equivalent of the total book of foreign currency options.[137]

718(xxxiii). Positions in composite currencies need to be separately reported but, for measuring banks' open positions, may be either treated as a currency in their own right or split into their component parts on a consistent basis. Positions in gold should be measured in the same manner as described in paragraph 718(xLix).[138]

718(xxxiv). Three aspects call for more specific comment: the treatment of interest, other income and expenses; the measurement of forward currency positions and gold; and the treatment of "structural" positions.

The treatment of interest, other income and expenses

718(xxxv). Interest accrued (i.e. earned but not yet received) should be included as a position. Accrued expenses should also be included. Unearned but expected future interest and anticipated expenses may be excluded unless the amounts are certain and banks have taken the opportunity to hedge them. If banks include future income/expenses they should do so on a consistent basis, and not be permitted to select only those expected future flows which reduce their position.

The measurement of forward currency and gold positions

718(xxxvi). Forward currency and gold positions will normally be valued at current spot market exchange rates. Using forward exchange rates would be inappropriate since it would result in the measured positions reflecting current interest rate differentials to some extent. However, banks which base their normal management accounting on net present values are expected to use the net present values of each position, discounted using current interest rates and valued at current spot rates, for measuring their forward currency and gold positions.

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[137] Subject to a separately calculated capital charge for gamma and vega as described in paragraphs 718(Lix) to 718(Lxii); alternatively, options and their associated underlyings are subject to one of the other methods described in paragraphs 718(Lvi) to 718(Lxix).

[138] Where gold is part of a forward contract (quantity of gold to be received or to be delivered), any interest rate or foreign currency exposure from the other leg of the contract should be reported as set out in paragraphs 709 to 718(xviii) and 718(xxxii) above.

The treatment of structural positions

718(xxxvii). A matched currency position will protect a bank against loss from movements in exchange rates, but will not necessarily protect its capital adequacy ratio. If a bank has its capital denominated in its domestic currency and has a portfolio of foreign currency assets and liabilities that is completely matched, its capital/asset ratio will fall if the domestic currency depreciates. By running a short position in the domestic currency the bank can protect its capital adequacy ratio, although the position would lead to a loss if the domestic currency were to appreciate.

718(xxxviii). Supervisory authorities are free to allow banks to protect their capital adequacy ratio in this way. Thus, any positions which a bank has deliberately taken in order to hedge partially or totally against the adverse effect of the exchange rate on its capital ratio may be excluded from the calculation of net open currency positions, subject to each of the following conditions being met:

- Such positions need to be of a “structural”, i.e. of a non-dealing, nature (the precise definition to be set by national authorities according to national accounting standards and practices);
- The national authority needs to be satisfied that the “structural” position excluded does no more than protect the bank’s capital adequacy ratio;
- Any exclusion of the position needs to be applied consistently, with the treatment of the hedge remaining the same for the life of the assets or other items.

718(xxxix). No capital charge need apply to positions related to items that are deducted from a bank’s capital when calculating its capital base, such as investments in non-consolidated subsidiaries, nor to other long-term participations denominated in foreign currencies which are reported in the published accounts at historic cost. These may also be treated as structural positions.

(ii). Measuring the foreign exchange risk in a portfolio of foreign currency positions and gold

718(xL). Banks will have a choice between two alternative measures at supervisory discretion; a “shorthand” method which treats all currencies equally; and the use of internal models which takes account of the actual degree of risk dependent on the composition of the bank’s portfolio. The conditions for the use of internal models are set out in paragraphs 718(Lxx) to 718(xcix) below.

718(xLi). Under the shorthand method, the nominal amount (or net present value) of the net position in each foreign currency and in gold is converted at spot rates into the reporting currency.[139] The overall net open position is measured by aggregating:

- The sum of the net short positions or the sum of the net long positions, whichever is the greater;[140] plus

139 Where the bank is assessing its foreign exchange risk on a consolidated basis, it may be technically impractical in the case of some marginal operations to include the currency positions of a foreign branch or subsidiary of the bank. In such cases the internal limit in each currency may be used as a proxy for the positions. Provided there is adequate ex post monitoring of actual positions against such limits, the limits should be added, without regard to sign, to the net open position in each currency.

- The net position (short or long) in gold, regardless of sign.

The capital charge will be 8% of the overall net open position (see example below).

Example of the shorthand measure of foreign exchange risk

YEN	EUR	GB£	CA$	US$	GOLD
+ 50	+ 100	+ 150	- 20	- 180	- 35
	+ 300		- 200		35

The capital charge would be 8% of the higher of either the net long currency positions or the net short currency positions (i.e. 300) and of the net position in gold (35) = 335 x 8% = 26.8.

718(xlii). A bank doing negligible business in foreign currency and which does not take foreign exchange positions for its own account may, at the discretion of its national authority, be exempted from capital requirements on these positions provided that:

- Its foreign currency business, defined as the greater of the sum of its gross long positions and the sum of its gross short positions in all foreign currencies, does not exceed 100% of eligible capital as defined in paragraphs 49(xxi) and 49(xxii); **and**

- Its overall net open position as defined in the paragraph above does not exceed 2% of its eligible capital as defined in paragraphs 49(xxi) and 49(xxii)

4. Commodities risk

718(xliii). This section establishes a minimum capital standard to cover the risk of holding or taking positions in commodities, including precious metals, but excluding gold (which is treated as a foreign currency according to the methodology set out in paragraphs 718(xxx) to 718(xlii) above). A commodity is defined as a physical product which is or can be traded on a secondary market, e.g. agricultural products, minerals (including oil) and precious metals.

718(xliv). The price risk in commodities is often more complex and volatile than that associated with currencies and interest rates. Commodity markets may also be less liquid than those for interest rates and currencies and, as a result, changes in supply and demand can have a more dramatic effect on price and volatility.[141] These market characteristics can make price transparency and the effective hedging of commodities risk more difficult.

718(xlv). For spot or physical trading, the directional risk arising from a change in the spot price is the most important risk. However, banks using portfolio strategies involving forward and derivative contracts are exposed to a variety of additional risks, which may well be larger than the risk of a change in spot prices. These include:

- Basis risk (the risk that the relationship between the prices of similar commodities alters through time);

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[140] An alternative calculation, which produces an identical result, is to include the reporting currency as a residual and to take the sum of all the short (or long) positions.

[141] Banks need also to guard against the risk that arises when the short position falls due before the long position. Owing to a shortage of liquidity in some markets it might be difficult to close the short position and the bank might be squeezed by the market.

- Interest rate risk (the risk of a change in the cost of carry for forward positions and options);
- Forward gap risk (the risk that the forward price may change for reasons other than a change in interest rates);

In addition banks may face credit counterparty risk on over-the-counter derivatives, but this is captured by one of the methods set out in Annex 4 of this Framework. The funding of commodities positions may well open a bank to interest rate or foreign exchange exposure and if that is so the relevant positions should be included in the measures of interest rate and foreign exchange risk described in paragraphs 709 to 718(xviii) and paragraphs 718(xxx) to 718(xlii), respectively.[142]

718(xlvi). There are three alternatives for measuring commodities position risk which are described in paragraphs 718(xlviii) to 718(lv) below. As with other categories of market risk, banks may use models subject to the conditions set out in paragraphs 718(lxx) to 718(xcix). Commodities risk can also be measured in a standardised manner, using either a very simple framework (paragraphs 718(liv) and 718(lv) below) or a measurement system which captures forward gap and interest rate risk separately by basing the methodology on seven time-bands (paragraphs 718(xlix) to 718(liii) below). Both the simplified approach and the maturity ladder approach are appropriate only for banks which, in relative terms, conduct only a limited amount of commodities business. Major traders would be expected over time to adopt a models approach subject to the safeguards set out in paragraphs 718(lxx) to 718(xcix).

718(xlvii). For the maturity ladder approach and the simplified approach, long and short positions in each commodity may be reported on a net basis for the purposes of calculating open positions. However, positions in different commodities will as a general rule not be offsettable in this fashion. Nevertheless, national authorities will have discretion to permit netting between different sub-categories[143] of the same commodity in cases where the sub-categories are deliverable against each other. They can also be considered as offsettable if they are close substitutes against each other and a minimum correlation of 0.9 between the price movements can be clearly established over a minimum period of one year. However, a bank wishing to base its calculation of capital charges for commodities on correlations would have to satisfy the relevant supervisory authority of the accuracy of the method which has been chosen and obtain its prior approval. Where banks use the models approach they can offset long and short positions in different commodities to a degree which is determined by empirical correlations, in the same way as a limited degree of offsetting is allowed, for instance, between interest rates in different currencies.

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[142] Where a commodity is part of a forward contract (quantity of commodities to be received or to be delivered), any interest rate or foreign currency exposure from the other leg of the contract should be reported as set out in paragraphs 709 to 718(xviii) and paragraphs 718(xxx) to 718(xlii). Positions which are purely stock financing (i.e. a physical stock has been sold forward and the cost of funding has been locked in until the date of the forward sale) may be omitted from the commodities risk calculation although they will be subject to interest rate and counterparty risk requirements.

[143] Commodities can be grouped into clans, families, sub-groups and individual commodities. For example, a clan might be Energy Commodities, within which Hydro-Carbons are a family with Crude Oil being a sub-group and West Texas Intermediate, Arabian Light and Brent being individual commodities.

(i) Models for measuring commodities risk

718(xLviii). Banks may choose to adopt the models approach as set out in paragraphs 718(Lxx) to 718(xcix). It is essential that the methodology used encompasses:

- Directional risk, to capture the exposure from changes in spot prices arising from net open positions;
- Forward gap and interest rate risk, to capture the exposure to changes in forward prices arising from maturity mismatches; and
- Basis risk, to capture the exposure to changes in the price relationships between two similar, but not identical, commodities.

It is also particularly important that models take proper account of market characteristics - notably delivery dates and the scope provided to traders to close out positions.

(ii) Maturity ladder approach

718(xLix). In calculating the capital charges under this approach banks will first have to express each commodity position (spot plus forward) in terms of the standard unit of measurement (barrels, kilos, grams etc.). The net position in each commodity will then be converted at current spot rates into the national currency.

718(L). Secondly, in order to capture forward gap and interest rate risk within a time-band (which, together, are sometimes referred to as curvature/spread risk), matched long and short positions in each time-band will carry a capital charge. The methodology will be rather similar to that used for interest rate related instruments as set out in paragraphs 709 to 718(xviii). Positions in the separate commodities (expressed in terms of the standard unit of measurement) will first be entered into a maturity ladder while physical stocks should be allocated to the first time-band. A separate maturity ladder will be used for each commodity as defined in paragraph 718(xLvii) above.[144] For each time-band, the sum of short and long positions which are matched will be multiplied first by the spot price for the commodity, and then by the appropriate spread rate for that band (as set out in the table below).

[144] For markets which have daily delivery dates, any contracts maturing within ten days of one another may be offset.

Time-bands and spread rates

Time-band	Spread rate
0 - 1 month	1.5%
1 - 3 months	1.5%
3 - 6 months	1.5%
6 - 12 months	1.5%
1 - 2 years	1.5%
2 - 3 years	1.5%
over 3 years	1.5%

718(Li). The residual net positions from nearer time-bands may then be carried forward to offset exposures in time-bands that are further out. However, recognising that such hedging of positions among different time-bands is imprecise, a surcharge equal to 0.6% of the net position carried forward will be added in respect of each time-band that the net position is carried forward. The capital charge for each matched amount created by carrying net positions forward will be calculated as in paragraph 718(L) above. At the end of this process a bank will have either only long or only short positions, to which a capital charge of 15% will apply.

718(Lii). Even though the Committee is aware that there are differences in volatility between different commodities, it has decided in the interest of simplicity, and given the fact that banks normally run rather small open positions in commodities, that one uniform capital charge for open positions in all commodities should apply. Those banks which desire to be more precise in this area may choose to adopt the models approach.

718(Liii). All commodity derivatives and off-balance-sheet positions which are affected by changes in commodity prices should be included in this measurement framework. This includes commodity futures, commodity swaps, and options where the "delta plus" method[145] is used (see paragraphs 718(Lix) to 718(Lxii) below). In order to calculate the risk, commodity derivatives should be converted into notional commodities positions and assigned to maturities as follows:

- *Futures and forward contracts relating to individual commodities* should be incorporated in the measurement system as notional amounts of barrels, kilos etc. and should be assigned a maturity with reference to expiry date;

- *Commodity swaps* where one leg is a fixed price and the other the current market price should be incorporated as a series of positions equal to the notional amount of the contract, with one position corresponding with each payment on the swap and slotted into the maturity ladder accordingly. The positions would be long positions if

[145] For banks using other approaches to measure options risk, all options and the associated underlyings should be excluded from both the maturity ladder approach and the simplified approach.

the bank is paying fixed and receiving floating, and short positions if the bank is receiving fixed and paying floating;[146]

- *Commodity swaps* where the legs are in different commodities are to be incorporated in the relevant maturity ladder. No offsetting will be allowed in this regard except where the commodities belong to the same sub-category as defined in paragraph 718(xLvii) above.

(iii) Simplified approach

718(Liv). In calculating the capital charge for directional risk, the same procedure will be adopted as in the maturity ladder approach above (see paragraphs 718(xLix) and 718(Liii)). Once again, all commodity derivatives and off-balance-sheet positions which are affected by changes in commodity prices should be included. The capital charge will equal 15% of the net position, long or short, in each commodity.

718(Lv). In order to protect the bank against basis risk, interest rate risk and forward gap risk, the capital charge for each commodity as described in paragraphs 718(xLix) and 718(Liii) above will be subject to an additional capital charge equivalent to 3% of the bank's gross positions, long plus short, in that particular commodity. In valuing the gross positions in commodity derivatives for this purpose, banks should use the current spot price.

5. Treatment of options

718(Lvi). In recognition of the wide diversity of banks' activities in options and the difficulties of measuring price risk for options, several alternative approaches will be permissible at the discretion of the national authority:

- Those banks which solely use purchased options[147] will be free to use the simplified approach described in paragraph 718(Lviii) below;

- Those banks which also write options will be expected to use one of the intermediate approaches as set out in paragraphs 718(Lix) to 718(Lxix) or a comprehensive risk management model under the terms of paragraphs 718(Lxx) to 718(xcix) of this Framework. The more significant its trading, the more the bank will be expected to use a sophisticated approach.

718(Lvii). In the *simplified approach*, the positions for the options and the associated underlying, cash or forward, are not subject to the standardised methodology but rather are "carved-out" and subject to separately calculated capital charges that incorporate both general market risk and specific risk. The risk numbers thus generated are then added to the capital charges for the relevant category, i.e. interest rate related instruments, equities, foreign exchange and commodities as described in paragraphs 709 to 718(Lv). The *delta-plus method* uses the sensitivity parameters or "Greek letters" associated with options to measure their market risk and capital requirements. Under this method, the delta-equivalent position of each option becomes part of the standardised methodology set out in paragraphs 709 to 718(Lv) with the delta-equivalent amount subject to the applicable general market risk

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[146] If one of the legs involves receiving/paying a fixed or floating interest rate, that exposure should be slotted into the appropriate repricing maturity band in the maturity ladder covering interest rate related instruments.

[147] Unless all their written option positions are hedged by perfectly matched long positions in exactly the same options, in which case no capital charge for market risk is required.

charges. Separate capital charges are then applied to the gamma and vega risks of the option positions. The *scenario approach* uses simulation techniques to calculate changes in the value of an options portfolio for changes in the level and volatility of its associated underlyings. Under this approach, the general market risk charge is determined by the scenario "grid" (i.e. the specified combination of underlying and volatility changes) that produces the largest loss. For the delta-plus method and the scenario approach the specific risk capital charges are determined separately by multiplying the delta-equivalent of each option by the specific risk weights set out in paragraphs 709 to 718(xxix).

(i) Simplified approach

718(Lviii). Banks which handle a limited range of purchased options only will be free to use the simplified approach set out in the table below for particular trades. As an example of how the calculation would work, if a holder of 100 shares currently valued at $10 each holds an equivalent put option with a strike price of $11, the capital charge would be: $1,000 x 16% (i.e. 8% specific plus 8% general market risk) = $160, less the amount the option is in the money ($11 - $10) x 100 = $100, i.e. the capital charge would be $60. A similar methodology applies for options whose underlying is a foreign currency, an interest rate related instrument or a commodity.

Simplified approach: capital charges

Position	Treatment
Long cash and Long put or Short cash and Long call	The capital charge will be the market value of the underlying security[148] multiplied by the sum of specific and general market risk charges[149] for the underlying less the amount the option is in the money (if any) bounded at zero[150]
Long call or Long put	The capital charge will be the lesser of: (i) the market value of the underlying security multiplied by the sum of specific and general market risk charges[149] for the underlying (ii) the market value of the option[151]

[148] In some cases such as foreign exchange, it may be unclear which side is the "underlying security"; this should be taken to be the asset which would be received if the option were exercised. In addition the nominal value should be used for items where the market value of the underlying instrument could be zero, e.g. caps and floors, swaptions etc.

[149] Some options (e.g. where the underlying is an interest rate, a currency or a commodity) bear no specific risk but specific risk will be present in the case of options on certain interest rate related instruments (e.g. options on a corporate debt security or corporate bond index; see paragraphs 709 to 718(xviii) for the relevant capital charges) and for options on equities and stock indices (see paragraphs 718(xix) to 718(xxix)). The charge under this measure for currency options will be 8% and for options on commodities 15%.

[150] For options with a residual maturity of more than six months the strike price should be compared with the forward, not current, price. A bank unable to do this must take the in the money amount to be zero.

[151] Where the position does not fall within the trading book (i.e. options on certain foreign exchange or commodities positions not belonging to the trading book), it may be acceptable to use the book value instead.

(ii) Intermediate approaches

Delta-plus method

718(Lix). Banks which write options will be allowed to include delta-weighted options positions within the standardised methodology set out in paragraphs 709 to 718(Lv). Such options should be reported as a position equal to the market value of the underlying multiplied by the delta. However, since delta does not sufficiently cover the risks associated with options positions, banks will also be required to measure gamma (which measures the rate of change of delta) and vega (which measures the sensitivity of the value of an option with respect to a change in volatility) sensitivities in order to calculate the total capital charge. These sensitivities will be calculated according to an approved exchange model or to the bank's proprietary options pricing model subject to oversight by the national authority.[152]

718(Lx). Delta-weighted positions with *debt securities or interest rates as the underlying* will be slotted into the interest rate time-bands, as set out in paragraphs 709 to 718(xviii), under the following procedure. A two-legged approach should be used as for other derivatives, requiring one entry at the time the underlying contract takes effect and a second at the time the underlying contract matures. For instance, a bought call option on a June three-month interest-rate future will in April be considered, on the basis of its delta-equivalent value, to be a long position with a maturity of five months and a short position with a maturity of two months.[153] The written option will be similarly slotted as a long position with a maturity of two months and a short position with a maturity of five months. Floating rate instruments with caps or floors will be treated as a combination of floating rate securities and a series of European-style options. For example, the holder of a three-year floating rate bond indexed to six month LIBOR with a cap of 15% will treat it as:

(i) A debt security that reprices in six months; and

(ii) A series of five written call options on a FRA with a reference rate of 15%, each with a negative sign at the time the underlying FRA takes effect and a positive sign at the time the underlying FRA matures.[154]

718(Lxi). The capital charge for *options with equities as the underlying* will also be based on the delta-weighted positions which will be incorporated in the measure of market risk described in paragraphs 718(xix) to 718(xxix). For purposes of this calculation each national market is to be treated as a separate underlying. The capital charge for *options on foreign exchange and gold positions* will be based on the method set out in paragraphs 718(xxx) to 718(xLii). For delta risk, the net delta-based equivalent of the foreign currency and gold options will be incorporated into the measurement of the exposure for the respective currency (or gold) position. The capital charge for *options on commodities* will be based on the simplified or the maturity ladder approach set out in paragraphs 718(xLiii) to 718(Lv). The delta-weighted positions will be incorporated in one of the measures described in that section.

[152] National authorities may wish to require banks doing business in certain classes of exotic options (e.g. barriers, digitals) or in options at the money that are close to expiry to use either the scenario approach or the internal models alternative, both of which can accommodate more detailed revaluation approaches.

[153] A two months call option on a bond future where delivery of the bond takes place in September would be considered in April as being long the bond and short a five months deposit, both positions being delta-weighted.

[154] The rules applying to closely matched positions set out in paragraph 718(xiv) will also apply in this respect.

718(LXII). In addition to the above capital charges arising from delta risk, there will be further capital charges for *gamma* and for *vega risk.* Banks using the delta-plus method will be required to calculate the gamma and vega for each option position (including hedge positions) separately. The capital charges should be calculated in the following way:

(i) for **each individual option** a "gamma impact" should be calculated according to a Taylor series expansion as:

$$\textit{Gamma impact} = \tfrac{1}{2} \times \textit{Gamma} \times VU^2$$

where VU = Variation of the underlying of the option.

(ii) VU will be calculated as follows:

- For interest rate options if the underlying is a bond, the market value of the underlying should be multiplied by the risk weights set out in paragraph 718(iv). An equivalent calculation should be carried out where the underlying is an interest rate, again based on the assumed changes in the corresponding yield in paragraph 718(iv);
- For options on equities and equity indices: the market value of the underlying should be multiplied by 8%;[155]
- For foreign exchange and gold options: the market value of the underlying should be multiplied by 8%;
- For options on commodities: the market value of the underlying should be multiplied by 15%.

(iii) For the purpose of this calculation the following positions should be treated as **the same underlying**:

- for interest rates,[156] each time-band as set out in paragraph 718(iv);[157]
- for equities and stock indices, each national market;
- for foreign currencies and gold, each currency pair and gold;
- for commodities, each individual commodity as defined in paragraph 718(XLVII).

(iv) Each option on the same underlying will have a gamma impact that is either positive or negative. These individual gamma impacts will be summed, resulting in a net gamma impact for each underlying that is either positive or negative. Only those net gamma impacts that are negative will be included in the capital calculation.

[155] The basic rules set out here for interest rate and equity options do not attempt to capture specific risk when calculating gamma capital charges. However, national authorities may wish to require specific banks to do so.

[156] Positions have to be slotted into separate maturity ladders by currency.

[157] Banks using the duration method should use the time-bands as set out in paragraph 718(vii).

(v) The total gamma capital charge will be the sum of the absolute value of the net negative gamma impacts as calculated above.

(vi) For **volatility risk**, banks will be required to calculate the capital charges by multiplying the sum of the vegas for all options on the same underlying, as defined above, by a proportional shift in volatility of ± 25%.

(vii) The **total capital charge** for vega risk will be the sum of the absolute value of the individual capital charges that have been calculated for vega risk.

Scenario approach

718(LXiii). More sophisticated banks will also have the right to base the market risk capital charge for options portfolios and associated hedging positions on *scenario matrix analysis*. This will be accomplished by specifying a fixed range of changes in the option portfolio's risk factors and calculating changes in the value of the option portfolio at various points along this "grid". For the purpose of calculating the capital charge, the bank will revalue the option portfolio using matrices for simultaneous changes in the option's underlying rate or price and in the volatility of that rate or price. A different matrix will be set up for each individual underlying as defined in paragraph 718(LXii) above. As an alternative, at the discretion of each national authority, banks which are significant traders in options will for interest rate options be permitted to base the calculation on a minimum of six sets of time-bands. When using this method, not more than three of the time-bands as defined in paragraphs 718(iv) and 718(vii) should be combined into any one set.

718(LXiv). The options and related hedging positions will be evaluated over a specified range above and below the current value of the underlying. The range for interest rates is consistent with the assumed changes in yield in paragraph 718(iv). Those banks using the alternative method for interest rate options set out in paragraph 718(LXiii) above should use, for each set of time-bands, the highest of the assumed changes in yield applicable to the group to which the time-bands belong.[158] The other ranges are ± 8% for equities[155], ± 8% for foreign exchange and gold, and ± 15% for commodities. For all risk categories, at least seven observations (including the current observation) should be used to divide the range into equally spaced intervals.

718(LXv). The second dimension of the matrix entails a change in the volatility of the underlying rate or price. A single change in the volatility of the underlying rate or price equal to a shift in volatility of + 25% and - 25% is expected to be sufficient in most cases. As circumstances warrant, however, the supervisory authority may choose to require that a different change in volatility be used and/or that intermediate points on the grid be calculated.

718(LXvi). After calculating the matrix each cell contains the net profit or loss of the option and the underlying hedge instrument. The capital charge for each underlying will then be calculated as the largest loss contained in the matrix.

718(LXvii). The application of the scenario analysis by any specific bank will be subject to supervisory consent, particularly as regards the precise way that the analysis is constructed. Banks' use of scenario analysis as part of the standardised methodology will also be subject to validation by the national authority, and to those of the qualitative standards listed in paragraphs 718(LXxiv) and 718(LXxv) which are appropriate given the nature of the business.

[158] If, for example, the time-bands 3 to 4 years, 4 to 5 years and 5 to 7 years are combined the highest assumed change in yield of these three bands would be 0.75.

718(lxviii). In drawing up these intermediate approaches the Committee has sought to cover the major risks associated with options. In doing so, it is conscious that so far as specific risk is concerned, only the delta-related elements are captured; to capture other risks would necessitate a much more complex regime. On the other hand, in other areas the simplifying assumptions used have resulted in a relatively conservative treatment of certain options positions. For these reasons, the Committee intends to keep this area under close review.

718(lxix). Besides the options risks mentioned above, the Committee is conscious of the other risks also associated with options, e.g. rho (rate of change of the value of the option with respect to the interest rate) and theta (rate of change of the value of the option with respect to time). While not proposing a measurement system for those risks at present, it expects banks undertaking significant options business at the very least to monitor such risks closely. Additionally, banks will be permitted to incorporate rho into their capital calculations for interest rate risk, if they wish to do so.

D. Market Risk – The Internal Models Approach

1. General criteria

718(lxx). The use of an internal model will be conditional upon the explicit approval of the bank's supervisory authority. Home and host country supervisory authorities of banks that carry out material trading activities in multiple jurisdictions intend to work co-operatively to ensure an efficient approval process.

718(lxxi). The supervisory authority will only give its approval if at a minimum:

- It is satisfied that the bank's risk management system is conceptually sound and is implemented with integrity;
- The bank has in the supervisory authority's view sufficient numbers of staff skilled in the use of sophisticated models not only in the trading area but also in the risk control, audit, and if necessary, back office areas;
- The bank's models have in the supervisory authority's judgement a proven track record of reasonable accuracy in measuring risk;
- The bank regularly conducts stress tests along the lines discussed in paragraphs 718(lxxvii) to 718(lxxxiv) below.

718(lxxii). Supervisory authorities will have the right to insist on a period of initial monitoring and live testing of a bank's internal model before it is used for supervisory capital purposes.

718(lxxiii). In addition to these general criteria, banks using internal models for capital purposes will be subject to the requirements detailed in paragraphs 718(lxxiv) to 718(xcix).

2. Qualitative standards

718(lxxiv). It is important that supervisory authorities are able to assure themselves that banks using models have market risk management systems that are conceptually sound and implemented with integrity. Accordingly, the supervisory authority will specify a number of *qualitative criteria* that banks would have to meet before they are permitted to use a models-based approach. The extent to which banks meet the qualitative criteria may influence the level at which supervisory authorities will set the multiplication factor referred to in paragraph 718(lxxvi) (j) below. Only those banks whose models are in full compliance with the qualitative criteria will be eligible for application of the minimum multiplication factor. The qualitative criteria include:

(a) The bank should have an independent risk control unit that is responsible for the design and implementation of the bank's risk management system. The unit should produce and analyse daily reports on the output of the bank's risk measurement model, including an evaluation of the relationship between measures of risk exposure and trading limits. This unit must be independent from business trading units and should report directly to senior management of the bank.

(b) The unit should conduct a regular back-testing programme, i.e. an ex-post comparison of the risk measure generated by the model against actual daily changes in portfolio value over longer periods of time, as well as hypothetical changes based on static positions.

(c) The unit should also conduct the initial and on-going validation of the internal model.[159]

(d) Board of directors and senior management should be actively involved in the risk control process and must regard risk control as an essential aspect of the business to which significant resources need to be devoted.[160] In this regard, the daily reports prepared by the independent risk control unit must be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual traders and reductions in the bank's overall risk exposure.

(e) The bank's internal risk measurement model must be closely integrated into the day-to-day risk management process of the bank. Its output should accordingly be an integral part of the process of planning, monitoring and controlling the bank's market risk profile.

(f) The risk measurement system should be used in conjunction with internal trading and exposure limits. In this regard, trading limits should be related to the bank's risk measurement model in a manner that is consistent over time and that is well-understood by both traders and senior management.

(g) A routine and rigorous programme of stress testing[161] should be in place as a supplement to the risk analysis based on the day-to-day output of the bank's risk measurement model. The results of stress testing should be reviewed periodically by senior management, used in the internal assessment of capital adequacy, and reflected in the policies and limits set by management and the board of directors. Where stress tests reveal particular vulnerability to a given set of circumstances, prompt steps should be taken to manage those risks appropriately (e.g. by hedging against that outcome or reducing the size of the bank's exposures, or increasing capital).

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[159] Further guidance regarding the standards that supervisory authorities will expect can be found in paragraph 718(xcix).

[160] The report, *Risk management guidelines for derivatives,* issued by the Basel Committee in July 1994 further discusses the responsibilities of the board of directors and senior management.

[161] Though banks will have some discretion as to how they conduct stress tests, their supervisory authorities will wish to see that they follow the general lines set out in paragraphs 718(Lxxvii) to 718(Lxxxiiii).

(h) Banks should have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the risk measurement system. The bank's risk measurement system must be well documented, for example, through a risk management manual that describes the basic principles of the risk management system and that provides an explanation of the empirical techniques used to measure market risk.

(i) An independent review of the risk measurement system should be carried out regularly in the bank's own internal auditing process. This review should include both the activities of the business trading units and of the independent risk control unit. A review of the overall risk management process should take place at regular intervals (ideally not less than once a year) and should specifically address, at a minimum:

- The adequacy of the documentation of the risk management system and process;
- The organisation of the risk control unit;
- The integration of market risk measures into daily risk management;
- The approval process for risk pricing models and valuation systems used by front and back-office personnel;
- The validation of any significant change in the risk measurement process;
- The scope of market risks captured by the risk measurement model;
- The integrity of the management information system;
- The accuracy and completeness of position data;
- The verification of the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources;
- The accuracy and appropriateness of volatility and correlation assumptions;
- The accuracy of valuation and risk transformation calculations;
- The verification of the model's accuracy through frequent back-testing as described in 718(LXXIV) (b) above and in the accompanying document: *Supervisory framework for the use of backtesting in conjunction with the internal models approach to market risk capital requirements*.

3. Specification of market risk factors

718(LXXV). An important part of a bank's internal market risk measurement system is the specification of an appropriate set of market risk factors, i.e. the market rates and prices that affect the value of the bank's trading positions. The risk factors contained in a market risk measurement system should be sufficient to capture the risks inherent in the bank's portfolio of on- and off-balance sheet trading positions. Although banks will have some discretion in specifying the risk factors for their internal models, the following guidelines should be fulfilled.

(a) For *interest rates*, there must be a set of risk factors corresponding to interest rates in each currency in which the bank has interest-rate-sensitive on- or off-balance sheet positions.

- The risk measurement system should model the yield curve using one of a number of generally accepted approaches, for example, by estimating forward rates of zero coupon yields. The yield curve should be divided into various maturity segments in order to capture variation in the volatility of rates along the yield curve; there will typically be one risk factor corresponding to each maturity segment. For material exposures to interest rate movements in the major currencies and markets, banks must model the yield curve using a minimum of six risk factors. However, the number of risk factors used should ultimately be driven by the nature of the bank's trading strategies. For instance, a bank with a portfolio of various types of securities across many points of the yield curve and that engages in complex arbitrage strategies would require a greater number of risk factors to capture interest rate risk accurately.

- The risk measurement system must incorporate separate risk factors to capture spread risk (e.g. between bonds and swaps). A variety of approaches may be used to capture the spread risk arising from less than perfectly correlated movements between government and other fixed-income interest rates, such as specifying a completely separate yield curve for non-government fixed-income instruments (for instance, swaps or municipal securities) or estimating the spread over government rates at various points along the yield curve.

(b) For *exchange rates* (which may include gold), the risk measurement system should incorporate risk factors corresponding to the individual foreign currencies in which the bank's positions are denominated. Since the value-at-risk figure calculated by the risk measurement system will be expressed in the bank's domestic currency, any net position denominated in a foreign currency will introduce a foreign exchange risk. Thus, there must be risk factors corresponding to the exchange rate between the domestic currency and each foreign currency in which the bank has a significant exposure.

(c) For *equity prices*, there should be risk factors corresponding to each of the equity markets in which the bank holds significant positions:

- At a minimum, there should be a risk factor that is designed to capture market-wide movements in equity prices (e.g. a market index). Positions in individual securities or in sector indices could be expressed in "beta-equivalents"[162] relative to this market-wide index;

- A somewhat more detailed approach would be to have risk factors corresponding to various sectors of the overall equity market (for instance, industry sectors or cyclical and non-cyclical sectors). As above, positions in

[162] A "beta-equivalent" position would be calculated from a market model of equity price returns (such as the CAPM model) by regressing the return on the individual stock or sector index on the risk-free rate of return and the return on the market index.

individual stocks within each sector could be expressed in beta-equivalents[49] relative to the sector index;

- The most extensive approach would be to have risk factors corresponding to the volatility of individual equity issues.

- The sophistication and nature of the modelling technique for a given market should correspond to the bank's exposure to the overall market as well as its concentration in individual equity issues in that market.

(d) For *commodity prices*, there should be risk factors corresponding to each of the commodity markets in which the bank holds significant positions (also see paragraph 718(xLvii) above):

- For banks with relatively limited positions in commodity-based instruments, a straightforward specification of risk factors would be acceptable. Such a specification would likely entail one risk factor for each commodity price to which the bank is exposed. In cases where the aggregate positions are quite small, it might be acceptable to use a single risk factor for a relatively broad sub-category of commodities (for instance, a single risk factor for all types of oil);

- For more active trading, the model must also take account of variation in the "convenience yield"[163] between derivatives positions such as forwards and swaps and cash positions in the commodity.

4. *Quantitative standards*

718(Lxxvi). Banks will have flexibility in devising the precise nature of their models, but the following minimum standards will apply for the purpose of calculating their capital charge. Individual banks or their supervisory authorities will have discretion to apply stricter standards.

(a) *"Value-at-risk"* must be computed on a daily basis.

(b) In calculating the value-at-risk, a 99th percentile, one-tailed *confidence interval* is to be used.

(c) In calculating value-at-risk, an instantaneous price shock equivalent to a 10 day movement in prices is to be used, i.e. the minimum *"holding period"* will be ten trading days. Banks may use value-at-risk numbers calculated according to shorter holding periods scaled up to ten days by the square root of time (for the treatment of options, also see 718(Lxxvi) (h) below).

(d) The choice of *historical observation period* (sample period) for calculating value-at-risk will be constrained to a minimum length of one year. For banks that use a weighting scheme or other methods for the historical observation period, the

[163] The convenience yield reflects the benefits from direct ownership of the physical commodity (for example, the ability to profit from temporary market shortages), and is affected both by market conditions and by factors such as physical storage costs.

"effective" observation period must be at least one year (that is, the weighted average time lag of the individual observations cannot be less than 6 months).

(e) Banks should update their *data sets* no less frequently than once every three months and should also reassess them whenever market prices are subject to material changes. The supervisory authority may also require a bank to calculate its value-at-risk using a shorter observation period if, in the supervisor's judgement, this is justified by a significant upsurge in price volatility.

(f) No particular *type of model* is prescribed. So long as each model used captures all the material risks run by the bank, as set out in paragraph 718(LXXV), banks will be free to use models based, for example, on variance-covariance matrices, historical simulations, or Monte Carlo simulations.

(g) Banks will have discretion to recognise empirical *correlations* within broad risk categories (e.g. interest rates, exchange rates, equity prices and commodity prices, including related options volatilities in each risk factor category). The supervisory authority may also recognise empirical correlations across broad risk factor categories, provided that the supervisory authority is satisfied that the bank's system for measuring correlations is sound and implemented with integrity.

(h) Banks' models must accurately capture the unique risks associated with *options* within each of the broad risk categories. The following criteria apply to the measurement of options risk:

- Banks' models must capture the *non-linear price characteristics* of options positions;
- Banks are expected to ultimately move towards the application of a full 10 day price shock to options positions or positions that display option-like characteristics. In the interim, national authorities may require banks to adjust their capital measure for options risk through other methods, e.g. periodic simulations or stress testing;
- Each bank's risk measurement system must have a set of risk factors that captures the *volatilities of the rates and prices* underlying option positions, i.e. vega risk. Banks with relatively large and/or complex options portfolios should have detailed specifications of the relevant volatilities. This means that banks should measure the volatilities of options positions broken down by different maturities.

(i) Each bank must meet, on a daily basis, a *capital requirement* expressed as the higher of (i) its previous day's value-at-risk number measured according to the parameters specified in this section and (ii) an average of the daily value-at-risk measures on each of the preceding sixty business days, multiplied by a multiplication factor.

(j) The multiplication factor will be set by individual supervisory authorities on the basis of their assessment of the quality of the bank's risk management system, subject to an absolute minimum of 3. Banks will be required to add to this factor a "plus" directly related to the ex-post performance of the model, thereby introducing a built-in positive incentive to maintain the predictive quality of the model. The plus will range from 0 to 1 based on the outcome of so-called "backtesting." If the backtesting results are satisfactory and the bank meets all of the qualitative standards set out in paragraph 718(LXXIV) above, the plus factor could be zero. The Annex 10a of this

Framework presents in detail the approach to be applied for backtesting and the plus factor. Supervisors will have national discretion to require banks to perform backtesting on either hypothetical (i.e. using changes in portfolio value that would occur were end-of-day positions to remain unchanged), or actual trading (i.e. excluding fees, commissions, and net interest income) outcomes, or both.

(k) Banks using models will also be subject to a capital charge to cover *specific risk* (as defined under the standardised approach for market risk) of interest rate related instruments and equity securities. The manner in which the specific risk capital charge is to be calculated is set out in paragraphs 718(Lxxxvii) to 718(xcviii).

5. Stress testing

718(Lxxvii). Banks that use the internal models approach for meeting market risk capital requirements must have in place a rigorous and comprehensive stress testing program. Stress testing to identify events or influences that could greatly impact banks is a key component of a bank's assessment of its capital position.

718(Lxxviii). Banks' stress scenarios need to cover a range of factors that can create extraordinary losses or gains in trading portfolios, or make the control of risk in those portfolios very difficult. These factors include low-probability events in all major types of risks, including the various components of market, credit, and operational risks. Stress scenarios need to shed light on the impact of such events on positions that display both linear and non-linear price characteristics (i.e. options and instruments that have options-like characteristics).

718(Lxxix). Banks' stress tests should be both of a quantitative and qualitative nature, incorporating both market risk and liquidity aspects of market disturbances. Quantitative criteria should identify plausible stress scenarios to which banks could be exposed. Qualitative criteria should emphasise that two major goals of stress testing are to evaluate the capacity of the bank's capital to absorb potential large losses and to identify steps the bank can take to reduce its risk and conserve capital. This assessment is integral to setting and evaluating the bank's management strategy and the results of stress testing should be routinely communicated to senior management and, periodically, to the bank's board of directors.

718(Lxxx). Banks should combine the use of supervisory stress scenarios with stress tests developed by banks themselves to reflect their specific risk characteristics. Specifically, supervisory authorities may ask banks to provide information on stress testing in three broad areas, which are discussed in turn below.

(i) Supervisory scenarios requiring no simulations by the bank

718(Lxxxi). Banks should have information on the largest losses experienced during the reporting period available for supervisory review. This loss information could be compared to the level of capital that results from a bank's internal measurement system. For example, it could provide supervisory authorities with a picture of how many days of peak day losses would have been covered by a given value-at-risk estimate.

(ii) Scenarios requiring a simulation by the bank

718(Lxxxii). Banks should subject their portfolios to a series of simulated stress scenarios and provide supervisory authorities with the results. These scenarios could include testing the current portfolio against past periods of significant disturbance, for example, the 1987 equity crash, the ERM crises of 1992 and 1993 or the fall in bond markets in the first quarter of 1994, incorporating both the large price movements and the sharp reduction in liquidity associated with these events. A second type of scenario would evaluate the sensitivity of the bank's market risk exposure to changes in the assumptions about volatilities and correlations. Applying this test would require an evaluation of the historical range of variation for volatilities and correlations and evaluation of the bank's current positions against the extreme values of the historical range. Due consideration should be given to the sharp variation that at times has occurred in a matter of days in periods of significant market disturbance. The 1987 equity crash, the suspension of the ERM, or the fall in bond markets in the first quarter of 1994, for example, all involved correlations within risk factors approaching the extreme values of 1 or -1 for several days at the height of the disturbance.

(iii) Scenarios developed by the bank itself to capture the specific characteristics of its portfolio.

718(LXXXiii). In addition to the scenarios prescribed by supervisory authorities under paragraphs 718(LXXXi) and 718(LXXXii) above, a bank should also develop its own stress tests which it identifies as most adverse based on the characteristics of its portfolio (e.g. problems in a key region of the world combined with a sharp move in oil prices). Banks should provide supervisory authorities with a description of the methodology used to identify and carry out the scenarios as well as with a description of the results derived from these scenarios.

718(LXXXiv). The results should be reviewed periodically by senior management and should be reflected in the policies and limits set by management and the board of directors. Moreover, if the testing reveals particular vulnerability to a given set of circumstances, the national authorities would expect the bank to take prompt steps to manage those risks appropriately (e.g. by hedging against that outcome or reducing the size of its exposures).

6. External validation

718(LXXXV). The validation of models' accuracy by external auditors and/or supervisory authorities should at a minimum include the following steps:

(a) Verifying that the *internal validation processes* described in paragraph 718(LXXiv) (i) are operating in a satisfactory manner;

(b) Ensuring that the *formulae* used in the calculation process as well as for the pricing of options and other complex instruments are validated by a qualified unit, which in all cases should be independent from the trading area;

(c) Checking that the *structure* of internal models is adequate with respect to the bank's activities and geographical coverage;

(d) Checking the results of the banks' *back-testing* of its internal measurement system (i.e. comparing value-at-risk estimates with actual profits and losses) to ensure that the model provides a reliable measure of potential losses over time. This means that banks should make the results as well as the underlying inputs to their value-at-risk calculations available to their supervisory authorities and/or external auditors on request;

(e) Making sure that data flows and processes associated with the risk measurement system are *transparent and accessible*. In particular, it is necessary that auditors or supervisory authorities are in a position to have easy access, whenever they judge it necessary and under appropriate procedures, to the models' specifications and parameters.

7. Combination of internal models and the standardised methodology

718(Lxxxvi). Unless a bank's exposure to a particular risk factor, such as commodity prices, is insignificant, the internal models approach will in principle require banks to have an integrated risk measurement system that captures the broad risk factor categories (i.e. interest rates, exchange rates (which may include gold), equity prices and commodity prices, with related options volatilities being included in each risk factor category). Thus, banks which start to use models for one or more risk factor categories will, over time, be expected to extend the models to all their market risks. A bank which has developed one or more models will no longer be able to revert to measuring the risk measured by those models according to the standardised methodology (unless the supervisory authority withdraws approval for that model). However, pending further experience regarding the process of changing to a models-based approach, no specific time limit will be set for banks which use a combination of internal models and the standardised methodology to move to a comprehensive model. The following conditions will apply to banks using such combinations:

(a) Each broad risk factor category must be assessed using a single approach (either internal models or the standardised approach), i.e. no combination of the two methods will in principle be permitted within a risk category or across banks' different entities for the same type of risk (but see paragraph 708(i) above);[164]

(b) All the criteria laid down in paragraphs 718(Lxx) to 718(xcix) of this Framework will apply to the models being used;

(c) Banks may not modify the combination of the two approaches they use without justifying to their supervisory authority that they have a good reason for doing so;

(d) No element of market risk may escape measurement, i.e. the exposure for all the various risk factors, whether calculated according to the standardised approach or internal models, would have to be captured;

(e) The capital charges assessed under the standardised approach and under the models approach are to be aggregated according to the simple sum method.

8. Treatment of specific risk

718(Lxxxvii). Where a bank has a VaR measure that incorporates specific risk and that meets all the qualitative and quantitative requirements for general risk models, it may base its charge on modelled estimates, provided the measure is based on models that meet the additional criteria and requirements set out below. Banks which are unable to meet these additional criteria and requirements will be required to base their specific risk capital charge on the full amount of the specific risk charge calculated under the standardised method.

718(Lxxxviii). The criteria for supervisory recognition of banks' modelling of specific risk require that a bank's model must capture all material components of price risk and be responsive to changes in market conditions and compositions of portfolios. In particular, the model must:

[164] However, banks may incur risks in positions which are not captured by their models, for example, in remote locations, in minor currencies or in negligible business areas. Such risks should be measured according to the standardised methodology.

- explain the historical price variation in the portfolio;[165]
- capture concentrations (magnitude and changes in composition);[166]
- be robust to an adverse environment;[167]
- capture name-related basis risk;[168]
- capture event risk;[169]
- be validated through backtesting.[170]

718(Lxxxix). Where a bank is subject to event risk that is not reflected in its VaR measure, because it is beyond the 10-day holding period and 99 percent confidence interval (i.e. low probability and high severity events), banks must ensure that the impact of such events is factored in to its internal capital assessment, for example through its stress testing.

718(xc). The bank's model must conservatively assess the risk arising from less liquid positions and/or positions with limited price transparency under realistic market scenarios. In addition, the model must meet minimum data standards. Proxies may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio, and only where they are appropriately conservative.

718(xci). Further, as techniques and best practices evolve, banks should avail themselves of these advances.

718(xcii). In addition, the bank must have an approach in place to capture in its regulatory capital default risk of its trading book positions that is incremental to the risk captured by the VaR-based calculation as specified in paragraph 718(Lxxxviii) above. To avoid double counting a bank may, when calculating its incremental default charge, take into account the

[165] The key ex ante measures of model quality are “goodness-of-fit” measures which address the question of how much of the historical variation in price value is explained by the risk factors included within the model. One measure of this type which can often be used is an R-squared measure from regression methodology. If this measure is to be used, the risk factors included in the bank’s model would be expected to be able to explain a high percentage, such as 90%, of the historical price variation or the model should explicitly include estimates of the residual variability not captured in the factors included in this regression. For some types of models, it may not be feasible to calculate a goodness-of-fit measure. In such instance, a bank is expected to work with its national supervisor to define an acceptable alternative measure which would meet this regulatory objective.

[166] The bank would be expected to demonstrate that the model is sensitive to changes in portfolio construction and that higher capital charges are attracted for portfolios that have increasing concentrations in particular names or sectors.

[167] The bank should be able to demonstrate that the model will signal rising risk in an adverse environment. This could be achieved by incorporating in the historical estimation period of the model at least one full credit cycle and ensuring that the model would not have been inaccurate in the downward portion of the cycle. Another approach for demonstrating this is through simulation of historical or plausible worst-case environments.

[168] Banks should be able to demonstrate that the model is sensitive to material idiosyncratic differences between similar but not identical positions, for example debt positions with different levels of subordination, maturity mismatches, or credit derivatives with different default events.

[169] For debt positions, this should include migration risk. For equity positions, events that are reflected in large changes or jumps in prices must be captured, e.g. merger break-ups/takeovers. In particular, firms must consider issues related to survivorship bias.

[170] Aimed at assessing whether specific risk, as well as general market risk, is being captured adequately.

extent to which default risk has already been incorporated into the VaR calculation, especially for risk positions that could and would be closed within 10 days in the event of adverse market conditions or other indications of deterioration in the credit environment. No specific approach for capturing the incremental default risk is prescribed; it may be part of the bank's internal model or a surcharge from a separate calculation. Where a bank captures its incremental risk through a surcharge, the surcharge will not be subject to a multiplier or regulatory backtesting, although the bank should be able to demonstrate that the surcharge meets its aim.

718(xciii). Whichever approach is used, the bank must demonstrate that it meets a soundness standard comparable to that of the internal-ratings based approach for credit risk as set forth in this Framework, under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging, and optionality. A bank that does not capture the incremental default risk through an internally developed approach must use the fallback of calculating the surcharge through an approach consistent with that for credit risk as set forth in this Framework.

718(xciv). Whichever approach is used, cash or synthetic exposures that would be subject to a deduction treatment under the securitisation framework set forth in this Framework (e.g. equity tranches that absorb first losses),[171] as well as securitisation exposures that are unrated liquidity lines or letters of credit, would be subject to a capital charge that is no less than that set forth in the securitisation framework.

718(xcv). An exception to this treatment could be afforded to banks that are dealers in the above exposures where they can demonstrate, in addition to trading intent, that a liquid two-way market exists for the securitisation exposures or, in the case of synthetic securitisations that rely solely on credit derivatives, for the securitisation exposures themselves or all their constituent risk components. For purposes of this section, a two-way market is deemed to exist where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at such price within a relatively short time conforming to trade custom. In addition, for a bank to apply this exception, it must have sufficient market data to ensure that it fully captures the concentrated default risk of these exposures in its internal approach for measuring the incremental default risk in accordance with the standards set forth above.

718(xcvi). Banks that already have received specific risk model recognition for particular portfolios or lines of business should agree a timetable with their supervisors to bring their model in line with the new standards in a timely manner as is practicable.

718(xcvii). Banks which apply modelled estimates of specific risk are required to conduct backtesting aimed at assessing whether specific risk is being accurately captured. The methodology a bank should use for validating its specific risk estimates is to perform separate backtests on sub-portfolios using daily data on sub-portfolios subject to specific risk. The key sub-portfolios for this purpose are traded-debt and equity positions. However, if a bank itself decomposes its trading portfolio into finer categories (e.g. emerging markets, traded corporate debt, etc.), it is appropriate to keep these distinctions for sub-portfolio backtesting purposes. Banks are required to commit to a sub-portfolio structure and stick to it

[171] These include risk equivalent positions, e.g. inventories of credit exposures that the bank intends to sell through cash securitisations and for which it has in place tranched credit protections so that it retains an exposure that would be subject to deduction under the securitisation framework.

unless it can be demonstrated to the supervisor that it would make sense to change the structure.

718(xcviii). Banks are required to have in place a process to analyse exceptions identified through the backtesting of specific risk. This process is intended to serve as the fundamental way in which banks correct their models of specific risk in the event they become inaccurate. There will be a presumption that models that incorporate specific risk are "unacceptable" if the results at the sub-portfolio level produce a number of exceptions commensurate with the *Red Zone* as defined in Annex 10a of this Framework. Banks with "unacceptable" specific risk models are expected to take immediate action to correct the problem in the model and to ensure that there is a sufficient capital buffer to absorb the risk that the backtest showed had not been adequately captured.

9. Model validation standards

718(xcix). It is important that banks have processes in place to ensure that their internal models have been adequately validated by suitably qualified parties independent of the development process to ensure that they are conceptually sound and adequately capture all material risks. This validation should be conducted when the model is initially developed and when any significant changes are made to the model. The validation should also be conducted on a periodic basis but especially where there have been any significant structural changes in the market or changes to the composition of the portfolio which might lead to the model no longer being adequate. More extensive model validation is particularly important where specific risk is also modelled and is required to meet the further specific risk criteria. As techniques and best practices evolve, banks should avail themselves of these advances. Model validation should not be limited to backtesting, but should, at a minimum, also include the following:

(a) Tests to demonstrate that any assumptions made within the internal model are appropriate and do not underestimate risk. This may include the assumption of the normal distribution, the use of the square root of time to scale from a one day holding period to a 10 day holding period or where extrapolation or interpolation techniques are used, or pricing models;

(b) Further to the regulatory backtesting programmes, testing for model validation should be carried out using additional tests, which may include, for instance:

- Testing carried out using hypothetical changes in portfolio value that would occur were end-of-day positions to remain unchanged. It therefore excludes fees, commissions, bid-ask spreads, net interest income and intra-day trading;

- Testing carried out for longer periods than required for the regular backtesting programme (e.g. 3 years). The longer time period generally improves the power of the backtesting. A longer time period may not be desirable if the VaR model or market conditions have changed to the extent that historical data is no longer relevant;

- Testing carried out using confidence intervals other than the 99 percent interval required under the quantitative standards;

- Testing of portfolios below the overall bank level;

(c) The use of hypothetical portfolios to ensure that the model is able to account for particular structural features that may arise, for example:

- Where data histories for a particular instrument do not meet the quantitative standards in paragraph 718(LXXVI) and where the bank has to map these positions to proxies, then the bank must ensure that the proxies produce conservative results under relevant market scenarios;

- Ensuring that material basis risks are adequately captured. This may include mismatches between long and short positions by maturity or by issuer;

- Ensuring that the model captures concentration risk that may arise in an undiversified portfolio.

Part 3: The Second Pillar – Supervisory Review Process

719. This section discusses the key principles of supervisory review, risk management guidance and supervisory transparency and accountability produced by the Committee with respect to banking risks, including guidance relating to, among other things, the treatment of interest rate risk in the banking book, credit risk (stress testing, definition of default, residual risk, and credit concentration risk), operational risk, enhanced cross-border communication and cooperation, and securitisation.

I. Importance of supervisory review

720. The supervisory review process of the Framework is intended not only to ensure that banks have adequate capital to support all the risks in their business, but also to encourage banks to develop and use better risk management techniques in monitoring and managing their risks.

721. The supervisory review process recognises the responsibility of bank management in developing an internal capital assessment process and setting capital targets that are commensurate with the bank's risk profile and control environment. In the Framework, bank management continues to bear responsibility for ensuring that the bank has adequate capital to support its risks beyond the core minimum requirements.

722. Supervisors are expected to evaluate how well banks are assessing their capital needs relative to their risks and to intervene, where appropriate. This interaction is intended to foster an active dialogue between banks and supervisors such that when deficiencies are identified, prompt and decisive action can be taken to reduce risk or restore capital. Accordingly, supervisors may wish to adopt an approach to focus more intensely on those banks with risk profiles or operational experience that warrants such attention.

723. The Committee recognises the relationship that exists between the amount of capital held by the bank against its risks and the strength and effectiveness of the bank's risk management and internal control processes. However, increased capital should not be viewed as the only option for addressing increased risks confronting the bank. Other means for addressing risk, such as strengthening risk management, applying internal limits, strengthening the level of provisions and reserves, and improving internal controls, must also be considered. Furthermore, capital should not be regarded as a substitute for addressing fundamentally inadequate control or risk management processes.

724. There are three main areas that might be particularly suited to treatment under Pillar 2: risks considered under Pillar 1 that are not fully captured by the Pillar 1 process (e.g. credit concentration risk); those factors not taken into account by the Pillar 1 process (e.g. interest rate risk in the banking book, business and strategic risk); and factors external to the bank (e.g. business cycle effects). A further important aspect of Pillar 2 is the assessment of compliance with the minimum standards and disclosure requirements of the more advanced methods in Pillar 1, in particular the IRB framework for credit risk and the Advanced Measurement Approaches for operational risk. Supervisors must ensure that these requirements are being met, both as qualifying criteria and on a continuing basis.

II. Four key principles of supervisory review

725. The Committee has identified four key principles of supervisory review, which complement those outlined in the extensive supervisory guidance that has been developed by the Committee, the keystone of which is the Core Principles for Effective Banking Supervision and the Core Principles Methodology.[172] A list of the specific guidance relating to the management of banking risks is provided at the end of this Part of the Framework.

Principle 1: Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.

726. Banks must be able to demonstrate that chosen internal capital targets are well founded and that these targets are consistent with their overall risk profile and current operating environment. In assessing capital adequacy, bank management needs to be mindful of the particular stage of the business cycle in which the bank is operating. Rigorous, forward-looking stress testing that identifies possible events or changes in market conditions that could adversely impact the bank should be performed. Bank management clearly bears primary responsibility for ensuring that the bank has adequate capital to support its risks.

727. The five main features of a rigorous process are as follows:

- Board and senior management oversight;
- Sound capital assessment;
- Comprehensive assessment of risks;
- Monitoring and reporting; and
- Internal control review.

1. Board and senior management oversight[173]

728. A sound risk management process is the foundation for an effective assessment of the adequacy of a bank's capital position. Bank management is responsible for understanding the nature and level of risk being taken by the bank and how this risk relates to adequate capital levels. It is also responsible for ensuring that the formality and sophistication of the risk management processes are appropriate in light of the risk profile and business plan.

[172] *Core Principles for Effective Banking Supervision,* Basel Committee on Banking Supervision (September 1997 and April 2006 – for comment), and *Core Principles Methodology,* Basel Committee on Banking Supervision (October 1999 and April 2006 – for comment).

[173] This section of the paper refers to a management structure composed of a board of directors and senior management. The Committee is aware that there are significant differences in legislative and regulatory frameworks across countries as regards the functions of the board of directors and senior management. In some countries, the board has the main, if not exclusive, function of supervising the executive body (senior management, general management) so as to ensure that the latter fulfils its tasks. For this reason, in some cases, it is known as a supervisory board. This means that the board has no executive functions. In other countries, by contrast, the board has a broader competence in that it lays down the general framework for the management of the bank. Owing to these differences, the notions of the board of directors and senior management are used in this section not to identify legal constructs but rather to label two decision-making functions within a bank.

729. The analysis of a bank's current and future capital requirements in relation to its strategic objectives is a vital element of the strategic planning process. The strategic plan should clearly outline the bank's capital needs, anticipated capital expenditures, desirable capital level, and external capital sources. Senior management and the board should view capital planning as a crucial element in being able to achieve its desired strategic objectives.

730. The bank's board of directors has responsibility for setting the bank's tolerance for risks. It should also ensure that management establishes a framework for assessing the various risks, develops a system to relate risk to the bank's capital level, and establishes a method for monitoring compliance with internal policies. It is likewise important that the board of directors adopts and supports strong internal controls and written policies and procedures and ensures that management effectively communicates these throughout the organisation.

2. Sound capital assessment

731. Fundamental elements of sound capital assessment include:

- Policies and procedures designed to ensure that the bank identifies, measures, and reports all material risks;
- A process that relates capital to the level of risk;
- A process that states capital adequacy goals with respect to risk, taking account of the bank's strategic focus and business plan; and
- A process of internal controls, reviews and audit to ensure the integrity of the overall management process.

3. Comprehensive assessment of risks

732. All material risks faced by the bank should be addressed in the capital assessment process. While the Committee recognises that not all risks can be measured precisely, a process should be developed to estimate risks. Therefore, the following risk exposures, which by no means constitute a comprehensive list of *all* risks, should be considered.

733. ***Credit risk:*** Banks should have methodologies that enable them to assess the credit risk involved in exposures to individual borrowers or counterparties as well as at the portfolio level. For more sophisticated banks, the credit review assessment of capital adequacy, at a minimum, should cover four areas: risk rating systems, portfolio analysis/aggregation, securitisation/complex credit derivatives, and large exposures and risk concentrations.

734. Internal risk ratings are an important tool in monitoring credit risk. Internal risk ratings should be adequate to support the identification and measurement of risk from all credit exposures, and should be integrated into an institution's overall analysis of credit risk and capital adequacy. The ratings system should provide detailed ratings for all assets, not only for criticised or problem assets. Loan loss reserves should be included in the credit risk assessment for capital adequacy.

735. The analysis of credit risk should adequately identify any weaknesses at the portfolio level, including any concentrations of risk. It should also adequately take into consideration the risks involved in managing credit concentrations and other portfolio issues through such mechanisms as securitisation programmes and complex credit derivatives. Further, the analysis of counterparty credit risk should include consideration of public

evaluation of the supervisor's compliance with the Core Principles for Effective Banking Supervision.

736. ***Operational risk:*** The Committee believes that similar rigour should be applied to the management of operational risk, as is done for the management of other significant banking risks. The failure to properly manage operational risk can result in a misstatement of an institution's risk/return profile and expose the institution to significant losses.

737. A bank should develop a framework for managing operational risk and evaluate the adequacy of capital given this framework. The framework should cover the bank's appetite and tolerance for operational risk, as specified through the policies for managing this risk, including the extent and manner in which operational risk is transferred outside the bank. It should also include policies outlining the bank's approach to identifying, assessing, monitoring and controlling/mitigating the risk.

738. ***Market risk***: Banks should have methodologies that enable them to assess and actively manage all material market risks, wherever they arise, at position, desk, business line and firm-wide level. For more sophisticated banks, their assessment of internal capital adequacy for market risk, at a minimum, should be based on both VaR modelling and stress testing, including an assessment of concentration risk and the assessment of illiquidity under stressful market scenarios, although all firms' assessments should include stress testing appropriate to their trading activity.

738(i). VaR is an important tool in monitoring aggregate market risk exposures and provides a common metric for comparing the risk being run by different desks and business lines. A bank's VaR model should be adequate to identify and measure risks arising from all its trading activities and should be integrated into the bank's overall internal capital assessment as well as subject to rigorous on-going validation. A VaR model estimates should be sensitive to changes in the trading book risk profile.

738(ii). Banks must supplement their VaR model with stress tests (factor shocks or integrated scenarios whether historic or hypothetical) and other appropriate risk management techniques. In the bank's internal capital assessment it must demonstrate that it has enough capital to not only meet the minimum capital requirements but also to withstand a range of severe but plausible market shocks. In particular, it must factor in, where appropriate:

- Illiquidity/gapping of prices;
- Concentrated positions (in relation to market turnover);
- One-way markets;
- Non-linear products/deep out-of-the money positions;
- Events and jumps-to-defaults;
- Significant shifts in correlations;
- Other risks that may not be captured appropriately in VaR (e.g. recovery rate uncertainty, implied correlations, or skew risk).

The stress tests applied by a bank and, in particular, the calibration of those tests (e.g. the parameters of the shocks or types of events considered) should be reconciled back to a clear statement setting out the premise upon which the bank's internal capital assessment is based (e.g. ensuring there is adequate capital to manage the traded portfolios within stated limits through what may be a prolonged period of market stress and illiquidity, or that there is adequate capital to ensure that, over a given time horizon to a specified confidence level, all positions can be liquidated or the risk hedged in an orderly fashion). The market shocks applied in the tests must reflect the nature of portfolios and the time it could take to hedge out or manage risks under severe market conditions.

738(iii). Concentration risk should be pro-actively managed and assessed by firms and concentrated positions should be routinely reported to senior management.

738(iv). Banks should design their risk management systems, including the VaR methodology and stress tests, to properly measure the material risks in instruments they trade as well as the trading strategies they pursue. As their instruments and trading strategies change, the VaR methodologies and stress tests should also evolve to accommodate the changes.

738(v). Banks must demonstrate how they combine their risk measurement approaches to arrive at the overall internal capital for market risk.

739. ***Interest rate risk in the banking book:*** The measurement process should include all material interest rate positions of the bank and consider all relevant repricing and maturity data. Such information will generally include current balance and contractual rate of interest associated with the instruments and portfolios, principal payments, interest reset dates, maturities, the rate index used for repricing, and contractual interest rate ceilings or floors for adjustable-rate items. The system should also have well-documented assumptions and techniques.

740. Regardless of the type and level of complexity of the measurement system used, bank management should ensure the adequacy and completeness of the system. Because the quality and reliability of the measurement system is largely dependent on the quality of the data and various assumptions used in the model, management should give particular attention to these items.

741. ***Liquidity risk:*** Liquidity is crucial to the ongoing viability of any banking organisation. Banks' capital positions can have an effect on their ability to obtain liquidity, especially in a crisis. Each bank must have adequate systems for measuring, monitoring and controlling liquidity risk. Banks should evaluate the adequacy of capital given their own liquidity profile and the liquidity of the markets in which they operate.

742***.*** ***Other risks:*** Although the Committee recognises that 'other' risks, such as reputational and strategic risk, are not easily measurable, it expects industry to further develop techniques for managing all aspects of these risks.

4. Monitoring and reporting

743. The bank should establish an adequate system for monitoring and reporting risk exposures and assessing how the bank's changing risk profile affects the need for capital. The bank's senior management or board of directors should, on a regular basis, receive reports on the bank's risk profile and capital needs. These reports should allow senior management to:

- Evaluate the level and trend of material risks and their effect on capital levels;
- Evaluate the sensitivity and reasonableness of key assumptions used in the capital assessment measurement system;
- Determine that the bank holds sufficient capital against the various risks and is in compliance with established capital adequacy goals; and

- Assess its future capital requirements based on the bank's reported risk profile and make necessary adjustments to the bank's strategic plan accordingly.

5. Internal control review

744. The bank's internal control structure is essential to the capital assessment process. Effective control of the capital assessment process includes an independent review and, where appropriate, the involvement of internal or external audits. The bank's board of directors has a responsibility to ensure that management establishes a system for assessing the various risks, develops a system to relate risk to the bank's capital level, and establishes a method for monitoring compliance with internal policies. The board should regularly verify whether its system of internal controls is adequate to ensure well-ordered and prudent conduct of business.

745. The bank should conduct periodic reviews of its risk management process to ensure its integrity, accuracy, and reasonableness. Areas that should be reviewed include:

- Appropriateness of the bank's capital assessment process given the nature, scope and complexity of its activities;
- Identification of large exposures and risk concentrations;
- Accuracy and completeness of data inputs into the bank's assessment process;
- Reasonableness and validity of scenarios used in the assessment process; and
- Stress testing and analysis of assumptions and inputs.

Principle 2: Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the result of this process.

746. The supervisory authorities should regularly review the process by which a bank assesses its capital adequacy, risk position, resulting capital levels, and quality of capital held. Supervisors should also evaluate the degree to which a bank has in place a sound internal process to assess capital adequacy. The emphasis of the review should be on the quality of the bank's risk management and controls and should not result in supervisors functioning as bank management. The periodic review can involve some combination of:

- On-site examinations or inspections;
- Off-site review;
- Discussions with bank management;
- Review of work done by external auditors (provided it is adequately focused on the necessary capital issues); and
- Periodic reporting.

747. The substantial impact that errors in the methodology or assumptions of formal analyses can have on resulting capital requirements requires a detailed review by supervisors of each bank's internal analysis.

1. Review of adequacy of risk assessment

748. Supervisors should assess the degree to which internal targets and processes incorporate the full range of material risks faced by the bank. Supervisors should also review the adequacy of risk measures used in assessing internal capital adequacy and the extent to which these risk measures are also used operationally in setting limits, evaluating business line performance, and evaluating and controlling risks more generally. Supervisors should consider the results of sensitivity analyses and stress tests conducted by the institution and how these results relate to capital plans.

2. Assessment of capital adequacy

749. Supervisors should review the bank's processes to determine that:

- Target levels of capital chosen are comprehensive and relevant to the current operating environment;
- These levels are properly monitored and reviewed by senior management; and
- The composition of capital is appropriate for the nature and scale of the bank's business.

750. Supervisors should also consider the extent to which the bank has provided for unexpected events in setting its capital levels. This analysis should cover a wide range of external conditions and scenarios, and the sophistication of techniques and stress tests used should be commensurate with the bank's activities.

3. Assessment of the control environment

751. Supervisors should consider the quality of the bank's management information reporting and systems, the manner in which business risks and activities are aggregated, and management's record in responding to emerging or changing risks.

752. In all instances, the capital level at an individual bank should be determined according to the bank's risk profile and adequacy of its risk management process and internal controls. External factors such as business cycle effects and the macroeconomic environment should also be considered.

4. Supervisory review of compliance with minimum standards

753. In order for certain internal methodologies, credit risk mitigation techniques and asset securitisations to be recognised for regulatory capital purposes, banks will need to meet a number of requirements, including risk management standards and disclosures. In particular, banks will be required to disclose features of their internal methodologies used in calculating minimum capital requirements. As part of the supervisory review process, supervisors must ensure that these conditions are being met on an ongoing basis.

754. The Committee regards this review of minimum standards and qualifying criteria as an integral part of the supervisory review process under Principle 2. In setting the minimum criteria the Committee has considered current industry practice and so anticipates that these minimum standards will provide supervisors with a useful set of benchmarks that are aligned with bank management expectations for effective risk management and capital allocation.

755. There is also an important role for supervisory review of compliance with certain conditions and requirements set for standardised approaches. In this context, there will be a particular need to ensure that use of various instruments that can reduce Pillar 1 capital requirements are utilised and understood as part of a sound, tested, and properly documented risk management process.

5. Supervisory response

756. Having carried out the review process described above, supervisors should take appropriate action if they are not satisfied with the results of the bank's own risk assessment and capital allocation. Supervisors should consider a range of actions, such as those set out under Principles 3 and 4 below.

Principle 3: Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.

757. Pillar 1 capital requirements will include a buffer for uncertainties surrounding the Pillar 1 regime that affect the banking population as a whole. Bank-specific uncertainties will be treated under Pillar 2. It is anticipated that such buffers under Pillar 1 will be set to provide reasonable assurance that a bank with good internal systems and controls, a well-diversified risk profile and a business profile well covered by the Pillar 1 regime, and which operates with capital equal to Pillar 1 requirements, will meet the minimum goals for soundness embodied in Pillar 1. However, supervisors will need to consider whether the particular features of the markets for which they are responsible are adequately covered. Supervisors will typically require (or encourage) banks to operate with a buffer, over and above the Pillar 1 standard. Banks should maintain this buffer for a combination of the following:

(a) Pillar 1 minimums are anticipated to be set to achieve a level of bank creditworthiness in markets that is below the level of creditworthiness sought by many banks for their own reasons. For example, most international banks appear to prefer to be highly rated by internationally recognised rating agencies. Thus, banks are likely to choose to operate above Pillar 1 minimums for competitive reasons.

(b) In the normal course of business, the type and volume of activities will change, as will the different risk exposures, causing fluctuations in the overall capital ratio.

(c) It may be costly for banks to raise additional capital, especially if this needs to be done quickly or at a time when market conditions are unfavourable.

(d) For banks to fall below minimum regulatory capital requirements is a serious matter. It may place banks in breach of the relevant law and/or prompt non-discretionary corrective action on the part of supervisors.

(e) There may be risks, either specific to individual banks, or more generally to an economy at large, that are not taken into account in Pillar 1.

758. There are several means available to supervisors for ensuring that individual banks are operating with adequate levels of capital. Among other methods, the supervisor may set trigger and target capital ratios or define categories above minimum ratios (e.g. well capitalised and adequately capitalised) for identifying the capitalisation level of the bank.

Principle 4: Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.

759. Supervisors should consider a range of options if they become concerned that a bank is not meeting the requirements embodied in the supervisory principles outlined above. These actions may include intensifying the monitoring of the bank, restricting the payment of dividends, requiring the bank to prepare and implement a satisfactory capital adequacy restoration plan, and requiring the bank to raise additional capital immediately. Supervisors should have the discretion to use the tools best suited to the circumstances of the bank and its operating environment.

760. The permanent solution to banks' difficulties is not always increased capital. However, some of the required measures (such as improving systems and controls) may take a period of time to implement. Therefore, increased capital might be used as an interim measure while permanent measures to improve the bank's position are being put in place. Once these permanent measures have been put in place and have been seen by supervisors to be effective, the interim increase in capital requirements can be removed.

III. Specific issues to be addressed under the supervisory review process

761. The Committee has identified a number of important issues that banks and supervisors should particularly focus on when carrying out the supervisory review process. These issues include some key risks which are not directly addressed under Pillar 1 and important assessments that supervisors should make to ensure the proper functioning of certain aspects of Pillar 1.

A. Interest rate risk in the banking book

762. The Committee remains convinced that interest rate risk in the banking book is a potentially significant risk which merits support from capital. However, comments received from the industry and additional work conducted by the Committee have made it clear that there is considerable heterogeneity across internationally active banks in terms of the nature of the underlying risk and the processes for monitoring and managing it. In light of this, the Committee has concluded that it is at this time most appropriate to treat interest rate risk in the banking book under Pillar 2 of the Framework. Nevertheless, supervisors who consider that there is sufficient homogeneity within their banking populations regarding the nature and methods for monitoring and measuring this risk could establish a mandatory minimum capital requirement.

763. The revised guidance on interest rate risk recognises banks' internal systems as the principal tool for the measurement of interest rate risk in the banking book and the supervisory response. To facilitate supervisors' monitoring of interest rate risk exposures across institutions, banks would have to provide the results of their internal measurement systems, expressed in terms of economic value relative to capital, using a standardised interest rate shock.

764. If supervisors determine that banks are not holding capital commensurate with the level of interest rate risk, they must require the bank to reduce its risk, to hold a specific additional amount of capital or some combination of the two. Supervisors should be

particularly attentive to the sufficiency of capital of 'outlier banks' where economic value declines by more than 20% of the sum of Tier 1 and Tier 2 capital as a result of a standardised interest rate shock (200 basis points) or its equivalent, as described in the supporting document *Principles for the Management and Supervision of Interest Rate Risk*.

B. Credit risk

1. Stress tests under the IRB approaches

765. A bank should ensure that it has sufficient capital to meet the Pillar 1 requirements and the results (where a deficiency has been indicated) of the credit risk stress test performed as part of the Pillar 1 IRB minimum requirements (paragraphs 434 to 437). Supervisors may wish to review how the stress test has been carried out. The results of the stress test will thus contribute directly to the expectation that a bank will operate above the Pillar 1 minimum regulatory capital ratios. Supervisors will consider whether a bank has sufficient capital for these purposes. To the extent that there is a shortfall, the supervisor will react appropriately. This will usually involve requiring the bank to reduce its risks and/or to hold additional capital/provisions, so that existing capital resources could cover the Pillar 1 requirements plus the result of a recalculated stress test.

2. Definition of default

766. A bank must use the reference definition of default for its internal estimations of PD and/or LGD and EAD. However, as detailed in paragraph 454, national supervisors will issue guidance on how the reference definition of default is to be interpreted in their jurisdictions. Supervisors will assess individual banks' application of the reference definition of default and its impact on capital requirements. In particular, supervisors will focus on the impact of deviations from the reference definition according to paragraph 456 (use of external data or historic internal data not fully consistent with the reference definition of default).

3. Residual risk

767. The Framework allows banks to offset credit or counterparty risk with collateral, guarantees or credit derivatives, leading to reduced capital charges. While banks use credit risk mitigation (CRM) techniques to reduce their credit risk, these techniques give rise to risks that may render the overall risk reduction less effective. Accordingly these risks (e.g. legal risk, documentation risk, or liquidity risk) to which banks are exposed are of supervisory concern. Where such risks arise, and irrespective of fulfilling the minimum requirements set out in Pillar 1, a bank could find itself with greater credit risk exposure to the underlying counterparty than it had expected. Examples of these risks include:

- Inability to seize, or realise in a timely manner, collateral pledged (on default of the counterparty);
- Refusal or delay by a guarantor to pay; and
- Ineffectiveness of untested documentation.

768. Therefore, supervisors will require banks to have in place appropriate written CRM policies and procedures in order to control these residual risks. A bank may be required to submit these policies and procedures to supervisors and must regularly review their appropriateness, effectiveness and operation.

769. In its CRM policies and procedures, a bank must consider whether, when calculating capital requirements, it is appropriate to give the full recognition of the value of the credit risk

mitigant as permitted in Pillar 1 and must demonstrate that its CRM management policies and procedures are appropriate to the level of capital benefit that it is recognising. Where supervisors are not satisfied as to the robustness, suitability or application of these policies and procedures they may direct the bank to take immediate remedial action or hold additional capital against residual risk until such time as the deficiencies in the CRM procedures are rectified to the satisfaction of the supervisor. For example, supervisors may direct a bank to:

- Make adjustments to the assumptions on holding periods, supervisory haircuts, or volatility (in the own haircuts approach);
- Give less than full recognition of credit risk mitigants (on the whole credit portfolio or by specific product line); and/or
- Hold a specific additional amount of capital.

4. Credit concentration risk

770. A risk concentration is any single exposure or group of exposures with the potential to produce losses large enough (relative to a bank's capital, total assets, or overall risk level) to threaten a bank's health or ability to maintain its core operations. Risk concentrations are arguably the single most important cause of major problems in banks.

771. Risk concentrations can arise in a bank's assets, liabilities, or off-balance sheet items, through the execution or processing of transactions (either product or service), or through a combination of exposures across these broad categories. Because lending is the primary activity of most banks, credit risk concentrations are often the most material risk concentrations within a bank.

772. Credit risk concentrations, by their nature, are based on common or correlated risk factors, which, in times of stress, have an adverse effect on the creditworthiness of each of the individual counterparties making up the concentration. Concentration risk arises in both direct exposures to obligors and may also occur through exposures to protection providers. Such concentrations are not addressed in the Pillar 1 capital charge for credit risk.

773. Banks should have in place effective internal policies, systems and controls to identify, measure, monitor, and control their credit risk concentrations. Banks should explicitly consider the extent of their credit risk concentrations in their assessment of capital adequacy under Pillar 2. These policies should cover the different forms of credit risk concentrations to which a bank may be exposed. Such concentrations include:

- Significant exposures to an individual counterparty or group of related counterparties. In many jurisdictions, supervisors define a limit for exposures of this nature, commonly referred to as a large exposure limit. Banks might also establish an aggregate limit for the management and control of all of its large exposures as a group;
- Credit exposures to counterparties in the same economic sector or geographic region;
- Credit exposures to counterparties whose financial performance is dependent on the same activity or commodity; and
- Indirect credit exposures arising from a bank's CRM activities (e.g. exposure to a single collateral type or to credit protection provided by a single counterparty).

774. A bank's framework for managing credit risk concentrations should be clearly documented and should include a definition of the credit risk concentrations relevant to the

bank and how these concentrations and their corresponding limits are calculated. Limits should be defined in relation to a bank's capital, total assets or, where adequate measures exist, its overall risk level.

775. A bank's management should conduct periodic stress tests of its major credit risk concentrations and review the results of those tests to identify and respond to potential changes in market conditions that could adversely impact the bank's performance.

776. A bank should ensure that, in respect of credit risk concentrations, it complies with the Committee document *Principles for the Management of Credit Risk* (September 2000) and the more detailed guidance in the Appendix to that paper.

777. In the course of their activities, supervisors should assess the extent of a bank's credit risk concentrations, how they are managed, and the extent to which the bank considers them in its internal assessment of capital adequacy under Pillar 2. Such assessments should include reviews of the results of a bank's stress tests. Supervisors should take appropriate actions where the risks arising from a bank's credit risk concentrations are not adequately addressed by the bank.

5. Counterparty credit risk

777(i). As counterparty credit risk (CCR) represents a form of credit risk, this would include meeting this Framework's standards regarding their approaches to stress testing, "residual risks" associated with credit risk mitigation techniques, and credit concentrations, as specified in the paragraphs above.

777(ii). The bank must have counterparty credit risk management policies, processes and systems that are conceptually sound and implemented with integrity relative to the sophistication and complexity of a firm's holdings of exposures that give rise to CCR. A sound counterparty credit risk management framework shall include the identification, measurement, management, approval and internal reporting of CCR.

777(iii). The bank's risk management policies must take account of the market, liquidity, legal and operational risks that can be associated with CCR and, to the extent practicable, interrelationships among those risks. The bank must not undertake business with a counterparty without assessing its creditworthiness and must take due account of both settlement and pre-settlement credit risk. These risks must be managed as comprehensively as practicable at the counterparty level (aggregating counterparty exposures with other credit exposures) and at the firm-wide level.

777(iv). The board of directors and senior management must be actively involved in the CCR control process and must regard this as an essential aspect of the business to which significant resources need to be devoted. Where the bank is using an internal model for CCR, senior management must be aware of the limitations and assumptions of the model used and the impact these can have on the reliability of the output. They should also consider the uncertainties of the market environment (e.g. timing of realisation of collateral) and operational issues (e.g. pricing feed irregularities) and be aware of how these are reflected in the model.

777(v). In this regard, the daily reports prepared on a firm's exposures to CCR must be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the firm's overall CCR exposure.

777(vi). The bank's CCR management system must be used in conjunction with internal credit and trading limits. In this regard, credit and trading limits must be related to the firm's risk measurement model in a manner that is consistent over time and that is well understood by credit managers, traders and senior management.

777(vii). The measurement of CCR must include monitoring daily and intra-day usage of credit lines. The bank must measure current exposure gross and net of collateral held where such measures are appropriate and meaningful (e.g. OTC derivatives, margin lending, etc.). Measuring and monitoring peak exposure or potential future exposure (PFE) at a confidence level chosen by the bank at both the portfolio and counterparty levels is one element of a robust limit monitoring system. Banks must take account of large or concentrated positions, including concentrations by groups of related counterparties, by industry, by market, customer investment strategies, etc.

777(viii). The bank must have a routine and rigorous program of stress testing in place as a supplement to the CCR analysis based on the day-to-day output of the firm's risk measurement model. The results of this stress testing must be reviewed periodically by senior management and must be reflected in the CCR policies and limits set by management and the board of directors. Where stress tests reveal particular vulnerability to a given set of circumstances, management should explicitly consider appropriate risk management strategies (e.g. by hedging against that outcome, or reducing the size of the firm's exposures).

777(ix). The bank must have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the CCR management system. The firm's CCR management system must be well documented, for example, through a risk management manual that describes the basic principles of the risk management system and that provides an explanation of the empirical techniques used to measure CCR.

777(x). The bank must conduct an independent review of the CCR management system regularly through its own internal auditing process. This review must include both the activities of the business credit and trading units and of the independent CCR control unit. A review of the overall CCR management process must take place at regular intervals (ideally not less than once a year) and must specifically address, at a minimum:

- the adequacy of the documentation of the CCR management system and process;
- the organisation of the CCR control unit;
- the integration of CCR measures into daily risk management;
- the approval process for risk pricing models and valuation systems used by front and back-office personnel;
- the validation of any significant change in the CCR measurement process;
- the scope of counterparty credit risks captured by the risk measurement model;
- the integrity of the management information system;
- the accuracy and completeness of CCR data;
- the verification of the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources;
- the accuracy and appropriateness of volatility and correlation assumptions;
- the accuracy of valuation and risk transformation calculations;
- the verification of the model's accuracy through frequent backtesting.

777(xi). A bank that receives approval to use an internal model to estimate its exposure amount or EAD for CCR exposures must monitor the appropriate risks and have processes to adjust its estimation of EPE when those risks become significant. This includes the following:

- Banks must identify and manage their exposures to specific wrong-way risk.
- For exposures with a rising risk profile after one year, banks must compare on a regular basis the estimate of EPE over one year with the EPE over the life of the exposure.
- For exposures with a short-term maturity (below one year), banks must compare on a regular basis the replacement cost (current exposure) and the realised exposure profile, and/or store data that allow such a comparisons.

777(xii). When assessing an internal model used to estimate EPE, and especially for banks that receive approval to estimate the value of the alpha factor, supervisors must review the characteristics of the firm's portfolio of exposures that give rise to CCR. In particular, supervisors must consider the following characteristics, namely:

- the diversification of the portfolio (number of risk factors the portfolio is exposed to);
- the correlation of default across counterparties; and
- the number and granularity of counterparty exposures.

777(xiii). Supervisors will take appropriate action where the firm's estimates of exposure or EAD under the Internal Model Method or alpha do not adequately reflect its exposure to CCR. Such action might include directing the bank to revise its estimates; directing the bank to apply a higher estimate of exposure or EAD under the IMM or alpha; or disallowing a bank from recognising internal estimates of EAD for regulatory capital purposes.

777(xiv). For banks that make use of the standardised method, supervisors should review the bank's evaluation of the risks contained in the transactions that give rise to CCR and the bank's assessment of whether the standardised method captures those risks appropriately and satisfactorily. If the standardised method does not capture the risk inherent in the bank's relevant transactions (as could be the case with structured, more complex OTC derivatives), supervisors may require the bank to apply the CEM or the SM on a transaction-by-transaction basis (i.e. no netting will be recognised).

C. Operational risk

778. Gross income, used in the Basic Indicator and Standardised Approaches for operational risk, is only a proxy for the scale of operational risk exposure of a bank and can in some cases (e.g. for banks with low margins or profitability) underestimate the need for capital for operational risk. With reference to the Committee document on *Sound Practices for the Management and Supervision of Operational Risk* (February 2003), the supervisor should consider whether the capital requirement generated by the Pillar 1 calculation gives a consistent picture of the individual bank's operational risk exposure, for example in comparison with other banks of similar size and with similar operations.

D. Market risk

1. Policies and procedures for trading book eligibility

778(i). Clear policies and procedures used to determine the exposures that may be included in, and those that should be excluded from, the trading book for purposes of calculating regulatory capital are critical to ensure the consistency and integrity of firms' trading book. Such policies must conform to paragraph 687(i) of this Framework. Supervisors should be satisfied that the policies and procedures clearly delineate the boundaries of the firm's trading book, in compliance with the general principles set forth in paragraphs 684 to 689(iii) of this Framework, and consistent with the bank's risk management capabilities and practices. Supervisors should also be satisfied that transfers of positions between banking and trading books can only occur in a very limited set of circumstances. A supervisor will require a firm to modify its policies and procedures when they prove insufficient for preventing the booking in the trading book of positions that are not compliant with the general principles set forth in paragraphs 684 to 689(iii) of this Framework, or not consistent with the bank's risk management capabilities and practices.

2. Valuation

778(ii). Prudent valuation policies and procedures form the foundation on which any robust assessment of market risk capital adequacy should be built. For a well diversified portfolio consisting of highly liquid cash instruments, and without market concentration, the valuation of the portfolio, combined with the minimum quantitative standards set out in paragraph 718(Lxxvi), as revised in this section, may deliver sufficient capital to enable a bank, in adverse market conditions, to close out or hedge its positions within 10 days in an orderly fashion. However, for less well diversified portfolios, for portfolios containing less liquid instruments, for portfolios with concentrations in relation to market turnover, and/or for portfolios which contain large numbers of positions that are marked-to-model this is less likely to be the case. In such circumstances, supervisors will consider whether a bank has sufficient capital. To the extent there is a shortfall the supervisor will react appropriately. This will usually require the bank to reduce its risks and/or hold an additional amount of capital.

3. Stress testing under the internal models approach

778(iii). A bank must ensure that it has sufficient capital to meet the minimum capital requirements set out in paragraphs 718(Lxx) to 718(xciv) and to cover the results of its stress testing required by paragraph 718(Lxxiv) (g), taking into account the principles set forth in paragraphs 738(ii) and 738(iv). Supervisors will consider whether a bank has sufficient capital for these purposes, taking into account the nature and scale of the bank's trading activities and any other relevant factors such as valuation adjustments made by the bank. To the extent that there is a shortfall, or if supervisors are not satisfied with the premise upon which the bank's assessment of internal market risk capital adequacy is based, supervisors will take the appropriate measures. This will usually involve requiring the bank to reduce its risk exposures and/or to hold an additional amount of capital, so that its overall capital resources at least cover the Pillar 1 requirements plus the result of a stress test acceptable to the supervisor.

4. Specific risk modelling under the internal models approach

778(iv). For banks wishing to model the specific risk arising from their trading activities, additional criteria have been set out in paragraph 718(Lxxxix) , including conservatively assessing the risk arising from less liquid positions and/or positions with limited price transparency under realistic market scenarios. Where supervisors consider that limited liquidity or price transparency undermines the effectiveness of a bank's model to capture the specific risk, they will take appropriate measures, including requiring the exclusion of positions from the bank's specific risk model. Supervisors should review the adequacy of the bank's measure of the default risk surcharge; where the bank's approach is inadequate, the use of the standardised specific risk charges will be required.

IV. Other aspects of the supervisory review process

A. Supervisory transparency and accountability

779. The supervision of banks is not an exact science, and therefore, discretionary elements within the supervisory review process are inevitable. Supervisors must take care to carry out their obligations in a transparent and accountable manner. Supervisors should make publicly available the criteria to be used in the review of banks' internal capital assessments. If a supervisor chooses to set target or trigger ratios or to set categories of capital in excess of the regulatory minimum, factors that may be considered in doing so should be publicly available. Where the capital requirements are set above the minimum for an individual bank, the supervisor should explain to the bank the risk characteristics specific to the bank which resulted in the requirement and any remedial action necessary.

B. Enhanced cross-border communication and cooperation

780. Effective supervision of large banking organisations necessarily entails a close and continuous dialogue between industry participants and supervisors. In addition, the Framework will require enhanced cooperation between supervisors, on a practical basis, especially for the cross-border supervision of complex international banking groups.

781. The Framework will not change the legal responsibilities of national supervisors for the regulation of their domestic institutions or the arrangements for consolidated supervision as set out in the existing Basel Committee standards. The home country supervisor is responsible for the oversight of the implementation of the Framework for a banking group on a consolidated basis; host country supervisors are responsible for supervision of those entities operating in their countries. In order to reduce the compliance burden and avoid regulatory arbitrage, the methods and approval processes used by a bank at the group level may be accepted by the host country supervisor at the local level, provided that they adequately meet the local supervisor's requirements. Wherever possible, supervisors should avoid performing redundant and uncoordinated approval and validation work in order to reduce the implementation burden on banks, and conserve supervisory resources.

782. In implementing the Framework, supervisors should communicate the respective roles of home country and host country supervisors as clearly as possible to banking groups with significant cross-border operations in multiple jurisdictions. The home country supervisor would lead this coordination effort in cooperation with the host country supervisors. In communicating the respective supervisory roles, supervisors will take care to clarify that existing supervisory legal responsibilities remain unchanged.

783. The Committee supports a pragmatic approach of mutual recognition for internationally active banks as a key basis for international supervisory co-operation. This approach implies recognising common capital adequacy approaches when considering the entities of internationally active banks in host jurisdictions, as well as the desirability of minimising differences in the national capital adequacy regulations between home and host jurisdictions so that subsidiary banks are not subjected to excessive burden.

V. Supervisory review process for securitisation

784. Further to the Pillar 1 principle that banks should take account of the economic substance of transactions in their determination of capital adequacy, supervisory authorities will monitor, as appropriate, whether banks have done so adequately. As a result, regulatory

capital treatments for specific securitisation exposures might differ from those specified in Pillar 1 of the Framework, particularly in instances where the general capital requirement would not adequately and sufficiently reflect the risks to which an individual banking organisation is exposed.

785. Amongst other things, supervisory authorities may review where relevant a bank's own assessment of its capital needs and how that has been reflected in the capital calculation as well as the documentation of certain transactions to determine whether the capital requirements accord with the risk profile (e.g. substitution clauses). Supervisors will also review the manner in which banks have addressed the issue of maturity mismatch in relation to retained positions in their economic capital calculations. In particular, they will be vigilant in monitoring for the structuring of maturity mismatches in transactions to artificially reduce capital requirements. Additionally, supervisors may review the bank's economic capital assessment of actual correlation between assets in the pool and how they have reflected that in the calculation. Where supervisors consider that a bank's approach is not adequate, they will take appropriate action. Such action might include denying or reducing capital relief in the case of originated assets, or increasing the capital required against securitisation exposures acquired.

A. Significance of risk transfer

786. Securitisation transactions may be carried out for purposes other than credit risk transfer (e.g. funding). Where this is the case, there might still be a limited transfer of credit risk. However, for an originating bank to achieve reductions in capital requirements, the risk transfer arising from a securitisation has to be deemed significant by the national supervisory authority. If the risk transfer is considered to be insufficient or non existent, the supervisory authority can require the application of a higher capital requirement than prescribed under Pillar 1 or, alternatively, may deny a bank from obtaining any capital relief from the securitisations. Therefore, the capital relief that can be achieved will correspond to the amount of credit risk that is effectively transferred. The following includes a set of examples where supervisors may have concerns about the degree of risk transfer, such as retaining or repurchasing significant amounts of risk or "cherry picking" the exposures to be transferred via a securitisation.

787. Retaining or repurchasing significant securitisation exposures, depending on the proportion of risk held by the originator, might undermine the intent of a securitisation to transfer credit risk. Specifically, supervisory authorities might expect that a significant portion of the credit risk and of the nominal value of the pool be transferred to at least one independent third party at inception and on an ongoing basis. Where banks repurchase risk for market making purposes, supervisors could find it appropriate for an originator to buy part of a transaction but not, for example, to repurchase a whole tranche. Supervisors would expect that where positions have been bought for market making purposes, these positions should be resold within an appropriate period, thereby remaining true to the initial intention to transfer risk.

788. Another implication of realising only a non-significant risk transfer, especially if related to good quality unrated exposures, is that both the poorer quality unrated assets and most of the credit risk embedded in the exposures underlying the securitised transaction are likely to remain with the originator. Accordingly, and depending on the outcome of the supervisory review process, the supervisory authority may increase the capital requirement for particular exposures or even increase the overall level of capital the bank is required to hold.

B. Market innovations

789. As the minimum capital requirements for securitisation may not be able to address all potential issues, supervisory authorities are expected to consider new features of securitisation transactions as they arise. Such assessments would include reviewing the impact new features may have on credit risk transfer and, where appropriate, supervisors will be expected to take appropriate action under Pillar 2. A Pillar 1 response may be formulated to take account of market innovations. Such a response may take the form of a set of operational requirements and/or a specific capital treatment.

C. Provision of implicit support

790. Support to a transaction, whether contractual (i.e. credit enhancements provided at the inception of a securitised transaction) or non-contractual (implicit support) can take numerous forms. For instance, contractual support can include over collateralisation, credit derivatives, spread accounts, contractual recourse obligations, subordinated notes, credit risk mitigants provided to a specific tranche, the subordination of fee or interest income or the deferral of margin income, and clean-up calls that exceed 10 percent of the initial issuance. Examples of implicit support include the purchase of deteriorating credit risk exposures from the underlying pool, the sale of discounted credit risk exposures into the pool of securitised credit risk exposures, the purchase of underlying exposures at above market price or an increase in the first loss position according to the deterioration of the underlying exposures.

791. The provision of implicit (or non-contractual) support, as opposed to contractual credit support (i.e. credit enhancements), raises significant supervisory concerns. For traditional securitisation structures the provision of implicit support undermines the clean break criteria, which when satisfied would allow banks to exclude the securitised assets from regulatory capital calculations. For synthetic securitisation structures, it negates the significance of risk transference. By providing implicit support, banks signal to the market that the risk is still with the bank and has not in effect been transferred. The institution's capital calculation therefore understates the true risk. Accordingly, national supervisors are expected to take appropriate action when a banking organisation provides implicit support.

792. When a bank has been found to provide implicit support to a securitisation, it will be required to hold capital against all of the underlying exposures associated with the structure as if they had not been securitised. It will also be required to disclose publicly that it was found to have provided non-contractual support, as well as the resulting increase in the capital charge (as noted above). The aim is to require banks to hold capital against exposures for which they assume the credit risk, and to discourage them from providing non-contractual support.

793. If a bank is found to have provided implicit support on more than one occasion, the bank is required to disclose its transgression publicly and national supervisors will take appropriate action that may include, but is not limited to, one or more of the following:

- The bank may be prevented from gaining favourable capital treatment on securitised assets for a period of time to be determined by the national supervisor;
- The bank may be required to hold capital against all securitised assets as though the bank had created a commitment to them, by applying a conversion factor to the risk weight of the underlying assets;
- For purposes of capital calculations, the bank may be required to treat all securitised assets as if they remained on the balance sheet;

- The bank may be required by its national supervisory authority to hold regulatory capital in excess of the minimum risk-based capital ratios.

794. Supervisors will be vigilant in determining implicit support and will take appropriate supervisory action to mitigate the effects. Pending any investigation, the bank may be prohibited from any capital relief for planned securitisation transactions (moratorium). National supervisory response will be aimed at changing the bank's behaviour with regard to the provision of implicit support, and to correct market perception as to the willingness of the bank to provide future recourse beyond contractual obligations.

D. Residual risks

795. As with credit risk mitigation techniques more generally, supervisors will review the appropriateness of banks' approaches to the recognition of credit protection. In particular, with regard to securitisations, supervisors will review the appropriateness of protection recognised against first loss credit enhancements. On these positions, expected loss is less likely to be a significant element of the risk and is likely to be retained by the protection buyer through the pricing. Therefore, supervisors will expect banks' policies to take account of this in determining their economic capital. Where supervisors do not consider the approach to protection recognised is adequate, they will take appropriate action. Such action may include increasing the capital requirement against a particular transaction or class of transactions.

E. Call provisions

796. Supervisors expect a bank not to make use of clauses that entitles it to call the securitisation transaction or the coverage of credit protection prematurely if this would increase the bank's exposure to losses or deterioration in the credit quality of the underlying exposures.

797. Besides the general principle stated above, supervisors expect banks to only execute clean-up calls for economic business purposes, such as when the cost of servicing the outstanding credit exposures exceeds the benefits of servicing the underlying credit exposures.

798. Subject to national discretion, supervisory authorities may require a review prior to the bank exercising a call which can be expected to include consideration of:

- The rationale for the bank's decision to exercise the call; and
- The impact of the exercise of the call on the bank's regulatory capital ratio.

799. The supervisory authority may also require the bank to enter into a follow-up transaction, if necessary, depending on the bank's overall risk profile, and existing market conditions.

800. Date related calls should be set at a date no earlier than the duration or the weighted average life of the underlying securitisation exposures. Accordingly, supervisory authorities may require a minimum period to elapse before the first possible call date can be set, given, for instance, the existence of up-front sunk costs of a capital market securitisation transaction.

F. Early amortisation

801. Supervisors should review how banks internally measure, monitor, and manage risks associated with securitisations of revolving credit facilities, including an assessment of the risk and likelihood of early amortisation of such transactions. At a minimum, supervisors should ensure that banks have implemented reasonable methods for allocating economic capital against the economic substance of the credit risk arising from revolving securitisations and should expect banks to have adequate capital and liquidity contingency plans that evaluate the probability of an early amortisation occurring and address the implications of both scheduled and early amortisation. In addition, the capital contingency plan should address the possibility that the bank will face higher levels of required capital under the early amortisation Pillar 1 capital requirement.

802. Because most early amortisation triggers are tied to excess spread levels, the factors affecting these levels should be well understood, monitored, and managed, to the extent possible (see paragraphs 790 to 794 on implicit support), by the originating bank. For example, the following factors affecting excess spread should generally be considered:

- Interest payments made by borrowers on the underlying receivable balances;
- Other fees and charges to be paid by the underlying obligors (e.g. late-payment fees, cash advance fees, over-limit fees);
- Gross charge-offs;
- Principal payments;
- Recoveries on charged-off loans;
- Interchange income;
- Interest paid on investors' certificates;
- Macroeconomic factors such as bankruptcy rates, interest rate movements, unemployment rates; etc.

803. Banks should consider the effects that changes in portfolio management or business strategies may have on the levels of excess spread and on the likelihood of an early amortisation event. For example, marketing strategies or underwriting changes that result in lower finance charges or higher charge-offs, might also lower excess spread levels and increase the likelihood of an early amortisation event.

804. Banks should use techniques such as static pool cash collections analyses and stress tests to better understand pool performance. These techniques can highlight adverse trends or potential adverse impacts. Banks should have policies in place to respond promptly to adverse or unanticipated changes. Supervisors will take appropriate action where they do not consider these policies adequate. Such action may include, but is not limited to, directing a bank to obtain a dedicated liquidity line or raising the early amortisation credit conversion factor, thus, increasing the bank's capital requirements.

805. While the early amortisation capital charge described in Pillar 1 is meant to address potential supervisory concerns associated with an early amortisation event, such as the inability of excess spread to cover potential losses, the policies and monitoring described in this section recognise that a given level of excess spread is not, by itself, a perfect proxy for credit performance of the underlying pool of exposures. In some circumstances, for example, excess spread levels may decline so rapidly as to not provide a timely indicator of underlying credit deterioration. Further, excess spread levels may reside far above trigger levels, but still exhibit a high degree of volatility which could warrant supervisory attention. In addition, excess spread levels can fluctuate for reasons unrelated to underlying credit risk, such as a

mismatch in the rate at which finance charges reprice relative to investor certificate rates. Routine fluctuations of excess spread might not generate supervisory concerns, even when they result in different capital requirements. This is particularly the case as a bank moves in or out of the first step of the early amortisation credit conversion factors. On the other hand, existing excess spread levels may be maintained by adding (or designating) an increasing number of new accounts to the master trust, an action that would tend to mask potential deterioration in a portfolio. For all of these reasons, supervisors will place particular emphasis on internal management, controls, and risk monitoring activities with respect to securitisations with early amortisation features.

806. Supervisors expect that the sophistication of a bank's system in monitoring the likelihood and risks of an early amortisation event will be commensurate with the size and complexity of the bank's securitisation activities that involve early amortisation provisions.

807. For controlled amortisations specifically, supervisors may also review the process by which a bank determines the minimum amortisation period required to pay down 90% of the outstanding balance at the point of early amortisation. Where a supervisor does not consider this adequate it will take appropriate action, such as increasing the conversion factor associated with a particular transaction or class of transactions.

Guidance Related to the Supervisory Review Process
(Published by the Basel Committee on Banking Supervision)

1.	Core Principles for Effective Banking Supervision	April 2006, *For comment*
2.	The Core Principles Methodology	April 2006, *For comment*
3.	Risk Management Guidelines for Derivatives	July 1994, *Final*
4.	Framework for Internal Controls	September 1998, *Final*
5.	Sound Practices for Banks' Interactions with Highly Leveraged Institutions	January 1999, *Final*
6.	Enhancing Corporate Governance	August 1999, *Final*
7.	Sound Practices for Managing Liquidity	February 2000, *Final*
8.	Principles for the Management of Credit Risk	September 2000, *Final*
9.	Supervisory Guidance for Managing Settlement Risk in Foreign Exchange Transactions	September 2000, *Final*
10.	Internal Audit in Banks and the Supervisor's Relationship with Auditors	August 2001, *Final*
11.	Customer Due Diligence for Banks	October 2001, *Final*
12.	The Relationship Between Banking Supervisors and Banks' External Auditors	January 2002, *Final*
13.	Supervisory Guidance for Dealing with Weak Banks	March 2002, *Final*
14.	Sound Practices for the Management and Supervision of Operational Risk	February 2003, *Final*
15.	Management and supervision of cross-border electronic banking activities	July 2003, *Final*
16.	Risk management principles for electronic banking	July 2003, *Final*
17.	Principles for the management and supervision of interest rate risk	July 2004, *Final*
18.	Enhancing corporate governance for banking organisations	February 2006, *Final*

Note: the papers are available from the BIS website (www.bis.org/bcbs/publ/index.htm).

Part 4: The Third Pillar – Market Discipline

I. General considerations

A. Disclosure requirements

808. The Committee believes that the rationale for Pillar 3 is sufficiently strong to warrant the introduction of disclosure requirements for banks using the Framework. Supervisors have an array of measures that they can use to require banks to make such disclosures. Some of these disclosures will be qualifying criteria for the use of particular methodologies or the recognition of particular instruments and transactions.

B. Guiding principles

809. The purpose of Pillar 3 ─ market discipline is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). The Committee aims to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the institution. The Committee believes that such disclosures have particular relevance under the Framework, where reliance on internal methodologies gives banks more discretion in assessing capital requirements.

810. In principle, banks' disclosures should be consistent with how senior management and the board of directors assess and manage the risks of the bank. Under Pillar 1, banks use specified approaches/methodologies for measuring the various risks they face and the resulting capital requirements. The Committee believes that providing disclosures that are based on this common framework is an effective means of informing the market about a bank's exposure to those risks and provides a consistent and understandable disclosure framework that enhances comparability.

C. Achieving appropriate disclosure

811. The Committee is aware that supervisors have different powers available to them to achieve the disclosure requirements. Market discipline can contribute to a safe and sound banking environment, and supervisors require firms to operate in a safe and sound manner. Under safety and soundness grounds, supervisors could require banks to disclose information. Alternatively, supervisors have the authority to require banks to provide information in regulatory reports. Some supervisors could make some or all of the information in these reports publicly available. Further, there are a number of existing mechanisms by which supervisors may enforce requirements. These vary from country to country and range from "moral suasion" through dialogue with the bank's management (in order to change the latter's behaviour), to reprimands or financial penalties. The nature of the exact measures used will depend on the legal powers of the supervisor and the seriousness of the disclosure deficiency. However, it is not intended that direct additional capital requirements would be a response to non-disclosure, except as indicated below.

812. In addition to the general intervention measures outlined above, this Framework also anticipates a role for specific measures. Where disclosure is a qualifying criterion under Pillar 1 to obtain lower risk weightings and/or to apply specific methodologies, there would be a direct sanction (not being allowed to apply the lower weighting or the specific methodology).

D. Interaction with accounting disclosures

813. The Committee recognises the need for a Pillar 3 disclosure framework that does not conflict with requirements under accounting standards, which are broader in scope. The Committee has made a considerable effort to see that the narrower focus of Pillar 3, which is aimed at disclosure of bank capital adequacy, does not conflict with the broader accounting requirements. Going forward, the Committee intends to maintain an ongoing relationship with the accounting authorities, given that their continuing work may have implications for the disclosures required in Pillar 3. The Committee will consider future modifications to Pillar 3 as necessary in light of its ongoing monitoring of this area and industry developments.

814. Management should use its discretion in determining the appropriate medium and location of the disclosure. In situations where the disclosures are made under accounting requirements or are made to satisfy listing requirements promulgated by securities regulators, banks may rely on them to fulfil the applicable Pillar 3 expectations. In these situations, banks should explain material differences between the accounting or other disclosure and the supervisory basis of disclosure. This explanation does not have to take the form of a line by line reconciliation.

815. For those disclosures that are not mandatory under accounting or other requirements, management may choose to provide the Pillar 3 information through other means (such as on a publicly accessible internet website or in public regulatory reports filed with bank supervisors), consistent with requirements of national supervisory authorities. However, institutions are encouraged to provide all related information in one location to the degree feasible. In addition, if information is not provided with the accounting disclosure, institutions should indicate where the additional information can be found.

816. The recognition of accounting or other mandated disclosure in this manner is also expected to help clarify the requirements for validation of disclosures. For example, information in the annual financial statements would generally be audited and additional material published with such statements must be consistent with the audited statements. In addition, supplementary material (such as Management's Discussion and Analysis) that is published to satisfy other disclosure regimes (e.g. listing requirements promulgated by securities regulators) is generally subject to sufficient scrutiny (e.g. internal control assessments, etc.) to satisfy the validation issue. If material is not published under a validation regime, for instance in a stand alone report or as a section on a website, then management should ensure that appropriate verification of the information takes place, in accordance with the general disclosure principle set out below. Accordingly, Pillar 3 disclosures will not be required to be audited by an external auditor, unless otherwise required by accounting standards setters, securities regulators or other authorities.

E. Materiality

817. A bank should decide which disclosures are relevant for it based on the materiality concept. Information would be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions. This definition is consistent with International Accounting Standards and with many national accounting frameworks. The Committee recognises the need for a qualitative judgement of whether, in light of the particular circumstances, a user of financial information would consider the item to be material (user test). The Committee is not setting specific thresholds for disclosure as these can be open to manipulation and are difficult to determine, and it believes that the user test is a useful benchmark for achieving sufficient disclosure.

F. Frequency

818. The disclosures set out in Pillar 3 should be made on a semi-annual basis, subject to the following exceptions. Qualitative disclosures that provide a general summary of a bank's risk management objectives and policies, reporting system and definitions may be published on an annual basis. In recognition of the increased risk sensitivity of the Framework and the general trend towards more frequent reporting in capital markets, large internationally active banks and other significant banks (and their significant bank subsidiaries) must disclose their Tier 1 and total capital adequacy ratios, and their components,[174] on a quarterly basis. Furthermore, if information on risk exposure or other items is prone to rapid change, then banks should also disclose information on a quarterly basis. In all cases, banks should publish material information as soon as practicable and not later than deadlines set by like requirements in national laws.[175]

G. Proprietary and confidential information

819. Proprietary information encompasses information (for example on products or systems), that if shared with competitors would render a bank's investment in these products/systems less valuable, and hence would undermine its competitive position. Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship. This has an impact on what banks should reveal in terms of information about their customer base, as well as details on their internal arrangements, for instance methodologies used, parameter estimates, data etc. The Committee believes that the requirements set out below strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information. In exceptional cases, disclosure of certain items of information required by Pillar 3 may prejudice seriously the position of the bank by making public information that is either proprietary or confidential in nature. In such cases, a bank need not disclose those specific items, but must disclose more general information about the subject matter of the requirement, together with the fact that, and the reason why, the specific items of information have not been disclosed. This limited exemption is not intended to conflict with the disclosure requirements under the accounting standards.

II. The disclosure requirements[176]

820. The following sections set out in tabular form the disclosure requirements under Pillar 3. Additional definitions and explanations are provided in a series of footnotes.

A. General disclosure principle

821. Banks should have a formal disclosure policy approved by the board of directors that addresses the bank's approach for determining what disclosures it will make and the

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[174] These components include Tier 1 capital, total capital and total required capital.

[175] For some small banks with stable risk profiles, annual reporting may be acceptable. Where a bank publishes information on only an annual basis, it should state clearly why this is appropriate.

[176] In this section of this Framework, disclosures marked with an asterisk are conditions for use of a particular approach or methodology for the calculation of regulatory capital.

internal controls over the disclosure process. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency of them.

B. Scope of application

822. Pillar 3 applies at the top consolidated level of the banking group to which this Framework applies (as indicated above in Part 1: Scope of Application). Disclosures related to individual banks within the groups would not generally be required to fulfil the disclosure requirements set out below. An exception to this arises in the disclosure of Total and Tier 1 Capital Ratios by the top consolidated entity where an analysis of significant bank subsidiaries within the group is appropriate, in order to recognise the need for these subsidiaries to comply with this Framework and other applicable limitations on the transfer of funds or capital within the group.

Table 1

Scope of application

Qualitative Disclosures	(a)	The name of the top corporate entity in the group to which this Framework applies.
	(b)	An outline of differences in the basis of consolidation for accounting and regulatory purposes, with a brief description of the entities[177] within the group (a) that are fully consolidated;[178] (b) that are pro-rata consolidated;[179] (c) that are given a deduction treatment;[180] and (d) from which surplus capital is recognised[180] plus (e) that are neither consolidated nor deducted (e.g. where the investment is risk-weighted).
	(c)	Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group.
Quantitative Disclosures	(d)	The aggregate amount of surplus capital[181] of insurance subsidiaries (whether deducted or subjected to an alternative method[182]) included in the capital of the consolidated group.

[177] Entity = securities, insurance and other financial subsidiaries, commercial subsidiaries, significant minority equity investments in insurance, financial and commercial entities.

[178] Following the listing of significant subsidiaries in consolidated accounting, e.g. IAS 27.

[179] Following the listing of subsidiaries in consolidated accounting, e.g. IAS 31.

[180] May be provided as an extension (extension of entities only if they are significant for the consolidating bank) to the listing of significant subsidiaries in consolidated accounting, e.g. IAS 27 and 32.

[181] Surplus capital in unconsolidated regulated subsidiaries is the difference between the amount of the investment in those entities and their regulatory capital requirements.

[182] See paragraphs 30 and 33.

	(e)	The aggregate amount of capital deficiencies[183] in all subsidiaries not included in the consolidation i.e. that are deducted and the name(s) of such subsidiaries.
	(f)	The aggregate amounts (e.g. current book value) of the firm's total interests in insurance entities, which are risk-weighted[184] rather than deducted from capital or subjected to an alternate group-wide method,[185] as well as their name, their country of incorporation or residence, the proportion of ownership interest and, if different, the proportion of voting power in these entities. In addition, indicate the quantitative impact on regulatory capital of using this method versus using the deduction or alternate group-wide method.

C. Capital

Table 2

Capital structure

Qualitative Disclosures	(a)	Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments.
Quantitative Disclosures	(b)	The amount of Tier 1 capital, with separate disclosure of: • paid-up share capital/common stock; • reserves; • minority interests in the equity of subsidiaries; • innovative instruments; [186] • other capital instruments; • surplus capital from insurance companies;[187] • regulatory calculation differences deducted from Tier 1 capital; [188] and • other amounts deducted from Tier 1 capital, including goodwill and investments.
	(c)	The total amount of Tier 2 and Tier 3 capital.
	(d)	Other deductions from capital. [189]
	(e)	Total eligible capital.

[183] A capital deficiency is the amount by which actual capital is less than the regulatory capital requirement. Any deficiencies which have been deducted on a group level in addition to the investment in such subsidiaries are not to be included in the aggregate capital deficiency.

[184] See paragraph 31.

[185] See paragraph 30.

[186] Innovative instruments are covered under the Committee's press release, *Instruments eligible for inclusion in Tier 1 capital* (27 October 1998).

[187] See paragraph 33.

[188] Representing 50% of the difference (when expected losses as calculated within the IRB approach exceed total provisions) to be deducted from Tier 1 capital.

[189] Including 50% of the difference (when expected losses as calculated within the IRB approach exceed total provisions) to be deducted from Tier 2 capital.

Table 3

Capital Adequacy

Qualitative disclosures	(a)	A summary discussion of the bank's approach to assessing the adequacy of its capital to support current and future activities.

Quantitative disclosures	(b)	Capital requirements for credit risk:
		• Portfolios subject to standardised or simplified standardised approach, disclosed separately for each portfolio;
		• Portfolios subject to the IRB approaches, disclosed separately for each portfolio under the foundation IRB approach and for each portfolio under the advanced IRB approach:
		    • Corporate (including SL not subject to supervisory slotting criteria), sovereign and bank;
		    • Residential mortgage;
		    • Qualifying revolving retail;[190] and
		    • Other retail;
		• Securitisation exposures.

	(c)	Capital requirements for equity exposures in the IRB approach:
		• Equity portfolios subject to the market-based approaches;
		    • Equity portfolios subject to simple risk weight method; and
		    • Equities in the banking book under the internal models approach (for banks using IMA for banking book equity exposures).
		• Equity portfolios subject to PD/LGD approaches.

	(d)	Capital requirements for market risk[191]: • Standardised approach; • Internal models approach — Trading book.
	(e)	Capital requirements for operational risk[191]: • Basic indicator approach; • Standardised approach; • Advanced measurement approach (AMA).
	(f)	Total and Tier 1[192] capital ratio: • For the top consolidated group; and • For significant bank subsidiaries (stand alone or sub-consolidated depending on how the Framework is applied).

D. Risk exposure and assessment

823. The risks to which banks are exposed and the techniques that banks use to identify, measure, monitor and control those risks are important factors market participants consider in their assessment of an institution. In this section, several key banking risks are considered: credit risk, market risk, interest rate risk and equity risk in the banking book and operational risk. Also included in this section are disclosures relating to credit risk mitigation and asset

[190] Banks should distinguish between the separate non-mortgage retail portfolios used for the Pillar 1 capital calculation (i.e. qualifying revolving retail exposures and other retail exposures) unless these portfolios are insignificant in size (relative to overall credit exposures) and the risk profile of each portfolio is sufficiently similar such that separate disclosure would not help users' understanding of the risk profile of the banks' retail business.

[191] Capital requirements are to be disclosed only for the approaches used.

[192] Including proportion of innovative capital instruments.

securitisation, both of which alter the risk profile of the institution. Where applicable, separate disclosures are set out for banks using different approaches to the assessment of regulatory capital.

1. General qualitative disclosure requirement

824. For each separate risk area (e.g. credit, market, operational, banking book interest rate risk, equity) banks must describe their risk management objectives and policies, including:

- strategies and processes;
- the structure and organisation of the relevant risk management function;
- the scope and nature of risk reporting and/or measurement systems;
- policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

2. Credit risk

825. General disclosures of credit risk provide market participants with a range of information about overall credit exposure and need not necessarily be based on information prepared for regulatory purposes. Disclosures on the capital assessment techniques give information on the specific nature of the exposures, the means of capital assessment and data to assess the reliability of the information disclosed.

Table 4[193]

Credit risk: general disclosures for all banks

Qualitative Disclosures	(a)	The general qualitative disclosure requirement (paragraph 824) with respect to credit risk, including: • Definitions of past due and impaired (for accounting purposes); • Description of approaches followed for specific and general allowances and statistical methods; • Discussion of the bank's credit risk management policy; and • For banks that have partly, but not fully adopted either the foundation IRB or the advanced IRB approach, a description of the nature of exposures within each portfolio that are subject to the 1) standardised, 2) foundation IRB, and 3) advanced IRB approaches and of management's plans and timing for migrating exposures to full implementation of the applicable approach.

[193] Table 4 does not include equities.

Quantitative Disclosures	(b)	Total gross credit risk exposures,[194] plus average gross exposure[195] over the period[196] broken down by major types of credit exposure.[197]
	(c)	Geographic[198] distribution of exposures, broken down in significant areas by major types of credit exposure.
	(d)	Industry or counterparty type distribution of exposures, broken down by major types of credit exposure.
	(e)	Residual contractual maturity breakdown of the whole portfolio,[199] broken down by major types of credit exposure.
	(f)	By major industry or counterparty type: • Amount of impaired loans and if available, past due loans, provided separately;[200] • Specific and general allowances; and • Charges for specific allowances and charge-offs during the period.
	(g)	Amount of impaired loans and, if available, past due loans provided separately broken down by significant geographic areas including, if practical, the amounts of specific and general allowances related to each geographical area.[201]
	(h)	Reconciliation of changes in the allowances for loan impairment.[202]
	(i)	For each portfolio, the amount of exposures (for IRB banks, drawn plus EAD on undrawn) subject to the 1) standardised, 2) foundation IRB, and 3) advanced IRB approaches.

[194] That is, after accounting offsets in accordance with the applicable accounting regime and without taking into account the effects of credit risk mitigation techniques, e.g. collateral and netting.

[195] Where the period end position is representative of the risk positions of the bank during the period, average gross exposures need not be disclosed.

[196] Where average amounts are disclosed in accordance with an accounting standard or other requirement which specifies the calculation method to be used, that method should be followed. Otherwise, the average exposures should be calculated using the most frequent interval that an entity's systems generate for management, regulatory or other reasons, provided that the resulting averages are representative of the bank's operations. The basis used for calculating averages need be stated only if not on a daily average basis.

[197] This breakdown could be that applied under accounting rules, and might, for instance, be (a) loans, commitments and other non-derivative off balance sheet exposures, (b) debt securities, and (c) OTC derivatives.

[198] Geographical areas may comprise individual countries, groups of countries or regions within countries. Banks might choose to define the geographical areas based on the way the bank's portfolio is geographically managed. The criteria used to allocate the loans to geographical areas should be specified.

[199] This may already be covered by accounting standards, in which case banks may wish to use the same maturity groupings used in accounting.

[200] Banks are encouraged also to provide an analysis of the ageing of past-due loans.

[201] The portion of general allowance that is not allocated to a geographical area should be disclosed separately.

[202] The reconciliation shows separately specific and general allowances; the information comprises: a description of the type of allowance; the opening balance of the allowance; charge-offs taken against the allowance during the period; amounts set aside (or reversed) for estimated probable loan losses during the period, any other adjustments (e.g. exchange rate differences, business combinations, acquisitions and disposals of subsidiaries), including transfers between allowances; and the closing of the allowance. Charge-offs and recoveries that have been recorded directly to the income statement should be disclosed separately.

Table 5

Credit risk: disclosures for portfolios subject to the standardised approach and supervisory risk weights in the IRB approaches[203]

Qualitative Disclosures	(a)	For portfolios under the standardised approach: • Names of ECAIs and ECAs used, plus reasons for any changes;* • Types of exposure for which each agency is used; • A description of the process used to transfer public issue ratings onto comparable assets in the banking book; and • The alignment of the alphanumerical scale of each agency used with risk buckets.[204]
Quantitative Disclosures	(b)	• For exposure amounts after risk mitigation subject to the standardised approach, amount of a bank's outstandings (rated and unrated) in each risk bucket as well as those that are deducted; and • For exposures subject to the supervisory risk weights in IRB (HVCRE, any SL products subject to supervisory slotting criteria and equities under the simple risk weight method) the aggregate amount of a bank's outstandings in each risk bucket.

Credit risk: disclosures for portfolios subject to IRB approaches

826. An important part of this Framework is the introduction of an IRB approach for the assessment of regulatory capital for credit risk. To varying degrees, banks will have discretion to use internal inputs in their regulatory capital calculations. In this sub-section, the IRB approach is used as the basis for a set of disclosures intended to provide market participants with information about asset quality. In addition, these disclosures are important to allow market participants to assess the resulting capital in light of the exposures. There are two categories of quantitative disclosures: those focussing on an analysis of risk exposure and assessment (i.e. the inputs) and those focussing on the actual outcomes (as the basis for providing an indication of the likely reliability of the disclosed information). These are supplemented by a qualitative disclosure regime which provides background information on the assumptions underlying the IRB framework, the use of the IRB system as part of a risk management framework and the means for validating the results of the IRB system. The disclosure regime is intended to enable market participants to assess the credit risk exposure of IRB banks and the overall application and suitability of the IRB framework, without revealing proprietary information or duplicating the role of the supervisor in validating the detail of the IRB framework in place.

[203] A *de minimis* exception would apply where ratings are used for less than 1% of the total loan portfolio.

[204] This information need not be disclosed if the bank complies with a standard mapping which is published by the relevant supervisor.

Table 6

Credit risk: disclosures for portfolios subject to IRB approaches

Qualitative disclosures*	(a)	Supervisor's acceptance of approach/ supervisory approved transition
	(b)	Explanation and review of the: • Structure of internal rating systems and relation between internal and external ratings; • use of internal estimates other than for IRB capital purposes; • process for managing and recognising credit risk mitigation; and • Control mechanisms for the rating system including discussion of independence, accountability, and rating systems review.
	(c)	Description of the internal ratings process, provided separately for five distinct portfolios: • Corporate (including SMEs, specialised lending and purchased corporate receivables), sovereign and bank; • Equities;[205] • Residential mortgages; • Qualifying revolving retail;[206] and • Other retail. The description should include, for each portfolio: • The types of exposure included in the portfolio; • The definitions, methods and data for estimation and validation of PD, and (for portfolios subject to the IRB advanced approach) LGD and/or EAD, including assumptions employed in the derivation of these variables;[207] and • Description of deviations as permitted under paragraph 456 and footnote 89 from the reference definition of default where determined to be material, including the broad segments of the portfolio(s) affected by such deviations.[208]

[205] Equities need only be disclosed here as a separate portfolio where the bank uses the PD/LGD approach for equities held in the banking book.

[206] In both the qualitative disclosures and quantitative disclosures that follow, banks should distinguish between the qualifying revolving retail exposures and other retail exposures unless these portfolios are insignificant in size (relative to overall credit exposures) and the risk profile of each portfolio is sufficiently similar such that separate disclosure would not help users' understanding of the risk profile of the banks' retail business.

[207] This disclosure does not require a detailed description of the model in full — it should provide the reader with a broad overview of the model approach, describing definitions of the variables, and methods for estimating and validating those variables set out in the quantitative risk disclosures below. This should be done for each of the five portfolios. Banks should draw out any significant differences in approach to estimating these variables within each portfolio.

[208] This is to provide the reader with context for the quantitative disclosures that follow. Banks need only describe main areas where there has been material divergence from the reference definition of default such that it would affect the readers' ability to compare and understand the disclosure of exposures by PD grade.

Quantitative disclosures: risk assessment*	(d)	For each portfolio (as defined above) except retail, present the following information across a sufficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk:[209] • Total exposures (for corporate, sovereign and bank, outstanding loans and EAD on undrawn commitments;[210] for equities, outstanding amount); • For banks on the IRB advanced approach, exposure-weighted average LGD (percentage); and • Exposure-weighted average risk-weight. For banks on the IRB advanced approach, amount of undrawn commitments and exposure-weighted average EAD for each portfolio;[211] For each retail portfolio (as defined above), either:[212] • Disclosures as outlined above on a pool basis (i.e. same as for non-retail portfolios); or • Analysis of exposures on a pool basis (outstanding loans and EAD on commitments) against a sufficient number of EL grades to allow for a meaningful differentiation of credit risk.
Quantitative disclosures: historical results*	(e)	Actual losses (e.g. charge-offs and specific provisions) in the preceding period for each portfolio (as defined above) and how this differs from past experience. A discussion of the factors that impacted on the loss experience in the preceding period — for example, has the bank experienced higher than average default rates, or higher than average LGDs and EADs.
	(f)	Banks' estimates against actual outcomes over a longer period.[213] At a minimum, this should include information on estimates of losses against actual losses in each portfolio (as defined above) over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each portfolio.[214] Where appropriate, banks should further decompose this to provide analysis of PD and, for banks on the advanced IRB approach, LGD and EAD outcomes against estimates provided in the quantitative risk assessment disclosures above.[215]

209 The PD, LGD and EAD disclosures below should reflect the effects of collateral, netting and guarantees/credit derivatives, where recognised under Part 2. Disclosure of each PD grade should include the exposure weighted-average PD for each grade. Where banks are aggregating PD grades for the purposes of disclosure, this should be a representative breakdown of the distribution of PD grades used in the IRB approach.

210 Outstanding loans and EAD on undrawn commitments can be presented on a combined basis for these disclosures.

211 Banks need only provide one estimate of EAD for each portfolio. However, where banks believe it is helpful, in order to give a more meaningful assessment of risk, they may also disclose EAD estimates across a number of EAD categories, against the undrawn exposures to which these relate.

212 Banks would normally be expected to follow the disclosures provided for the non-retail portfolios. However, banks may choose to adopt EL grades as the basis of disclosure where they believe this can provide the reader with a meaningful differentiation of credit risk. Where banks are aggregating internal grades (either PD/LGD or EL) for the purposes of disclosure, this should be a representative breakdown of the distribution of those grades used in the IRB approach.

213 These disclosures are a way of further informing the reader about the reliability of the information provided in the "quantitative disclosures: risk assessment" over the long run. The disclosures are requirements from year-end 2009; In the meantime, early adoption would be encouraged. The phased implementation is to allow banks sufficient time to build up a longer run of data that will make these disclosures meaningful.

214 The Committee will not be prescriptive about the period used for this assessment. Upon implementation, it might be expected that banks would provide these disclosures for as long run of data as possible — for example, if banks have 10 years of data, they might choose to disclose the average default rates for each PD grade over that 10-year period. Annual amounts need not be disclosed.

215 Banks should provide this further decomposition where it will allow users greater insight into the reliability of the estimates provided in the 'quantitative disclosures: risk assessment'. In particular, banks should provide this information where there are material differences between the PD, LGD or EAD estimates given by banks compared to actual outcomes over the long run. Banks should also provide explanations for such differences.

Table 7

Credit risk mitigation: disclosures for standardised and IRB approaches[216,217]

Qualitative Disclosures*	(a)	The general qualitative disclosure requirement (paragraph 824) with respect to credit risk mitigation including: • policies and processes for, and an indication of the extent to which the bank makes use of, on- and off-balance sheet netting; • policies and processes for collateral valuation and management; • a description of the main types of collateral taken by the bank; • the main types of guarantor/credit derivative counterparty and their creditworthiness; and • information about (market or credit) risk concentrations within the mitigation taken.
Quantitative Disclosures*	(b)	For each separately disclosed credit risk portfolio under the standardised and/or foundation IRB approach, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by: • eligible financial collateral; and • other eligible IRB collateral; after the application of haircuts.[218]
	(c)	For each separately disclosed portfolio under the standardised and/or IRB approach, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees/credit derivatives.

[216] At a minimum, banks must give the disclosures below in relation to credit risk mitigation that has been recognised for the purposes of reducing capital requirements under this Framework. Where relevant, banks are encouraged to give further information about mitigants that have not been recognised for that purpose.

[217] Credit derivatives that are treated, for the purposes of this Framework, as part of synthetic securitisation structures should be excluded from the credit risk mitigation disclosures and included within those relating to securitisation.

[218] If the comprehensive approach is applied, where applicable, the total exposure covered by collateral after haircuts should be reduced further to remove any positive adjustments that were applied to the exposure, as permitted under Part 2.

Table 8

General disclosure for exposures related to counterparty credit risk

Qualitative Disclosures	(a)	The general qualitative disclosure requirement (paragraphs 824 and 825) with respect to derivatives and CCR, including: • Discussion of methodology used to assign economic capital and credit limits for counterparty credit exposures; • Discussion of policies for securing collateral and establishing credit reserves; • Discussion of policies with respect to wrong-way risk exposures; • Discussion of the impact of the amount of collateral the bank would have to provide given a credit rating downgrade.
Quantitative Disclosures	(b)	Gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held (including type, e.g. cash, government securities, etc.), and net derivatives credit exposure.[219] Also report measures for exposure at default, or exposure amount, under the IMM, SM or CEM, whichever is applicable. The notional value of credit derivative hedges, and the distribution of current credit exposure by types of credit exposure.[220]
	(c)	Credit derivative transactions that create exposures to CCR (notional value), segregated between use for the institution's own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivatives products used[221], broken down further by protection bought and sold within each product group.
	(d)	The estimate of alpha if the bank has received supervisory approval to estimate alpha.

[219] *Net credit exposure* is the credit exposure on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements. The notional amount of credit derivative hedges alerts market participants to an additional source of credit risk mitigation.

[220] This might be interest rate contracts, FX contracts, equity contracts, credit derivatives, and commodity/other contracts.

[221] This might be Credit Default Swaps, Total Return Swaps, Credit options, and other.

Table 9

Securitisation: disclosure for standardised and IRB approaches[217]

Qualitative disclosures*	(a)	The general qualitative disclosure requirement (paragraph 824) with respect to securitisation (including synthetics), including a discussion of: • the bank's objectives in relation to securitisation activity, including the extent to which these activities transfer credit risk of the underlying securitised exposures away from the bank to other entities; • the roles played by the bank in the securitisation process[222] and an indication of the extent of the bank's involvement in each of them; and the regulatory capital approaches (e.g. RBA, IAA and SFA) that the bank follows for its securitisation activities.
	(b)	Summary of the bank's accounting policies for securitisation activities, including: • whether the transactions are treated as sales or financings; • recognition of gain on sale; • key assumptions for valuing retained interests, including any significant changes since the last reporting period and the impact of such changes; and • treatment of synthetic securitisations if this is not covered by other accounting policies (e.g. on derivatives).
	(c)	Names of ECAIs used for securitisations and the types of securitisation exposure for which each agency is used.
Quantitative disclosures*	(d)	The total outstanding exposures securitised by the bank and subject to the securitisation framework (broken down into traditional/synthetic), by exposure type.[223,224,225]
	(e)	For exposures securitised by the bank and subject to the securitisation framework:[225] • amount of impaired/past due assets securitised; and • losses recognised by the bank during the current period[226] broken down by exposure type.
	(f)	Aggregate amount of securitisation exposures retained or purchased[227] broken down by exposure type.[223]
	(g)	Aggregate amount of securitisation exposures retained or purchased[227] and the associated IRB capital charges for these exposures broken down into a meaningful number of risk weight bands. Exposures that have been deducted entirely from Tier 1 capital, credit enhancing I/Os deducted from Total Capital, and other exposures deducted from total capital should be disclosed separately by type of underlying asset.

[222] For example: originator, investor, servicer, provider of credit enhancement, sponsor of asset backed commercial paper facility, liquidity provider, swap provider.

[223] For example, credit cards, home equity, auto, etc.

[224] Securitisation transactions in which the originating bank does not retain any securitisation exposure should be shown separately but need only be reported for the year of inception.

[225] Where relevant, banks are encouraged to differentiate between exposures resulting from activities in which they act only as sponsors, and exposures that result from all other bank securitisation activities that are subject to the securitisation framework.

[226] For example, charge-offs/allowances (if the assets remain on the bank's balance sheet) or write-downs of I/O strips and other residual interests.

[227] Securitisation exposures, as noted in Part 2, Section IV, include, but are not restricted to, securities, liquidity facilities, other commitments and credit enhancements such as I/O strips, cash collateral accounts and other subordinated assets.

	(h)	For securitisations subject to the early amortisation treatment, the following items by underlying asset type for securitised facilities: • the aggregate drawn exposures attributed to the seller's and investors' interests; • the aggregate IRB capital charges incurred by the bank against its retained (i.e. the seller's) shares of the drawn balances and undrawn lines; and • the aggregate IRB capital charges incurred by the bank against the investor's shares of drawn balances and undrawn lines.
	(i)	Banks using the standardised approach are also subject to disclosures (g) and (h), but should use the capital charges for the standardised approach.
	(j)	Summary of current year's securitisation activity, including the amount of exposures securitised (by exposure type), and recognised gain or loss on sale by asset type.

3. Market risk

Table 10

Market risk: disclosures for banks using the standardised approach[228]

Qualitative disclosures	(a)	The general qualitative disclosure requirement (paragraph 824) for market risk including the portfolios covered by the standardised approach.
Quantitative disclosures	(b)	The capital requirements for: • interest rate risk; • equity position risk; • foreign exchange risk; and • commodity risk.

[228] The standardised approach here refers to the "standardised measurement method" as defined in Part 2, Section VI C.

Table 11

Market risk: disclosures for banks using the internal models approach (IMA) for trading portfolios

Qualitative disclosures	(a)	The general qualitative disclosure requirement (paragraph 824) for market risk including the portfolios covered by the IMA. In addition, a discussion of the extent of and methodologies for compliance with the "Prudent valuation guidance" for positions held in the trading book (paragraphs 690 to 701).
	(b)	The discussion should include an articulation of the soundness standards on which the bank's internal capital adequacy assessment is based. It should also include a description of the methodologies used to achieve a capital adequacy assessment that is consistent with the soundness standards.
	(c)	For each portfolio covered by the IMA: • the characteristics of the models used; • a description of stress testing applied to the portfolio; and • a description of the approach used for backtesting/validating the accuracy and consistency of the internal models and modelling processes.
	(d)	The scope of acceptance by the supervisor.
Quantitative disclosures	(e)	For trading portfolios under the IMA: • The high, mean and low VaR values over the reporting period and period-end; and • A comparison of VaR estimates with actual gains/losses experienced by the bank, with analysis of important "outliers" in backtest results.

4. *Operational risk*

Table 12

Operational risk

Qualitative disclosures	(a)	In addition to the general qualitative disclosure requirement (paragraph 824), the approach(es) for operational risk capital assessment for which the bank qualifies.
	(b)	Description of the AMA, if used by the bank, including a discussion of relevant internal and external factors considered in the bank's measurement approach. In the case of partial use, the scope and coverage of the different approaches used.
	(c) *	For banks using the AMA, a description of the use of insurance for the purpose of mitigating operational risk.

5. *Equities*

Table 13

Equities: disclosures for banking book positions

Qualitative Disclosures	(a)	The general qualitative disclosure requirement (paragraph 824) with respect to equity risk, including: • differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; and • discussion of important policies covering the valuation and accounting of equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices.
Quantitative Disclosures*	(b)	Value disclosed in the balance sheet of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly quoted share values where the share price is materially different from fair value.
	(c)	The types and nature of investments, including the amount that can be classified as: • Publicly traded; and • Privately held.
	(d)	The cumulative realised gains (losses) arising from sales and liquidations in the reporting period.
	(e)	• Total unrealised gains (losses)[229] • Total latent revaluation gains (losses)[230] • any amounts of the above included in Tier 1 and/or Tier 2 capital.
	(f)	Capital requirements broken down by appropriate equity groupings, consistent with the bank's methodology, as well as the aggregate amounts and the type of equity investments subject to any supervisory transition or grandfathering provisions regarding regulatory capital requirements.

6. *Interest rate risk in the banking book*

Table 14

Interest rate risk in the banking book (IRRBB)

Qualitative disclosures	(a)	The general qualitative disclosure requirement (paragraph 824), including the nature of IRRBB and key assumptions, including assumptions regarding loan prepayments and behaviour of non-maturity deposits, and frequency of IRRBB measurement.
Quantitative disclosures	(b)	The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method for measuring IRRBB, broken down by currency (as relevant).

[229] Unrealised gains (losses) recognised in the balance sheet but not through the profit and loss account.

[230] Unrealised gains (losses) not recognised either in the balance sheet or through the profit and loss account.

Annex 1

The 15% of Tier 1 Limit on Innovative Instruments

1. This Annex is meant to clarify the calculation of the 15% limit on innovative instruments agreed by the Committee in its press release of October 1998.

2. Innovative instruments will be limited to 15% of Tier 1 capital, net of goodwill. To determine the allowable amount of innovative instruments, banks and supervisors should multiply the amount of non-innovative Tier 1 by 17.65%. This number is derived from the proportion of 15% to 85% (i.e. 15%/85% = 17.65%).

3. As an example, take a bank with €75 of common equity, €15 of non-cumulative perpetual preferred stock, €5 of minority interest in the common equity account of a consolidated subsidiary, and €10 of goodwill. The net amount of non-innovative Tier 1 is €75+€15+€5-€10 = €85.

4. The allowable amount of innovative instruments this bank may include in Tier 1 capital is €85 x 17.65% = €15. If the bank issues innovative Tier 1 instruments up to its limit, total Tier 1 will amount to €85 + €15 = €100. The percentage of innovative instruments to total Tier 1 would equal 15%.

Annex 1a

Definition of Capital Included in the Capital Base

A. Capital elements

Tier 1 (a) Paid-up share capital/common stock

(b) Disclosed reserves

Tier 2 (a) Undisclosed reserves

(b) Asset revaluation reserves

(c) General provisions/general loan-loss reserves (subject to provisions of paragraphs 42 and 43)

(d) Hybrid (debt/equity) capital instruments

(e) Subordinated debt

Tier 3 At the discretion of their national authority, banks may also use a third tier of capital (Tier 3), consisting of short-term subordinated debt as defined in paragraphs 49(xxi) and 49(xxii) of this Framework, for the sole purpose of meeting a proportion of the capital requirements for market risks.

The sum of Tier 1, Tier 2, and Tier 3 elements will be eligible for inclusion in the capital base, subject to the following limits.

B. Limits and restrictions

(i) The total of Tier 2 (supplementary) elements will be limited to a maximum of 100% of the total of Tier 1 elements;

(ii) Subordinated term debt will be limited to a maximum of 50% of Tier 1 elements;

(iii) Tier 3 capital will be limited to 250% of a bank's Tier 1 capital that is required to support market risks.

(iv) Where general provisions/general loan-loss reserves include amounts reflecting lower valuations of asset or latent but unidentified losses present in the balance sheet, the amount of such provisions or reserves will be limited to a maximum of 1.25 percentage points;

(v) Asset revaluation reserves which take the form of latent gains on unrealised securities (see below) will be subject to a discount of 55%.

C. Deductions from the capital base

From Tier 1: Goodwill and increase in equity capital resulting from a securitisation exposure, pursuant to paragraph 562 of this Framework

50% from Tier 1 and 50% from Tier 2 capital:

(i) Investments in unconsolidated banking and financial subsidiary companies.

N.B. The presumption is that this Framework would be applied on a consolidated basis to banking groups.

(ii) Investments in the capital of other banks and financial institutions (at the discretion of national authorities).

(iii) Significant minority investments in other financial entities.

D. Definition of capital elements

(i) **Tier 1**: includes only **permanent shareholders' equity** (issued and fully paid ordinary shares/common stock and perpetual non-cumulative preference shares) and **disclosed reserves** (created or increased by appropriations of retained earnings or other surplus, e.g. share premiums, retained profit, general reserves and legal reserves). Disclosed reserves also include general funds (such as fund for general banking risk in certain EC countries) of the same quality that meet the following criteria:

- Allocations to the funds must be made out of post-tax retained earnings or out of pre-tax earnings adjusted for all potential tax liabilities;
- The funds and movements into or out of them must be disclosed separately in the bank's published accounts;
- The funds must be available to a bank to meet losses for unrestricted and immediate use as soon as they occur;
- Losses cannot be charged directly to the funds but must be taken through the profit and loss account.

In the case of consolidated accounts, this also includes minority interests in the equity of subsidiaries which are less than wholly owned. This basic definition of capital excludes revaluation reserves and cumulative preference shares.

(ii) **Tier 2**

(a) Undisclosed reserves are eligible for inclusion within supplementary elements provided these reserves are accepted by the supervisor. Such reserves consist of that part of the accumulated after-tax surplus of retained profits which banks in some countries may be permitted to maintain as an undisclosed reserve. Apart from the fact that the reserve is not identified in the published balance sheet, it should have the same high quality and character as a disclosed capital reserve; as such, it should not be encumbered by any provision or other known liability but should be freely and immediately available to meet unforeseen future losses. This definition of undisclosed reserves excludes hidden values arising from holdings of securities in the balance sheet at below current market prices (see below).

(b) **Revaluation** reserves arise in two ways. Firstly, in some countries, banks (and other commercial companies) are permitted to revalue fixed assets, normally their own premises, from time to time in line with the change in market values. In some of these countries the amount of such revaluations is determined by law. Revaluations of this kind are reflected on the face of the balance sheet as a revaluation reserve.

Secondly, hidden values of "latent" revaluation reserves may be present as a result of long-term holdings of equity securities valued in the balance sheet at the historic cost of acquisition.

Both types of revaluation reserve may be included in Tier 2 provided that the assets are prudently valued, fully reflecting the possibility of price fluctuation and forced sale. In the case of "latent" revaluation reserves a discount of 55% will be applied to the difference between historic cost book value and market value to reflect the potential volatility of this form of unrealised capital and the notional tax charge on it.

(c) **General provisions/general loan-loss reserves** (for banks using the Standardised Approach for credit risk): provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses which subsequently materialise and therefore qualify for inclusion within supplementary elements. Provisions ascribed to identified deterioration of particular assets or known liabilities, whether individual or grouped, should be excluded. Furthermore, general provisions/general loan-loss reserves eligible for inclusion in Tier 2 will be limited to a maximum of 1.25 percentage points of weighted risk assets

(d) **Hybrid (debt/equity) capital instruments**. This heading includes a range of instruments which combine characteristics of equity capital and of debt. Their precise specifications differ from country to country, but they should meet the following requirements:

- they are *unsecured, subordinated* and *fully paid-up*;
- they are *not redeemable* at the initiative of the holder or without the prior consent of the supervisory authority;
- they are *available to participate in losses* without the bank being obliged to cease trading (unlike conventional subordinated debt);
- although the capital instrument may carry an obligation to pay interest that cannot permanently be reduced or waived (unlike dividends on ordinary shareholders' equity), *it should allow service obligations to be deferred* (as with cumulative preference shares) where the profitability of the bank would not support payment.

Cumulative preference shares, having these characteristics, would be eligible for inclusion in this category. In addition, the following are examples of instruments that may be eligible for inclusion: long-term preferred shares in Canada, titres participatifs and titres subordonnés à durée indéterminée in France, Genusscheine in Germany, perpetual subordinated debt and preference shares in the United Kingdom and mandatory convertible debt instruments in the United States. Debt capital instruments which do not meet these criteria may be eligible for inclusion in item (e).

(e) **Subordinated term debt**: includes conventional unsecured subordinated debt capital instruments with a minimum original fixed term to maturity of over five years and limited life redeemable preference shares. During the last five years to maturity, a cumulative discount (or amortisation) factor of 20% per year will be applied to reflect the diminishing value of these instruments as a continuing source of strength. Unlike instruments included in item (d), these instruments are not normally available to participate in the losses of a bank which continues trading. For this reason these instruments will be limited to a maximum of 50% of Tier 1.

Annex 2

Standardised Approach – Implementing the Mapping Process

1. Because supervisors will be responsible for assigning an eligible ECAI's credit risk assessments to the risk weights available under the standardised approach, they will need to consider a variety of qualitative and quantitative factors to differentiate between the relative degrees of risk expressed by each assessment. Such qualitative factors could include the pool of issuers that each agency covers, the range of ratings that an agency assigns, each rating's meaning, and each agency's definition of default, among others.

2. Quantifiable parameters may help to promote a more consistent mapping of credit risk assessments into the available risk weights under the standardised approach. This Annex summarises the Committee's proposals to help supervisors with mapping exercises. The parameters presented below are intended to provide guidance to supervisors and are not intended to establish new or complement existing eligibility requirements for ECAIs.

Evaluating CDRs: two proposed measures

3. To help ensure that a particular risk weight is appropriate for a particular credit risk assessment, the Committee recommends that supervisors evaluate the cumulative default rate (CDR) associated with all issues assigned the same credit risk rating. Supervisors would evaluate two separate measures of CDRs associated with each risk rating contained in the standardised approach, using in both cases the CDR measured over a three-year period.

- To ensure that supervisors have a sense of the long-run default experience over time, supervisors should evaluate the ten-year average of the three-year CDR when this depth of data is available.[231] For new rating agencies or for those that have compiled less than ten years of default data, supervisors may wish to ask rating agencies what they believe the 10-year average of the three-year CDR would be for each risk rating and hold them accountable for such an evaluation thereafter for the purpose of risk weighting the claims they rate.
- The other measure that supervisors should consider is the most recent three-year CDR associated with each credit risk assessment of an ECAI.

4. Both measurements would be compared to aggregate, historical default rates of credit risk assessments that were compiled by the Committee and that are believed to represent an equivalent level of credit risk.

5. As three-year CDR data is expected to be available from ECAIs, supervisors should be able to compare the default experience of a particular ECAI's assessments with those issued by other rating agencies, in particular major agencies rating a similar population.

[231] In 2002, for example, a supervisor would calculate the average of the three-year CDRs for issuers assigned to each rating grade (the "cohort") for each of the ten years 1990 to1999.

Mapping risk ratings to risk weights using CDRs

6. To help supervisors determine the appropriate risk weights to which an ECAI's risk ratings should be mapped, each of the CDR measures mentioned above could be compared to the following reference and benchmark values of CDRs:

- For each step in an ECAI's rating scale, a ten-year average of the three-year CDR would be compared to a long run "reference" three-year CDR that would represent a sense of the long-run international default experience of risk assessments.
- Likewise, for each step in the ECAI's rating scale, the two most recent three-year CDR would be compared to "benchmarks" for CDRs. This comparison would be intended to determine whether the ECAI's most recent record of assessing credit risk remains within the CDR supervisory benchmarks.

7. Table 1 below illustrates the overall framework for such comparisons.

Table 1

Comparisons of CDR Measures[232]

International Experience (derived from the combined experience of major rating agencies)	Compare to	External Credit Assessment Institution
Set by the Committee as guidance		*Calculated by national supervisors based on the ECAI's own default data*
Long-run "reference" CDR	⟺	Ten-year average of the three-year CDR
CDR Benchmarks	⟺	Two most recent three-year CDR

1. Comparing an ECAI's long-run average three-year CDR to a long-run "reference" CDR

8. For each credit risk category used in the standardised approach of this Framework, the corresponding long-run reference CDR would provide information to supervisors on what its default experience has been internationally. The ten-year average of an eligible ECAI's particular assessment would not be expected to match exactly the long-run reference CDR. The long run CDRs are meant as guidance for supervisors, and not as "targets" that ECAIs would have to meet. The recommended long-run "reference" three-year CDRs for each of the Committee's credit risk categories are presented in Table 2 below, based on the Committee's observations of the default experience reported by major rating agencies internationally.

232 It should be noted that each major rating agency would be subject to these comparisons as well, in which its individual experience would be compared to the aggregate international experience.

Table 2

Proposed long-run "reference" three-year CDRs

S&P Assessment ***(Moody's)***	**AAA-AA** ***(Aaa-Aa)***	**A** ***(A)***	**BBB** ***(Baa)***	**BB** ***(Ba)***	**B** ***(B)***
20-year average of three-year CDR	0.10%	0.25%	1.00%	7.50%	20.00%

2. Comparing an ECAI's most recent three-year CDR to CDR Benchmarks

9. Since an ECAI's own CDRs are not intended to match the reference CDRs exactly, it is important to provide a better sense of what upper bounds of CDRs are acceptable for each assessment, and hence each risk weight, contained in the standardised approach.

10. It is the Committee's general sense that the upper bounds for CDRs should serve as guidance for supervisors and not necessarily as mandatory requirements. Exceeding the upper bound for a CDR would therefore not necessarily require the supervisor to increase the risk weight associated with a particular assessment in all cases if the supervisor is convinced that the higher CDR results from some temporary cause other than weaker credit risk assessment standards.

11. To assist supervisors in interpreting whether a CDR falls within an acceptable range for a risk rating to qualify for a particular risk weight, two benchmarks would be set for each assessment, namely a "monitoring" level benchmark and a "trigger" level benchmark.

(a) "Monitoring" level benchmark

12. Exceeding the "monitoring" level CDR benchmark implies that a rating agency's current default experience for a particular credit risk-assessment grade is markedly higher than international default experience. Although such assessments would generally still be considered eligible for the associated risk weights, supervisors would be expected to consult with the relevant ECAI to understand why the default experience appears to be significantly worse. If supervisors determine that the higher default experience is attributable to weaker standards in assessing credit risk, they would be expected to assign a higher risk category to the ECAI's credit risk assessment.

(b) "Trigger" level

13. Exceeding the "trigger" level benchmark implies that a rating agency's default experience is considerably above the international historical default experience for a particular assessment grade. Thus there is a presumption that the ECAI's standards for assessing credit risk are either too weak or are not applied appropriately. If the observed three-year CDR exceeds the trigger level in two consecutive years, supervisors would be expected to move the risk assessment into a less favourable risk category. However, if supervisors determine that the higher observed CDR is not attributable to weaker

assessment standards, then they may exercise judgement and retain the original risk weight.[233]

14. In all cases where the supervisor decides to leave the risk category unchanged, it may wish to rely on Pillar 2 of this Framework and encourage banks to hold more capital temporarily or to establish higher reserves.

15. When the supervisor has increased the associated risk category, there would be the opportunity for the assessment to again map to the original risk category if the ECAI is able to demonstrate that its three-year CDR falls and remains below the monitoring level for two consecutive years.

(c) Calibrating the benchmark CDRs

16. After reviewing a variety of methodologies, the Committee decided to use Monte Carlo simulations to calibrate both the monitoring and trigger levels for each credit risk assessment category. In particular, the proposed monitoring levels were derived from the 99[th] percentile confidence interval and the trigger level benchmark from the 99.9[th] percentile confidence interval. The simulations relied on publicly available historical default data from major international rating agencies. The levels derived for each risk assessment category are presented in Table 3 below, rounded to the first decimal:

Table 3

Proposed three-year CDR benchmarks

S&P Assessment ***(Moody's)***	**AAA-AA** ***(Aaa-Aa)***	**A** ***(A)***	**BBB** ***(Baa)***	**BB** ***(Ba)***	**B** ***(B)***
Monitoring Level	0.8%	1.0%	2.4%	11.0%	28.6%
Trigger Level	1.2%	1.3%	3.0%	12.4%	35.0%

[233] For example, if supervisors determine that the higher default experience is a temporary phenomenon, perhaps because it reflects a temporary or exogenous shock such as a natural disaster, then the risk weighting proposed in the standardised approach could still apply. Likewise, a breach of the trigger level by several ECAIs simultaneously may indicate a temporary market change or exogenous shock as opposed to a loosening of credit standards. In either scenario, supervisors would be expected to monitor the ECAI's assessments to ensure that the higher default experience is not the result of a loosening of credit risk assessment standards.

Annex 3

Capital Treatment for Failed Trades and Non-DvP Transactions

I. Overarching principles

1. Banks should continue to develop, implement and improve systems for tracking and monitoring the credit risk exposures arising from unsettled and failed transactions as appropriate for producing management information that facilitates action on a timely basis, pursuant to paragraph 88 and 89 of this Framework.

2. Transactions settled through a delivery-versus-payment system (DvP)[234], providing simultaneous exchanges of securities for cash, expose firms to a risk of loss on the difference between the transaction valued at the agreed settlement price and the transaction valued at current market price (i.e. positive current exposure). Transactions where cash is paid without receipt of the corresponding receivable (securities, foreign currencies, gold, or commodities) or, conversely, deliverables were delivered without receipt of the corresponding cash payment (non-DvP, or free-delivery) expose firms to a risk of loss on the full amount of cash paid or deliverables delivered. The current rules set out specific capital charges that address these two kinds of exposures.

3. The following capital treatment is applicable to all transactions on securities, foreign exchange instruments, and commodities that give rise to a risk of delayed settlement or delivery. This includes transactions through recognised clearing houses that are subject to daily mark-to-market and payment of daily variation margins and that involve a mismatched trade. Repurchase and reverse-repurchase agreements as well as securities lending and borrowing that have failed to settle are excluded from this capital treatment[235].

4. In cases of a system wide failure of a settlement or clearing system, a national supervisor may use its discretion to waive capital charges until the situation is rectified.

5. Failure of a counterparty to settle a trade in itself will not be deemed a default for purposes of credit risk under this Framework.

6. In applying a risk weight to failed free-delivery exposures, banks using the IRB approach for credit risk may assign PDs to counterparties for which they have no other banking book exposure on the basis of the counterparty's external rating. Banks using the Advanced IRB approach may use a 45% LGD in lieu of estimating LGDs so long as they apply it to all failed trade exposures. Alternatively, banks using the IRB approach may opt to apply the standardised approach risk weights or a 100% risk weight.

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[234] For the purpose of this Framework, DvP transactions include payment-versus-payment (PvP) transactions.

[235] All repurchase and reverse-repurchase agreements as well as securities lending and borrowing, including those that have failed to settle, are treated in accordance with Annex 4 or the sections on credit risk mitigation of this Framework.

II. Capital requirements

7. For DvP transactions, if the payments have not yet taken place five business days after the settlement date, firms must calculate a capital charge by multiplying the positive current exposure of the transaction by the appropriate factor, according to the Table 1 below.

Table 1

Number of working days after the agreed settlement date	Corresponding risk multiplier
From 5 to 15	8%
From 16 to 30	50%
From 31 to 45	75%
46 or more	100%

A reasonable transition period may be allowed for firms to upgrade their information system to be able to track the number of days after the agreed settlement date and calculate the corresponding capital charge.

8. For non-DvP transactions (i.e. free deliveries), after the first contractual payment/delivery leg, the bank that has made the payment will treat its exposure as a loan if the second leg has not been received by the end of the business day[236]. This means that a bank under the IRB approach will apply the appropriate IRB formula set out in this Framework, for the exposure to the counterparty, in the same way as it does for all other banking book exposures. Similarly, banks under the standardised approach will use the standardised risk weights set forth in this Framework. However, when exposures are not material, banks may choose to apply a uniform 100% risk-weight to these exposures, in order to avoid the burden of a full credit assessment. If five business days after the second contractual payment/delivery date the second leg has not yet effectively taken place, the bank that has made the first payment leg will deduct from capital the full amount of the value transferred plus replacement cost, if any. This treatment will apply until the second payment/delivery leg is effectively made.

[236] If the dates when two payment legs are made are the same according to the time zones where each payment is made, it is deemed that they are settled on the same day. For example, if a bank in Tokyo transfers Yen on day X (Japan Standard Time) and receives corresponding US Dollar via CHIPS on day X (US Eastern Standard Time), the settlement is deemed to take place on the same value date.

Annex 4

Treatment of Counterparty Credit Risk and Cross-Product Netting

1. This rule identifies permissible methods for estimating the Exposure at Default (EAD) or the exposure amount for instruments with counterparty credit risk (CCR) under this Framework.[237] Banks may seek supervisory approval to make use of an internal modelling method meeting the requirements and specifications identified herein. As alternatives banks may also use the standardised method or the current exposure method.

I. Definitions and general terminology

2. This section defines terms that will be used throughout this text.

A. General terms

- **Counterparty Credit Risk (CCR)** is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. An economic loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value at the time of default. Unlike a firm's exposure to credit risk through a loan, where the exposure to credit risk is unilateral and only the lending bank faces the risk of loss, CCR creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.

B. Transaction types

- **Long Settlement Transactions** are transactions where a counterparty undertakes to deliver a security, a commodity, or a foreign exchange amount against cash, other financial instruments, or commodities, or vice versa, at a settlement or delivery date that is contractually specified as more than the lower of the market standard for this particular instrument and five business days after the date on which the bank enters into the transaction.
- **Securities Financing Transactions (SFTs)** are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements.
- **Margin Lending Transactions** are transactions in which a bank extends credit in connection with the purchase, sale, carrying or trading of securities. Margin lending transactions do not include other loans that happen to be secured by securities

[237] In the present document, the terms "exposure at default" and "exposure amount" are used together in order to identify measures of exposure under both an IRB and a standardised approach for credit risk.

collateral. Generally, in margin lending transactions, the loan amount is collateralised by securities whose value is greater than the amount of the loan.

C. Netting sets, hedging sets, and related terms

- **Netting Set** is a group of transactions with a single counterparty that are subject to a legally enforceable bilateral netting arrangement and for which netting is recognised for regulatory capital purposes under the provisions of paragraphs 96 (i) to 96 (v) of this Annex, this Framework text on credit risk mitigation techniques, or the Cross-Product Netting Rules set forth in this Annex. Each transaction that is not subject to a legally enforceable bilateral netting arrangement that is recognised for regulatory capital purposes should be interpreted as its own netting set for the purpose of these rules.
- **Risk Position** is a risk number that is assigned to a transaction under the CCR standardised method (set out in this Annex) using a regulatory algorithm.
- **Hedging Set** is a group of risk positions from the transactions within a single netting set for which only their balance is relevant for determining the exposure amount or EAD under the CCR standardised method.
- **Margin Agreement** is a contractual agreement or provisions to an agreement under which one counterparty must supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level.
- **Margin Threshold** is the largest amount of an exposure that remains outstanding until one party has the right to call for collateral.
- **Margin Period of Risk** is the time period from the last exchange of collateral covering a netting set of transactions with a defaulting counterpart until that counterpart is closed out and the resulting market risk is re-hedged.
- **Effective Maturity under the Internal Model Method** for a netting set with maturity greater than one year is the ratio of the sum of expected exposure over the life of the transactions in a netting set discounted at the risk-free rate of return divided by the sum of expected exposure over one year in a netting set discounted at the risk-free rate. This effective maturity may be adjusted to reflect rollover risk by replacing expected exposure with effective expected exposure for forecasting horizons under one year. The formula is given in paragraph 38.
- **Cross-Product Netting** refers to the inclusion of transactions of different product categories within the same netting set pursuant to the Cross-Product Netting Rules set out in this Annex.
- **Current Market Value (CMV)** refers to the net market value of the portfolio of transactions within the netting set with the counterparty. Both positive and negative market values are used in computing CMV.

D. Distributions

- **Distribution of Market Values** is the forecast of the probability distribution of net market values of transactions within a netting set for some future date (the forecasting horizon) given the realised market value of those transactions up to the present time.
- **Distribution of Exposures** is the forecast of the probability distribution of market values that is generated by setting forecast instances of negative net market values

equal to zero (this takes account of the fact that, when the bank owes the counterparty money, the bank does not have an exposure to the counterparty).

- **Risk-Neutral Distribution** is a distribution of market values or exposures at a future time period where the distribution is calculated using market implied values such as implied volatilities.
- **Actual Distribution** is a distribution of market values or exposures at a future time period where the distribution is calculated using historic or realised values such as volatilities calculated using past price or rate changes.

E. Exposure measures and adjustments

- **Current Exposure** is the larger of zero, or the market value of a transaction or portfolio of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in bankruptcy. Current exposure is often also called Replacement Cost.
- **Peak Exposure** is a high percentile (typically 95% or 99%) of the distribution of exposures at any particular future date before the maturity date of the longest transaction in the netting set. A peak exposure value is typically generated for many future dates up until the longest maturity date of transactions in the netting set.
- **Expected Exposure** is the mean (average) of the distribution of exposures at any particular future date before the longest-maturity transaction in the netting set matures. An expected exposure value is typically generated for many future dates up until the longest maturity date of transactions in the netting set.
- **Effective Expected Exposure** at a specific date is the maximum expected exposure that occurs at that date or any prior date. Alternatively, it may be defined for a specific date as the greater of the expected exposure at that date, or the effective exposure at the previous date. In effect, the Effective Expected Exposure is the Expected Exposure that is constrained to be non-decreasing over time.
- **Expected Positive Exposure (EPE)** is the weighted average over time of expected exposures where the weights are the proportion that an individual expected exposure represents of the entire time interval. When calculating the minimum capital requirement, the average is taken over the first year or, if all the contracts in the netting set mature before one year, over the time period of the longest-maturity contract in the netting set.
- **Effective Expected Positive Exposure (Effective EPE)** is the weighted average over time of effective expected exposure over the first year, or, if all the contracts in the netting set mature before one year, over the time period of the longest-maturity contract in the netting set where the weights are the proportion that an individual expected exposure represents of the entire time interval.
- **Credit Valuation Adjustment** is an adjustment to the mid-market valuation of the portfolio of trades with a counterparty. This adjustment reflects the market value of the credit risk due to any failure to perform on contractual agreements with a counterparty. This adjustment may reflect the market value of the credit risk of the counterparty or the market value of the credit risk of both the bank and the counterparty.
- **One-Sided Credit Valuation Adjustment** is a credit valuation adjustment that reflects the market value of the credit risk of the counterparty to the firm, but does not reflect the market value of the credit risk of the bank to the counterparty.

F. CCR-related risks

- **Rollover Risk** is the amount by which expected positive exposure is understated when future transactions with a counterpart are expected to be conducted on an ongoing basis, but the additional exposure generated by those future transactions is not included in calculation of expected positive exposure.
- **General Wrong-Way Risk** arises when the probability of default of counterparties is positively correlated with general market risk factors.
- **Specific Wrong-Way Risk** arises when the exposure to a particular counterpart is positively correlated with the probability of default of the counterparty due to the nature of the transactions with the counterparty.

II. Scope of application

3. The methods for computing the exposure amount under the standardised approach for credit risk or EAD under the internal ratings-based (IRB) approach to credit risk described in this Annex are applicable to SFTs and OTC derivatives.

4. Such instruments generally exhibit the following abstract characteristics:

- The transactions generate a current exposure or market value.
- The transactions have an associated random future market value based on market variables.
- The transactions generate an exchange of payments or an exchange of a financial instrument (including commodities) against payment.
- The transactions are undertaken with an identified counterparty against which a unique probability of default can be determined[238].

5. Other common characteristics of the transactions to be covered may include the following:

- Collateral may be used to mitigate risk exposure and is inherent in the nature of some transactions.
- Short-term financing may be a primary objective in that the transactions mostly consist of an exchange of one asset for another (cash or securities) for a relatively short period of time, usually for the business purpose of financing. The two sides of the transactions are not the result of separate decisions but form an indivisible whole to accomplish a defined objective.
- Netting may be used to mitigate the risk.
- Positions are frequently valued (most commonly on a daily basis), according to market variables.
- Remargining may be employed.

[238] Transactions for which the probability of default is defined on a pooled basis are not included in this treatment of CCR.

6. An exposure value of zero for counterparty credit risk can be attributed to derivative contracts or SFTs that are outstanding with a central counterparty (e.g. a clearing house). This does not apply to counterparty credit risk exposures from derivative transactions and SFTs that have been rejected by the central counterparty. Furthermore, an exposure value of zero can be attributed to banks' credit risk exposures to central counterparties that result from the derivative transactions, SFTs or spot transactions that the bank has outstanding with the central counterparty. This exemption extends in particular to credit exposures from clearing deposits and from collateral posted with the central counterparty. A central counterparty is an entity that interposes itself between counterparties to contracts traded within one or more financial markets, becoming the legal counterparty such that it is the buyer to every seller and the seller to every buyer. In order to qualify for the above exemptions, the central counterparty CCR exposures with all participants in its arrangements must be fully collateralized on a daily basis, thereby providing protection for the central counterparty's CCR exposures. Assets held by a central counterparty as a custodian on the bank's behalf would not be subject to a capital requirement for counterparty credit risk exposure.

7. Under all of the three methods identified in this Annex, when a bank purchases credit derivative protection against a banking book exposure, or against a counterparty credit risk exposure, it will determine its capital requirement for the hedged exposure subject to the criteria and general rules for the recognition of credit derivatives, i.e. substitution or double default rules as appropriate. Where these rules apply, the exposure amount or EAD for counterparty credit risk from such instruments is zero.

8. The exposure amount or EAD for counterparty credit risk is zero for sold credit default swaps in the banking book where they are treated in the framework as a guarantee provided by the bank and subject to a credit risk charge for the full notional amount.

9. Under all three methods identified in this Annex, the exposure amount or EAD for a given counterparty is equal to the sum of the exposure amounts or EADs calculated for each netting set with that counterparty.

III. Cross-product netting rules[239]

10. Banks that receive approval to estimate their exposures to CCR using the internal model method may include within a netting set SFTs, or both SFTs and OTC derivatives subject to a legally valid form of bilateral netting that satisfies the following legal and operational criteria for a Cross-Product Netting Arrangement (as defined below). The bank must also have satisfied any prior approval or other procedural requirements that its national supervisor determines to implement for purposes of recognising a Cross-Product Netting Arrangement.

[239] These Cross-Product Netting Rules apply specifically to netting across SFTs, or to netting across both SFTs and OTC derivatives, for purposes of regulatory capital computation under IMM. They do not revise or replace the rules that apply to recognition of netting within the OTC derivatives, repo-style transaction, and margin lending transaction product categories under the 1988 Accord, as amended, or in this Framework. The rules in the 1988 Accord and this Framework continue to apply for purposes of regulatory capital recognition of netting within product categories under IMM or other relevant methodology.

Legal Criteria

11. The bank has executed a written, bilateral netting agreement with the counterparty that creates a single legal obligation, covering all included bilateral master agreements and transactions ("Cross-Product Netting Arrangement"), such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative (i) close-out values of any included individual master agreements and (ii) mark-to-market values of any included individual transactions (the "Cross-Product Net Amount"), in the event a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances.

12. The bank has written and reasoned legal opinions that conclude with a high degree of certainty that, in the event of a legal challenge, relevant courts or administrative authorities would find the firm's exposure under the Cross-Product Netting Arrangement to be the Cross-Product Net Amount under the laws of all relevant jurisdictions. In reaching this conclusion, legal opinions must address the validity and enforceability of the entire Cross-Product Netting Arrangement under its terms and the impact of the Cross-Product Netting Arrangement on the material provisions of any included bilateral master agreement.

- The laws of "all relevant jurisdictions" are: (i) the law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of the jurisdiction in which the branch is located, (ii) the law that governs the individual transactions, and (iii) the law that governs any contract or agreement necessary to effect the netting.
- A legal opinion must be generally recognised as such by the legal community in the firm's home country or a memorandum of law that addresses all relevant issues in a reasoned manner.

13. The bank has internal procedures to verify that, prior to including a transaction in a netting set, the transaction is covered by legal opinions that meet the above criteria.

14. The bank undertakes to update legal opinions as necessary to ensure continuing enforceability of the Cross-Product Netting Arrangement in light of possible changes in relevant law.

15. The Cross-Product Netting Arrangement does not include a walkaway clause. A walkaway clause is a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of the defaulter, even if the defaulter is a net creditor.

16. Each included bilateral master agreement and transaction included in the Cross-Product Netting Arrangement satisfies applicable legal requirements for recognition of (i) bilateral netting of derivatives contracts in paragraphs 96(i) to 96(v) of this Annex, or (ii) credit risk mitigation techniques in Part 2, Section II.D of this Framework.

17. The bank maintains all required documentation in its files.

Operational Criteria

18. The supervisory authority is satisfied that the effects of a Cross-Product Netting Arrangement are factored into the firm's measurement of a counterparty's aggregate credit risk exposure and that the bank manages its counterparty credit risk on such basis.

19. Credit risk to each counterparty is aggregated to arrive at a single legal exposure across products covered by the Cross-Product Netting Arrangement. This aggregation must be factored into credit limit and economic capital processes.

IV. Approval to adopt an internal modelling method to estimate EAD

20. A bank (meaning the individual legal entity or a group) that wishes to adopt an internal modelling method to measure exposure or EAD for regulatory capital purposes must seek approval from its supervisor. The internal modelling method is available both for banks that adopt the internal ratings-based approach to credit risk and for banks for which the standardised approach to credit risk applies to all of their credit risk exposures. The bank must meet all of the requirements given in Section V of this Annex and must apply the method to all of its exposures that are subject to counterparty credit risk, except for long settlement transactions.

21. A bank may also choose to adopt an internal modelling method to measure CCR for regulatory capital purposes for its exposures or EAD to only OTC derivatives, to only SFTs, or to both, subject to the appropriate recognition of netting specified above. The bank must apply the method to all relevant exposures within that category, except for those that are immaterial in size and risk. During the initial implementation of the internal models method, a bank may use the standardised method or the current exposure method for a portion of its business. The bank must submit a plan to its supervisor to bring all material exposures for that category of transactions under the internal model method.

22. For all OTC derivative transactions and for all long settlement transactions for which a bank has not received approval from its supervisor to use the internal models method, the bank must use either the standardised method or the current exposure method. Combined use of the current exposure method and the standardised method is permitted on a permanent basis within a group. Combined use of the current exposure method and the standardised method within a legal entity is only permissible for the cases indicated in paragraph 90 of this Annex.

23. Exposures or EAD arising from long settlement transactions can be determined using any of the three methods identified in this document regardless of the methods chosen for treating OTC derivatives and SFTs. In computing capital requirements for long settlement transactions banks that hold permission to use the internal ratings-based approach may opt to apply the risk weights under this Framework's standardised approach for credit risk on a permanent basis and irrespective to the materiality of such positions.

24. After adoption of the internal model method, the bank must comply with the above requirements on a permanent basis. Only under exceptional circumstances or for immaterial exposures can a bank revert to either the current exposure or standardised methods for all or part of its exposure. The bank must demonstrate that reversion to a less sophisticated method does not lead to an arbitrage of the regulatory capital rules.

V. Internal Model Method: measuring exposure and minimum requirements

A. Exposure amount or EAD under the internal model method

25. CCR exposure or EAD is measured at the level of the netting set as defined in Sections I and III of this Annex. A qualifying internal model for measuring counterparty credit exposure must specify the forecasting distribution for changes in the market value of the netting set attributable to changes in market variables, such as interest rates, foreign exchange rates, etc. The model then computes the firm's CCR exposure for the netting set at each future date given the changes in the market variables. For margined counterparties, the model may also capture future collateral movements. Banks may include eligible financial

collateral as defined in paragraphs 146 and 703 of this Framework in their forecasting distributions for changes in the market value of the netting set, if the quantitative, qualitative and data requirements for internal model method are met for the collateral.

26. To the extent that a bank recognises collateral in exposure amount or EAD via current exposure, a bank would not be permitted to recognise the benefits in its estimates of LGD. As a result, the bank would be required to use an LGD of an otherwise similar uncollateralised facility. In other words, the bank would be required to use an LGD that does not include collateral that is already included in EAD.

27. Under the Internal Model Method, the bank need not employ a single model. Although the following text describes an internal model as a simulation model, no particular form of model is required. Analytical models are acceptable so long as they are subject to supervisory review, meet all of the requirements set forth in this section and are applied to all material exposures subject to a CCR-related capital charge as noted above, with the exception of long settlement transactions, which are treated separately, and with the exception of those exposures that are immaterial in size and risk.

28. Expected exposure or peak exposure measures should be calculated based on a distribution of exposures that accounts for the possible non-normality of the distribution of exposures, including the existence of leptokurtosis ("fat tails"), where appropriate.

29. When using an internal model, exposure amount or EAD is calculated as the product of alpha times Effective EPE, as specified below:

$$\text{EAD} = \alpha \times \text{Effective EPE} \qquad (1)$$

30. Effective EPE ("Expected Positive Exposure") is computed by estimating expected exposure (EE_t) as the average exposure at future date t, where the average is taken across possible future values of relevant market risk factors, such as interest rates, foreign exchange rates, etc. The internal model estimates EE at a series of future dates t_1, t_2, t_3…[240] Specifically, "Effective EE" is computed recursively as

$$\text{Effective } EE_{t_k} = \max(\text{Effective } EE_{t_{k-1}}, EE_{t_k}) \qquad (2)$$

where the current date is denoted as t_0 and Effective EE_{t_0} equals current exposure.

31. In this regard, "Effective EPE" is the average Effective EE during the first year of future exposure. If all contracts in the netting set mature before one year, EPE is the average of expected exposure until all contracts in the netting set mature. Effective EPE is computed as a weighted average of Effective EE:

$$\mathit{Effective\ EPE} = \sum_{k=1}^{\min(1\mathit{year},\mathit{maturity})} \mathit{Effective\,EE}_{t_k} \times \Delta t_k \qquad (3)$$

where the weights $\Delta t_k = t_k - t_{k-1}$ allows for the case when future exposure is calculated at dates that are not equally spaced over time.

[240] In theory, the expectations should be taken with respect to the actual probability distribution of future exposure and not the risk-neutral one. Supervisors recognise that practical considerations may make it more feasible to use the risk-neutral one. As a result, supervisors will not mandate which kind of forecasting distribution to employ.

32. Alpha (α) is set equal to 1.4.

33. Supervisors have the discretion to require a higher alpha based on a firm's CCR exposures. Factors that may require a higher alpha include the low granularity of counterparties; particularly high exposures to general wrong-way risk; particularly high correlation of market values across counterparties; and other institution-specific characteristics of CCR exposures.

B. Own estimates for alpha

34. Banks may seek approval from their supervisors to compute internal estimates of alpha subject to a floor of 1.2, where alpha equals the ratio of economic capital from a full simulation of counterparty exposure across counterparties (numerator) and economic capital based on EPE (denominator), assuming they meet certain operating requirements. Eligible banks must meet all the operating requirements for internal estimates of EPE and must demonstrate that their internal estimates of alpha capture in the numerator the material sources of stochastic dependency of distributions of market values of transactions or of portfolios of transactions across counterparties (e.g. the correlation of defaults across counterparties and between market risk and default).

35. In the denominator, EPE must be used as if it were a fixed outstanding loan amount.

36. To this end, banks must ensure that the numerator and denominator of alpha are computed in a consistent fashion with respect to the modelling methodology, parameter specifications and portfolio composition. The approach used must be based on the firm's internal economic capital approach, be well-documented and be subject to independent validation. In addition, banks must review their estimates on at least a quarterly basis, and more frequently when the composition of the portfolio varies over time. Banks must assess the model risk.

37. Where appropriate, volatilities and correlations of market risk factors used in the joint simulation of market and credit risk should be conditioned on the credit risk factor to reflect potential increases in volatility or correlation in an economic downturn. Internal estimates of alpha should take account of the granularity of exposures.

C. Maturity

38. If the original maturity of the longest-dated contract contained in the set is greater than one year, the formula for effective maturity (M) in paragraph 320 of this Framework is replaced with the following:

$$M = \frac{\sum_{k=1}^{t_k \le 1year} Effective\,EE_k \times \Delta t_k \times df_k + \sum_{t_k > 1year}^{maturity} EE_k \times \Delta t_k \times df_k}{\sum_{k=1}^{t_k \le 1year} Effective\,EE_k \times \Delta t_k \times df_k}$$

where df_k is the risk-free discount factor for future time period t_k and the remaining symbols are defined above. Similar to the treatment under corporate exposures, M has a cap of five years.[241]

39. For netting sets in which all contracts have an original maturity of less than one year, the formula for effective maturity (M) in paragraph 320 of this Framework is unchanged and a floor of one year applies, with the exception of short-term exposures as described in paragraphs 321 to 323 of this Framework.

D. Margin agreements

40. If the netting set is subject to a margin agreement and the internal model captures the effects of margining when estimating EE, the model's EE measure may be used directly in equation (2). Such models are noticeably more complicated than models of EPE for unmargined counterparties. As such, they are subject to a higher degree of supervisory scrutiny before they are approved, as discussed below.

41. A bank that can model EPE without margin agreements but cannot achieve the higher level of modelling sophistication to model EPE with margin agreements can use the following method for margined counterparties. The method is a simple and conservative approximation to Effective EPE and sets Effective EPE for a margined counterparty equal to the lesser of:

- The threshold, if positive, under the margin agreement plus an add-on that reflects the potential increase in exposure over the margin period of risk. The add-on is computed as the expected increase in the netting set's exposure beginning from current exposure of zero over the margin period of risk.[242] A supervisory floor of five business days for netting sets consisting only of repo-style transactions subject to daily remargining and daily mark-to-market, and 10 business days for all other netting sets is imposed on the margin period of risk used for this purpose;
- Effective EPE without a margin agreement.

E. Model validation

42. Because counterparty exposures are driven by movements in market variables, the validation of an EPE model is similar to the validation of a Value-at-Risk (VaR) model that is used to measure market risk. Therefore, in principle, the qualitative standards in paragraph 718 (LXXIV) for the use of VaR models should be carried over to EPE models. However, an EPE model has additional elements that require validation:

- Interest rates, foreign exchange rates, equity prices, commodities, and other market risk factors must be forecast over long time horizons for measuring counterparty exposure. The performance of the forecasting model for market risk factors must be

[241] Conceptually, M equals the effective credit duration of the counterparty exposure. A bank that uses an internal model to calculate a one-sided credit valuation adjustment (CVA) can use the effective credit duration estimated by such a model in place of the above formula with prior approval of its supervisor.

[242] In other words, the add-on equals EE at the end of the margin period of risk assuming current exposure of zero. Since no roll-off of transactions would be occurring as part of this EE calculation, there would be no difference between EE and Effective EE.

validated over a long time horizon. In contrast, VaR for market risk is measured over a short time horizon (typically, one to ten days).

- The pricing models used to calculate counterparty exposure for a given scenario of future shocks to market risk factors must be tested as part of the model validation process. These pricing models may be different from those used to calculate VaR over a short horizon. Pricing models for options must account for the nonlinearity of option value with respect to market risk factors.
- An EPE model must capture transaction-specific information in order to aggregate exposures at the level of the netting set. Banks must verify that transactions are assigned to the appropriate netting set within the model.
- An EPE model must also include transaction-specific information in order to capture the effects of margining. It must take into account both the current amount of margin and margin that would be passed between counterparties in the future. Such a model must account for the nature of margin agreements (unilateral or bilateral), the frequency of margin calls, the margin period of risk, the threshold of unmargined exposure the bank is willing to accept, and the minimum transfer amount. Such a model must either model the mark-to-market change in the value of collateral posted or apply this Framework's rules for collateral.

43. Static, historical backtesting on representative counterparty portfolios must be part of the model validation process. At regular intervals as directed by its supervisor, a bank must conduct such backtesting on a number of representative counterparty portfolios (actual or hypothetical). These representative portfolios must be chosen based on their sensitivity to the material risk factors and correlations to which the bank is exposed.

44. Starting at a particular historical date, backtesting of an EPE model would use the internal model to forecast each portfolio's probability distribution of exposure at various time horizons. Using historical data on movements in market risk factors, backtesting then computes the actual exposures that would have occurred on each portfolio at each time horizon assuming no change in the portfolio's composition. These realised exposures would then be compared with the model's forecast distribution at various time horizons. The above must be repeated for several historical dates covering a wide range of market conditions (e.g. rising rates, falling rates, quiet markets, volatile markets). Significant differences between the realised exposures and the model's forecast distribution could indicate a problem with the model or the underlying data that the supervisor would require the bank to correct. Under such circumstances, supervisors may require additional capital. Unlike the backtesting requirement for VaR models prescribed in paragraph 718(Lxxiv) (b) and 718(xcviii), no particular statistical test is specified for backtesting of EPE models.

45. Under the internal model method, a measure that is more conservative than Effective EPE (e.g. a measure based on peak rather than average exposure) for every counterparty may be used in place of alpha times Effective EPE in equation (1) with the prior approval of the supervisor. The degree of relative conservatism will be assessed upon initial supervisory approval and subject to periodic validation.

46. Banks using an EPE model or a VaR model (as described in paragraphs 178 to 181 of this Framework) must meet the above validation requirements.

F. Operational requirements for EPE models

47. In order to be eligible to adopt an internal model for estimating EPE arising from CCR for regulatory capital purposes, a bank must meet the following operational requirements. These include meeting the requirements related to the qualifying standards on

CCR Management, a use test, stress testing, identification of wrong-way risk, and internal controls.

Qualifying standards on CCR Management

48. The bank must satisfy its supervisor that, in addition to meeting the operational requirements identified in paragraphs 49 to 69 below, it adheres to sound practices for CCR management, including those specified in paragraphs 777 (i) to 777 (xiv) of this Framework.

Use test

49. The distribution of exposures generated by the internal model used to calculate effective EPE must be closely integrated into the day-to-day CCR management process of the bank. For example, the bank could use the peak exposure from the distributions for counterparty credit limits or expected positive exposure for its internal allocation of capital. The internal model's output must accordingly play an essential role in the credit approval, counterparty credit risk management, internal capital allocations, and corporate governance of banks that seek approval to apply such models for capital adequacy purposes. Models and estimates designed and implemented exclusively to qualify for the internal models method are not acceptable.

50. A bank must have a credible track record in the use of internal models that generate a distribution of exposures to CCR. Thus, the bank must demonstrate that it has been using an internal model to calculate the distributions of exposures upon which the EPE calculation is based that meets broadly the minimum requirements for at least one year prior to supervisory approval.

51. Banks employing the internal model method must have an independent control unit that is responsible for the design and implementation of the firm's CCR management system, including the initial and on-going validation of the internal model. This unit must control input data integrity and produce and analyse reports on the output of the firm's risk measurement model, including an evaluation of the relationship between measures of risk exposure and credit and trading limits. This unit must be independent from business credit and trading units; it must be adequately staffed; it must report directly to senior management of the firm. The work of this unit should be closely integrated into the day-to-day credit risk management process of the firm. Its output should accordingly be an integral part of the process of planning, monitoring and controlling the firm's credit and overall risk profile.

52. The internal model used to generate the distribution of exposures must be part of a counterparty risk management framework that includes the identification, measurement, management, approval and internal reporting of counterparty risk.[243] This Framework must include the measurement of usage of credit lines (aggregating counterparty exposures with other credit exposures) and economic capital allocation. In addition to EPE (a measure of future exposure), a bank must measure and manage current exposures. Where appropriate, the bank must measure current exposure gross and net of collateral held. The use test is satisfied if a bank uses other counterparty risk measures, such as peak exposure or potential future exposure (PFE), based on the distribution of exposures generated by the same model to compute EPE.

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[243] This section draws heavily on the Counterparty Risk Management Policy Group's paper, *Improving Counterparty Risk Management Practices* (June 1999); a copy can be found online at http://www.mfainfo.org/washington/derivatives/Improving%20Counterparty%20risk.pdf.

53. A bank is not required to estimate or report EE daily, but to meet the use test it must have the systems capability to estimate EE daily, if necessary, unless it demonstrates to its supervisor that its exposures to CCR warrant some less frequent calculation. It must choose a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of the contracts. For example, a bank may compute EE on a daily basis for the first ten days, once a week out to one month, once a month out to eighteen months, once a quarter out to five years and beyond five years in a manner that is consistent with the materiality and composition of the exposure.

54. Exposure must be measured out to the life of all contracts in the netting set (not just to the one year horizon), monitored and controlled. The bank must have procedures in place to identify and control the risks for counterparties where exposure rises beyond the one-year horizon. Moreover, the forecasted increase in exposure must be an input into the firm's internal economic capital model.

Stress testing

55. A bank must have in place sound stress testing processes for use in the assessment of capital adequacy. These stress measures must be compared against the measure of EPE and considered by the bank as part of its internal capital adequacy assessment process. Stress testing must also involve identifying possible events or future changes in economic conditions that could have unfavourable effects on a firm's credit exposures and assessment of the firm's ability to withstand such changes. Examples of scenarios that could be used are; (i) economic or industry downturns, (ii) market-place events, or (iii) decreased liquidity conditions.

56. The bank must stress test its counterparty exposures including jointly stressing market and credit risk factors. Stress tests of counterparty risk must consider concentration risk (to a single counterparty or groups of counterparties), correlation risk across market and credit risk (for example, a counterparty for which a large market move would result in a large exposure, a material deterioration in credit quality, or both), and the risk that liquidating the counterparty's positions could move the market. Such stress tests must also consider the impact on the firm's own positions of such market moves and integrate that impact in its assessment of counterparty risk.

Wrong-way risk

57. Banks must be aware of exposures that give rise to a greater degree of general wrong-way risk.

58. A bank is said to be exposed to "specific wrong-way risk" if future exposure to a specific counterparty is expected to be high when the counterparty's probability of default is also high. For example, a company writing put options on its own stock creates wrong-way exposures for the buyer that is specific to the counterparty. A bank must have procedures in place to identify, monitor and control cases of specific wrong way risk, beginning at the inception of a trade and continuing through the life of the trade.

Integrity of Modelling Process

59. Other operational requirements focus on the internal controls needed to ensure the integrity of model inputs; specifically, the requirements address the transaction data, historical market data, frequency of calculation, and valuation models used in measuring EPE.

60. The internal model must reflect transaction terms and specifications in a timely, complete, and conservative fashion. Such terms include, but are not limited to, contract notional amounts, maturity, reference assets, collateral thresholds, margining arrangements,

netting arrangements, etc. The terms and specifications must reside in a secure database that is subject to formal and periodic audit. The process for recognising netting arrangements must require signoff by legal staff to verify the legal enforceability of netting and be input into the database by an independent unit. The transmission of transaction terms and specifications data to the internal model must also be subject to internal audit and formal reconciliation processes must be in place between the internal model and source data systems to verify on an ongoing basis that transaction terms and specifications are being reflected in EPE correctly or at least conservatively.

61. The internal model must employ current market data to compute current exposures. When using historical data to estimate volatility and correlations, at least three years of historical data must be used and must be updated quarterly or more frequently if market conditions warrant. The data should cover a full range of economic conditions, such as a full business cycle. A unit independent from the business unit must validate the price supplied by the business unit. The data must be acquired independently of the lines of business, must be fed into the internal model in a timely and complete fashion, and maintained in a secure database subject to formal and periodic audit. Banks must also have a well-developed data integrity process to scrub the data of erroneous and/or anomalous observations. To the extent that the internal model relies on proxy market data, for example for new products where three years of historical data may not be available, internal policies must identify suitable proxies and the bank must demonstrate empirically that the proxy provides a conservative representation of the underlying risk under adverse market conditions. If the internal model includes the effect of collateral on changes in the market value of the netting set, the bank must have adequate historical data to model the volatility of the collateral

62. The EPE model (and modifications made to it) must be subject to an internal model validation process. The process must be clearly articulated in firms' policies and procedures. The validation process must specify the kind of testing needed to ensure model integrity and identify conditions under which assumptions are violated and may result in an understatement of EPE. The validation process must include a review of the comprehensiveness of the EPE model, for example such as whether the EPE model covers all products that have a material contribution to counterparty risk exposures.

63. The use of an internal model to estimate EPE, and hence the exposure amount or EAD, of positions subject to a CCR capital charge will be conditional upon the explicit approval of the firm's supervisory authority. Home and host country supervisory authorities of banks that carry out material trading activities in multiple jurisdictions will work co-operatively to ensure an efficient approval process.

64. In this Framework and in prior documents, the Committee has issued guidance regarding the use of internal models to estimate certain parameters of risk and determine minimum capital charges against those risks. Supervisors will require that banks seeking to make use of internal models to estimate EPE meet similar requirements regarding, for example, the integrity of the risk management system, the skills of staff that will rely on such measures in operational areas and in control functions, the accuracy of models, and the rigour of internal controls over relevant internal processes. As an example, banks seeking to make use of an internal model to estimate EPE must demonstrate that they meet the Committee's general criteria for banks seeking to make use of internal models to assess market risk exposures, but in the context of assessing counterparty credit risk.[244]

[244] See Part 2, Section VI D 1 (paragraphs 718 (LXX) to 718 (LXXIII)).

65. Pillar 2 of this Framework provides general background and specific guidance to cover counterparty credit risks that may not be fully covered by the Pillar 1 process.

66. No particular form of model is required to qualify to make use of an internal model. Although this text describes an internal model as a simulation model, other forms of models, including analytic models, are acceptable subject to supervisory approval and review. Banks that seek recognition for the use of an internal model that is not based on simulations must demonstrate to their supervisors that the model meets all operational requirements.

67. For a bank that qualifies to net transactions, the bank must have internal procedures to verify that, prior to including a transaction in a netting set, the transaction is covered by a legally enforceable netting contract that meets the applicable requirements of paragraphs 96(I) to 96(v) of this Annex, this Framework text on credit risk mitigation techniques, or the Cross-Product Netting Rules set forth in this Annex.

68. For a bank that makes use of collateral to mitigate its CCR, the bank must have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the appropriate legal certainty standards as set out in Part 2, Section II.D of this Framework.

VI. Standardised Method

69. Banks that do not have approval to apply the internal models method for the relevant OTC transactions may use the standardised method. The standardised method can be used only for OTC derivatives; SFTs are subject to the treatments set out under the Internal Model Method of this Annex or under the Part 2, Section II.D, of this Framework. The exposure amount (under the standardised approach for credit risk) or EAD is to be calculated separately for each netting set. It is determined as follows:

$$\text{exposure amount or EAD} = \beta \cdot \max\left(CMV - CMC; \sum_j \left| \sum_i RPT_{ij} - \sum_l RPC_{lj} \right| \times CCF_j \right)$$

where:

CMV = current market value of the portfolio of transactions within the netting set with a counterparty gross of collateral, i.e. $CMV = \sum_i CMV_i$, where CMV_i is the current market value of transaction i.

CMC = current market value of the collateral assigned to the netting set, i.e. $CMC = \sum_l CMC_l$, where CMC_l is the current market value of collateral l.

i = index designating transaction.

l = index designating collateral.

j = index designating supervisory hedging sets. These hedging sets correspond to risk factors for which risk positions of opposite sign can be offset to yield a net risk position on which the exposure measure is then based.

RPT_{ij} = Risk position from *transaction* i with respect to hedging set j[245].

RPC_{lj} = Risk position from collateral l with respect to hedging set j.

CCF_j = Supervisory credit conversion factor with respect to the hedging set j[246].

β = Supervisory scaling parameter.

Collateral received from a counterparty has a positive sign; collateral posted to a counterparty has a negative sign.

Collateral that is recognised for the standardised approach is confined to the collateral that is eligible under paragraphs 146 and 703 of this Framework for credit risk mitigation.

70. When an OTC derivative transaction with linear risk profile (e.g. a forward, a future or a swap agreement) stipulates the exchange of a financial instrument (e.g. a bond, an equity, or a commodity) for a payment, the payment part is referred to as the payment leg. Transactions that stipulate the exchange of payment against payment (e.g. an interest rate swap or a foreign exchange forward) consist of two payment legs. The payment legs consist of the contractually agreed gross payments, including the notional amount of the transaction. Banks may disregard the interest rate risk from payment legs with a remaining maturity of less than one year from the following calculations. Banks may treat transactions that consist of two payment legs that are denominated in the same currency (e.g. interest rate swaps) as a single aggregate transaction. The treatment for payment legs applies to the aggregate transaction.

71. Transactions with linear risk profiles that have equity (including equity indices), gold, other precious metals or other commodities as the underlying financial instruments are mapped to a risk position in the respective equity (or equity index) or commodity (including gold and the other precious metals) hedging set. The payment leg of these transactions is mapped to an interest rate risk position within the appropriate interest rate hedging set. If the payment leg is denominated in a foreign currency, the transaction is also mapped to a foreign exchange risk position in the respective currency.

72. Transactions with linear risk profiles that have a debt instrument (e.g. a bond or a loan) as the underlying instrument are mapped to an interest rate risk positions with one risk position for the debt instrument and another risk position for the payment leg. Transactions with linear risk profiles that stipulate the exchange of payment against payment (including foreign exchange forwards) are mapped to an interest rate risk position for each of the payment legs. If the underlying debt instrument is denominated in a foreign currency, the debt instrument is mapped to a foreign exchange risk position in the respective currency. If a

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[245] E.g. a short-term FX forward with one leg denominated in the firm's domestic currency will be mapped into three risk positions: 1. an FX risk position, 2. a foreign currency interest rate risk position, 3. a domestic currency risk position.

[246] Calibration has been made assuming at the money forwards or swaps and given a forecasting horizon of one year.

payment leg is denominated in a foreign currency, the payment leg is also mapped to a foreign exchange risk position in this currency.[247] The exposure amount or EAD assigned to a foreign exchange basis swap transactions is zero.

73. For all but debt instruments, the size of a risk position from a transaction with linear risk profile is the effective notional value (market price multiplied by quantity) of the underlying financial instruments (including commodities) converted to the firm's domestic currency.

74. For debt instruments and the payment legs of all transactions, the size of the risk position is the effective notional value of the outstanding gross payments (including the notional amount) converted to the firm's domestic currency, multiplied by the modified duration of the debt instrument or payment leg, respectively.

75. The size of a risk position from a credit default swap is the notional value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.

76. The size of a risk position from an OTC derivative with non-linear risk profile (including options and swaptions) is equal to the delta equivalent effective notional value of the financial instrument that underlies the transaction, except in the case of an underlying debt instrument.

77. For OTC derivative with non-linear risk profiles (including options and swaptions), for which the underlying is a debt instrument or a payment leg, the size of the risk position is equal to the delta equivalent effective notional value of the financial instrument or payment leg multiplied by the modified duration of the debt instrument or payment leg.

78. Banks may use the following formulas to determine the size and sign of a risk position:

a. for all but debt instruments:

effective notional value, or delta equivalent notional value =

$$p_{ref} \frac{\partial V}{\partial p}$$

where

p_{ref}	price of the underlying instrument, expressed in the reference currency
v	value of the financial instrument (in the case of an option: option price; in the case of a transaction with a linear risk profile: value of the underlying instrument itself)
p	price of the underlying instrument, expressed in the same currency as v

b. for debt instruments and the payment legs of all transactions:

[247] E.g. a short-term FX forward with one leg denominated in the firm's domestic currency will be mapped into three risk positions: 1. an FX risk position, 2. a foreign currency interest rate risk position, 3. a domestic currency risk position.

effective notional value multiplied by the modified duration, or

delta equivalent in notional value multiplied by the modified duration

$$\frac{\partial V}{\partial r}$$

where

v	value of the financial instrument (in the case of an option: option price; in the case of a transaction with a linear risk profile: value of the underlying instrument itself or of the payment leg, respectively)
r	interest level

If v is denominated in a currency other than the reference currency, the derivative must be converted into the reference currency by multiplication with the relevant exchange rate.

79. The risk positions are to be grouped into hedging sets. For each hedging set, the absolute value amount of the sum of the resulting risk positions is computed. This sum is termed the "net risk position" and is represented as

$$\left| \sum_i RPT_{ij} - \sum_l RPC_{lj} \right|$$

in the formulas in paragraph 70 of this Annex.

80. Interest rate positions arising from debt instruments of low specific risk are to be mapped into one of six hedging sets for each represented currency. A debt instrument is classified as being of low specific risk when it is subject to a 1.6 percent or lower capital charge according to paragraphs 710 to 711(ii). Interest rate positions arising from the payment legs are to be assigned to the same hedging sets as interest rate risk positions from debt instruments of low specific risk. Interest rate positions arising from money deposits received from the counterparty as collateral are also to be assigned to the same hedging sets as interest rate risk positions from debt instruments of low specific risk. The six hedging sets per currency are defined by a combination of two criteria:

(i) The nature of the referenced interest rate — either a sovereign (government) rate or some other rate.

(ii) The remaining maturity or rate-adjustment frequency — less than one year, between one and five years, or longer than five years.

Table 1

Hedging Sets for Interest Rate Risk Positions Per Currency

Remaining maturity or rate-adjustment frequency	Sovereign-referenced interest rates	Non-sovereign-referenced interest rates
One year or less	X	X
Over one year to five years	X	X
Over five years	X	X

81. For underlying debt instruments (e.g. floating rate notes) or payment legs (e.g. floating rate legs of interest swaps) for which the interest rate is linked to a reference interest rate that represents a general market interest level (e.g. government bond yield, money market rate, swap rate), the rate-adjustment frequency is the length of the time interval up to the next re-adjustment of the reference interest rate. Otherwise, the remaining maturity is the remaining life of the underlying debt instrument, or, in the case of a payment leg, the remaining life of the transaction.

82. There is one hedging set for each issuer of a reference debt instrument that underlies a credit default swap.

83. There is one hedging set for each issuer of a debt instrument of high specific risk, i.e. debt instruments to which a capital charge of more than 1.60 percent applies under the standardised measurement method for interest rate risk in paragraph 710. The same applies to money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low specific risk outstanding. When a payment leg emulates a debt instrument of high specific risk (e.g. in the case of a total return swap with one leg that emulates a bond), there is also one hedging set for each issuer of the reference debt instrument. Banks may assign risk positions that arise from debt instruments of a certain issuer or from reference debt instruments of the same issuer that are emulated by payment legs or that underlie a credit default swap to the same hedging set.

84. Underlying financial instruments other than debt instruments (equities, precious metals, commodities, other instruments), are assigned to the same respective hedging sets only if they are identical or similar instruments. The similarity of instruments is established as follows:

- For equities, similar instruments are those of the same issuer. An equity index is treated as a separate issuer.
- For precious metals, similar instruments are those of the same metal. A precious metal index is treated as a separate precious metal.
- For commodities, similar instruments are those of the same commodity. A commodity index is treated as a separate commodity.
- For electric power, delivery rights and obligations that refer to the same peak or off-peak load time interval within any 24 hour interval are similar instruments.

85. The credit conversion factor that is applied to a net risk position from a hedging set depends on the supervisory hedging set category as given in paragraphs 86 to 88 of this Annex.

86. The credit conversion factors for underlying financial instruments other than debt instruments and for foreign exchange rates are given in Table 2.

Table 2

Exchange Rates	Gold	Equity	Precious Metals (except gold)	Electric Power	Other Commodities (excluding precious metals)
2.5%	5.0%	7.0%	8.5%	4%	10.0%

87. The credit conversion factor for risk positions from debt instruments are as follows:

- 0.6 percent for risk positions from a debt instrument or reference debt instrument of high specific risk.
- 0.3 percent for risk position from a reference debt instrument that underlies a credit default swap and that is of low specific risk.
- 0.2 percent otherwise.

88. Underlying instruments of OTC derivatives that are not in any of the categories above are assigned to separate individual hedging sets for each category of underlying instrument. A credit conversion factor of 10 percent is applied to the notional equivalent amount.

89. There may be transactions with a non-linear risk profile for which the bank cannot determine the delta with a model that the supervisor has approved for the purposes for determining the minimum capital requirements for market risk (instrument models approved for the purposes of the standardised approach for market risk, or instrument models approved as part of the firm's admission to the internal modelling approach for market risk). In the case of payment legs and transactions with debt instruments as underlying, there may be transactions for which the bank cannot determine the modified duration with such a model. For these transactions, the supervisor will determine the size of the risk positions and the applicable credit conversion factors conservatively. Alternatively, supervisors may require the use of the current exposure method. Netting will not be recognised: in other words, the exposure amount or EAD is to be determined as if there were a netting set that comprises just the individual transaction.

90. The supervisory scaling parameter β (beta) is set at 1.4.

VII. Current Exposure Method

91. Banks that do not have approval to apply the internal models method may use the current exposure method as identified in paragraphs 186, 187 and 317 of this Framework. The current exposure method is to be applied to OTC derivatives only; SFTs are subject to the treatments set out under the Internal Model Method of this Annex or under the Part 2, Section II.D, of this Framework.

92. (Deleted)

92(i) Under the Current Exposure Method, banks must calculate the current replacement cost by marking contracts to market, thus capturing the current exposure without any need for estimation, and then adding a factor (the "add-on") to reflect the potential future exposure over the remaining life of the contract. It has been agreed that, in order to calculate the credit equivalent amount of these instruments under this current exposure method, a bank would sum:

- The total replacement cost (obtained by "marking to market") of all its contracts with positive value; and
- An amount for potential future credit exposure calculated on the basis of the total notional principal amount of its book, split by residual maturity as follows:

	Interest Rates	**FX and Gold**	**Equities**	**Precious Metals Except Gold**	**Other Commodities**
One year or less	0.0%	1.0%	6.0%	7.0%	10.0%
Over one year to five years	0.5%	5.0%	8.0%	7.0%	12.0%
Over five years	1.5%	7.5%	10.0%	8.0%	15.0%

Notes:

1. For contracts with multiple exchanges of principal, the factors are to be multiplied by the number of remaining payments in the contract.
2. For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date. In the case of interest rate contracts with remaining maturities of more than one year that meet the above criteria, the add-on factor is subject to a floor of 0.5%.
3. Forwards, swaps, purchased options and similar derivative contracts not covered by any of the columns of this matrix are to be treated as "other commodities".
4. No potential future credit exposure would be calculated for single currency floating/floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

92(ii). Supervisors will take care to ensure that the add-ons are based on effective rather than apparent notional amounts. In the event that the stated notional amount is leveraged or enhanced by the structure of the transaction, banks must use the effective notional amount when determining potential future exposure.

93. Banks can obtain capital relief for collateral as defined in paragraphs 146 and 703 of this Framework. The methodology for the recognition of eligible collateral follows that of the applicable approach for credit risk.

94. The counterparty credit risk exposure amount or EAD for single name credit derivative transactions in the trading book will be calculated using the potential future exposure add-on factors set out in paragraph 707 of this Framework.

95. To determine capital requirements for hedged banking book exposures, the treatment for credit derivatives in this Framework applies to qualifying credit derivative instruments.

96. Where a credit derivative is an n^{th}-to-default transaction (such as a first-to-default transaction), the treatment specified in paragraph 708 of this Framework applies.

Bilateral netting

96(i). Careful consideration has been given to the issue of **bilateral netting**, i.e. weighting the net rather than the gross claims with the same counterparties arising out of the full range of forwards, swaps, options and similar derivative contracts.[248] The Committee is concerned that if a liquidator of a failed counterparty has (or may have) the right to unbundle netted contracts, demanding performance on those contracts favourable to the failed counterparty and defaulting on unfavourable contracts, there is no reduction in counterparty risk.

96(ii). Accordingly, it has been agreed for capital adequacy purposes that:

(a) Banks may net transactions subject to novation under which any obligation between a bank and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.

(b) Banks may also net transactions subject to any legally valid form of bilateral netting not covered in (a), including other forms of novation.

(c) In both cases (a) and (b), a bank will need to satisfy its national supervisor that it has:[249]

  (i) A netting contract or agreement with the counterparty which creates a single legal obligation, covering all included transactions, such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

  (ii) Written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the bank's exposure to be such a net amount under:

[248] Payments netting, which is designed to reduce the operational costs of daily settlements, will not be recognised in the capital framework since the counterparty's gross obligations are not in any way affected.

[249] In cases where an agreement as described in 96(ii) (a) has been recognised prior to July 1994, the supervisor will determine whether any additional steps are necessary to satisfy itself that the agreement meets the requirements set out below.

- The law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of the jurisdiction in which the branch is located;
- The law that governs the individual transactions; and
- The law that governs any contract or agreement necessary to effect the netting.

The national supervisor, after consultation when necessary with other relevant supervisors, must be satisfied that the netting is enforceable under the laws of each of the relevant jurisdictions;[250]

(iii) Procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.

96(iii). Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating capital requirements pursuant to this Framework. A walkaway clause is a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

96(iv). Credit exposure on bilaterally netted forward transactions will be calculated as the sum of the net mark-to-market replacement cost, if positive, plus an add-on based on the notional underlying principal. The add-on for netted transactions (A_{Net}) will equal the weighted average of the gross add-on (A_{Gross})[251] and the gross add-on adjusted by the ratio of net current replacement cost to gross current replacement cost (NGR). This is expressed through the following formula:

$$A_{Net}=0.4*A_{Gross}+0.6*NGR*A_{Gross}$$

where :

NGR=level of net replacement cost/level of gross replaceent cost for transactions subject to legally enforceable netting agreements[252]

96(v). The scale of the gross add-ons to apply in this formula will be the same as those for non-netted transactions as set out in paragraphs 91 to 96 of this Annex. The Committee will

[250] Thus, if any of these supervisors is dissatisfied about enforceability under its laws, the netting contract or agreement will not meet this condition and neither counterparty could obtain supervisory benefit.

[251] A_{Gross} equals the sum of individual add-on amounts (calculated by multiplying the notional principal amount by the appropriate add-on factors set out in paragraph 92(i) of this Annex) of all transactions subject to legally enforceable netting agreements with one counterparty.

[252] National authorities may permit a choice of calculating the NGR on a counterparty by counterparty or on an aggregate basis for all transactions subject to legally enforceable netting agreements. If supervisors permit a choice of methods, the method chosen by an institution is to be used consistently. Under the aggregate approach, net negative current exposures to individual counterparties cannot be used to offset net positive current exposures to others, i.e. for each counterparty the net current exposure used in calculating the NGR is the maximum of the net replacement cost or zero. Note that under the aggregate approach, the NGR is to be applied individually to each legally enforceable netting agreement so that the credit equivalent amount will be assigned to the appropriate counterparty risk weight category.

continue to review the scale of add-ons to make sure they are appropriate. For purposes of calculating potential future credit exposure to a netting counterparty for forward foreign exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, notional principal is defined as the net receipts falling due on each value date in each currency. The reason for this is that offsetting contracts in the same currency maturing on the same date will have lower potential future exposure as well as lower current exposure.

Risk weighting

96(vi). Once the bank has calculated the credit equivalent amounts they are to be **weighted** according to the category of counterparty in the same way as in the main framework, including concessionary weighting in respect of exposures backed by eligible guarantees and collateral. The Committee will keep a close eye on the credit quality of participants in these markets and reserves the right to raise the weights if average credit quality deteriorates or if loss experience increases.

Annex 5

Illustrative IRB Risk Weights

1. The following tables provide illustrative risk weights calculated for four asset classes types under the internal ratings-based (IRB) approach to credit risk. Each set of risk weights for unexpected loss (UL) was produced using the appropriate risk-weight function of the risk-weight functions set out in Part 2, Section III. The inputs used to calculate the illustrative risk weights include measures of the PD, LGD, and an assumed effective maturity (M) of 2.5 years.

2. A firm-size adjustment applies to exposures made to small- and medium-sized entity (SME) borrowers (defined as corporate exposures where the reported sales for the consolidated group of which the firm is a part is less than €50 million). Accordingly, the firm size adjustment was made in determining the second set of risk weights provided in column two given that the turnover of the firm receiving the exposure is assumed to be €5 million.

Illustrative IRB Risk Weights for UL

Asset Class:	Corporate Exposures		Residential Mortgages		Other Retail Exposures		Qualifying Revolving Retail Exposures	
LGD:	45%	45%	45%	25%	45%	85%	45%	85%
Maturity: 2.5 years								
Turnover (millions of €)	50	5						
PD:								
0.03%	14.44%	11.30%	4.15%	2.30%	4.45%	8.41%	0.98%	1.85%
0.05%	19.65%	15.39%	6.23%	3.46%	6.63%	12.52%	1.51%	2.86%
0.10%	29.65%	23.30%	10.69%	5.94%	11.16%	21.08%	2.71%	5.12%
0.25%	49.47%	39.01%	21.30%	11.83%	21.15%	39.96%	5.76%	10.88%
0.40%	62.72%	49.49%	29.94%	16.64%	28.42%	53.69%	8.41%	15.88%
0.50%	69.61%	54.91%	35.08%	19.49%	32.36%	61.13%	10.04%	18.97%
0.75%	82.78%	65.14%	46.46%	25.81%	40.10%	75.74%	13.80%	26.06%
1.00%	92.32%	72.40%	56.40%	31.33%	45.77%	86.46%	17.22%	32.53%
1.30%	100.95%	78.77%	67.00%	37.22%	50.80%	95.95%	21.02%	39.70%
1.50%	105.59%	82.11%	73.45%	40.80%	53.37%	100.81%	23.40%	44.19%
2.00%	114.86%	88.55%	87.94%	48.85%	57.99%	109.53%	28.92%	54.63%
2.50%	122.16%	93.43%	100.64%	55.91%	60.90%	115.03%	33.98%	64.18%
3.00%	128.44%	97.58%	111.99%	62.22%	62.79%	118.61%	38.66%	73.03%
4.00%	139.58%	105.04%	131.63%	73.13%	65.01%	122.80%	47.16%	89.08%
5.00%	149.86%	112.27%	148.22%	82.35%	66.42%	125.45%	54.75%	103.41%
6.00%	159.61%	119.48%	162.52%	90.29%	67.73%	127.94%	61.61%	116.37%
10.00%	193.09%	146.51%	204.41%	113.56%	75.54%	142.69%	83.89%	158.47%
15.00%	221.54%	171.91%	235.72%	130.96%	88.60%	167.36%	103.89%	196.23%
20.00%	238.23%	188.42%	253.12%	140.62%	100.28%	189.41%	117.99%	222.86%

Annex 6

Supervisory Slotting Criteria for Specialised Lending

Table 1 — Supervisory Rating Grades for Project Finance Exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Market conditions	Few competing suppliers or substantial and durable advantage in location, cost, or technology. Demand is strong and growing	Few competing suppliers or better than average location, cost, or technology but this situation may not last. Demand is strong and stable	Project has no advantage in location, cost, or technology. Demand is adequate and stable	Project has worse than average location, cost, or technology. Demand is weak and declining
Financial ratios (e.g. *debt service coverage ratio (DSCR), loan life coverage ratio (LLCR), project life coverage ratio (PLCR), and debt-to-equity ratio*)	Strong financial ratios considering the level of project risk; very robust economic assumptions	Strong to acceptable financial ratios considering the level of project risk; robust project economic assumptions	Standard financial ratios considering the level of project risk	Aggressive financial ratios considering the level of project risk
Stress analysis	The project can meet its financial obligations under sustained, severely stressed economic or sectoral conditions	The project can meet its financial obligations under normal stressed economic or sectoral conditions. The project is only likely to default under severe economic conditions	The project is vulnerable to stresses that are not uncommon through an economic cycle, and may default in a normal downturn	The project is likely to default unless conditions improve soon

	Strong	Good	Satisfactory	Weak
Financial structure				
Duration of the credit compared to the duration of the project	Useful life of the project significantly exceeds tenor of the loan	Useful life of the project exceeds tenor of the loan	Useful life of the project exceeds tenor of the loan	Useful life of the project may not exceed tenor of the loan
Amortisation schedule	Amortising debt	Amortising debt	Amortising debt repayments with limited bullet payment	Bullet repayment or amortising debt repayments with high bullet repayment
Political and legal environment				
Political risk, including transfer risk, considering project type and mitigants	Very low exposure; strong mitigation instruments, if needed	Low exposure; satisfactory mitigation instruments, if needed	Moderate exposure; fair mitigation instruments	High exposure; no or weak mitigation instruments
Force majeure risk (war, civil unrest, etc),	Low exposure	Acceptable exposure	Standard protection	Significant risks, not fully mitigated
Government support and project's importance for the country over the long term	Project of strategic importance for the country (preferably export-oriented). Strong support from Government	Project considered important for the country. Good level of support from Government	Project may not be strategic but brings unquestionable benefits for the country. Support from Government may not be explicit	Project not key to the country. No or weak support from Government
Stability of legal and regulatory environment (risk of change in law)	Favourable and stable regulatory environment over the long term	Favourable and stable regulatory environment over the medium term	Regulatory changes can be predicted with a fair level of certainty	Current or future regulatory issues may affect the project
Acquisition of all necessary supports and approvals for such relief from local content laws	Strong	Satisfactory	Fair	Weak

	Strong	Good	Satisfactory	Weak
Enforceability of contracts, collateral and security	Contracts, collateral and security are enforceable	Contracts, collateral and security are enforceable	Contracts, collateral and security are considered enforceable even if certain non-key issues may exist	There are unresolved key issues in respect if actual enforcement of contracts, collateral and security
Transaction characteristics				
Design and technology risk	Fully proven technology and design	Fully proven technology and design	Proven technology and design — start-up issues are mitigated by a strong completion package	Unproven technology and design; technology issues exist and/or complex design
Construction risk				
Permitting and siting	All permits have been obtained	Some permits are still outstanding but their receipt is considered very likely	Some permits are still outstanding but the permitting process is well defined and they are considered routine	Key permits still need to be obtained and are not considered routine. Significant conditions may be attached
Type of construction contract	Fixed-price date-certain turnkey construction EPC (engineering and procurement contract)	Fixed-price date-certain turnkey construction EPC	Fixed-price date-certain turnkey construction contract with one or several contractors	No or partial fixed-price turnkey contract and/or interfacing issues with multiple contractors
Completion guarantees	Substantial liquidated damages supported by financial substance and/or strong completion guarantee from sponsors with excellent financial standing	Significant liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Adequate liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Inadequate liquidated damages or not supported by financial substance or weak completion guarantees

	Strong	Good	Satisfactory	Weak
Track record and financial strength of contractor in constructing similar projects.	Strong	Good	Satisfactory	Weak
Operating risk				
Scope and nature of operations and maintenance (O & M) contracts	Strong long-term O&M contract, preferably with contractual performance incentives, and/or O&M reserve accounts	Long-term O&M contract, and/or O&M reserve accounts	Limited O&M contract or O&M reserve account	No O&M contract: risk of high operational cost overruns beyond mitigants
Operator's expertise, track record, and financial strength	Very strong, or committed technical assistance of the sponsors	Strong	Acceptable	Limited/weak, or local operator dependent on local authorities
Off-take risk				
(a) If there is a take-or-pay or fixed-price off-take contract:	Excellent creditworthiness of off-taker; strong termination clauses; tenor of contract comfortably exceeds the maturity of the debt	Good creditworthiness of off-taker; strong termination clauses; tenor of contract exceeds the maturity of the debt	Acceptable financial standing of off-taker; normal termination clauses; tenor of contract generally matches the maturity of the debt	Weak off-taker; weak termination clauses; tenor of contract does not exceed the maturity of the debt
(b) If there is no take-or-pay or fixed-price off-take contract:	Project produces essential services or a commodity sold widely on a world market; output can readily be absorbed at projected prices even at lower than historic market growth rates	Project produces essential services or a commodity sold widely on a regional market that will absorb it at projected prices at historical growth rates	Commodity is sold on a limited market that may absorb it only at lower than projected prices	Project output is demanded by only one or a few buyers or is not generally sold on an organised market

	Strong	Good	Satisfactory	Weak
Supply risk				
Price, volume and transportation risk of feed-stocks; supplier's track record and financial strength	Long-term supply contract with supplier of excellent financial standing	Long-term supply contract with supplier of good financial standing	Long-term supply contract with supplier of good financial standing — a degree of price risk may remain	Short-term supply contract or long-term supply contract with financially weak supplier — a degree of price risk definitely remains
Reserve risks (e.g. natural resource development)	Independently audited, proven and developed reserves well in excess of requirements over lifetime of the project	Independently audited, proven and developed reserves in excess of requirements over lifetime of the project	Proven reserves can supply the project adequately through the maturity of the debt	Project relies to some extent on potential and undeveloped reserves
Strength of Sponsor				
Sponsor's track record, financial strength, and country/sector experience	Strong sponsor with excellent track record and high financial standing	Good sponsor with satisfactory track record and good financial standing	Adequate sponsor with adequate track record and good financial standing	Weak sponsor with no or questionable track record and/or financial weaknesses
Sponsor support, as evidenced by equity, ownership clause and incentive to inject additional cash if necessary	Strong. Project is highly strategic for the sponsor (core business — long-term strategy)	Good. Project is strategic for the sponsor (core business — long-term strategy)	Acceptable. Project is considered important for the sponsor (core business)	Limited. Project is not key to sponsor's long-term strategy or core business
Security Package				
Assignment of contracts and accounts	Fully comprehensive	Comprehensive	Acceptable	Weak

	Strong	Good	Satisfactory	Weak
Pledge of assets, taking into account quality, value and liquidity of assets	First perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Acceptable security interest in all project assets, contracts, permits and accounts necessary to run the project	Little security or collateral for lenders; weak negative pledge clause
Lender's control over cash flow (e.g. cash sweeps, independent escrow accounts)	Strong	Satisfactory	Fair	Weak
Strength of the covenant package (mandatory prepayments, payment deferrals, payment cascade, dividend restrictions…)	Covenant package is strong for this type of project Project may issue no additional debt	Covenant package is satisfactory for this type of project Project may issue extremely limited additional debt	Covenant package is fair for this type of project Project may issue limited additional debt	Covenant package is Insufficient for this type of project Project may issue unlimited additional debt
Reserve funds (debt service, O&M, renewal and replacement, unforeseen events, etc)	Longer than average coverage period, all reserve funds fully funded in cash or letters of credit from highly rated bank	Average coverage period, all reserve funds fully funded	Average coverage period, all reserve funds fully funded	Shorter than average coverage period, reserve funds funded from operating cash flows

Table 2 — Supervisory Rating Grades for Income-Producing Real Estate Exposures and High-Volatility Commercial Real Estate Exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Market conditions	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is equal or lower than forecasted demand	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is roughly equal to forecasted demand	Market conditions are roughly in equilibrium. Competitive properties are coming on the market and others are in the planning stages. The project's design and capabilities may not be state of the art compared to new projects	Market conditions are weak. It is uncertain when conditions will improve and return to equilibrium. The project is losing tenants at lease expiration. New lease terms are less favourable compared to those expiring
Financial ratios and advance rate	The property's debt service coverage ratio (DSCR) is considered strong (DSCR is not relevant for the construction phase) and its loan to value ratio (LTV) is considered low given its property type. Where a secondary market exists, the transaction is underwritten to market standards	The DSCR (not relevant for development real estate) and LTV are satisfactory. Where a secondary market exists, the transaction is underwritten to market standards	The property's DSCR has deteriorated and its value has fallen, increasing its LTV	The property's DSCR has deteriorated significantly and its LTV is well above underwriting standards for new loans

	Strong	Good	Satisfactory	Weak
Stress analysis	The property's resources, contingencies and liability structure allow it to meet its financial obligations during a period of severe financial stress (e.g. interest rates, economic growth)	The property can meet its financial obligations under a sustained period of financial stress (e.g. interest rates, economic growth). The property is likely to default only under severe economic conditions	During an economic downturn, the property would suffer a decline in revenue that would limit its ability to fund capital expenditures and significantly increase the risk of default	The property's financial condition is strained and is likely to default unless conditions improve in the near term
Cash-flow predictability				
(a) For complete and stabilised property.	The property's leases are long-term with creditworthy tenants and their maturity dates are scattered. The property has a track record of tenant retention upon lease expiration. Its vacancy rate is low. Expenses (maintenance, insurance, security, and property taxes) are predictable	Most of the property's leases are long-term, with tenants that range in creditworthiness. The property experiences a normal level of tenant turnover upon lease expiration. Its vacancy rate is low. Expenses are predictable	Most of the property's leases are medium rather than long-term with tenants that range in creditworthiness. The property experiences a moderate level of tenant turnover upon lease expiration. Its vacancy rate is moderate. Expenses are relatively predictable but vary in relation to revenue	The property's leases are of various terms with tenants that range in creditworthiness. The property experiences a very high level of tenant turnover upon lease expiration. Its vacancy rate is high. Significant expenses are incurred preparing space for new tenants
(b) For complete but not stabilised property	Leasing activity meets or exceeds projections. The project should achieve stabilisation in the near future	Leasing activity meets or exceeds projections. The project should achieve stabilisation in the near future	Most leasing activity is within projections; however, stabilisation will not occur for some time	Market rents do not meet expectations. Despite achieving target occupancy rate, cash flow coverage is tight due to disappointing revenue

	Strong	Good	Satisfactory	Weak
(c) For construction phase	The property is entirely pre-leased through the tenor of the loan or pre-sold to an investment grade tenant or buyer, or the bank has a binding commitment for take-out financing from an investment grade lender	The property is entirely pre-leased or pre-sold to a creditworthy tenant or buyer, or the bank has a binding commitment for permanent financing from a creditworthy lender	Leasing activity is within projections but the building may not be pre-leased and there may not exist a take-out financing. The bank may be the permanent lender	The property is deteriorating due to cost overruns, market deterioration, tenant cancellations or other factors. There may be a dispute with the party providing the permanent financing
Asset characteristics				
Location	Property is located in highly desirable location that is convenient to services that tenants desire	Property is located in desirable location that is convenient to services that tenants desire	The property location lacks a competitive advantage	The property's location, configuration, design and maintenance have contributed to the property's difficulties
Design and condition	Property is favoured due to its design, configuration, and maintenance, and is highly competitive with new properties	Property is appropriate in terms of its design, configuration and maintenance. The property's design and capabilities are competitive with new properties	Property is adequate in terms of its configuration, design and maintenance	Weaknesses exist in the property's configuration, design or maintenance
Property is under construction	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified	Construction budget is adequate and contractors are ordinarily qualified	Project is over budget or unrealistic given its technical hazards. Contractors may be under qualified

	Strong	Good	Satisfactory	Weak
Strength of Sponsor/Developer				
Financial capacity and willingness to support the property.	The sponsor/developer made a substantial cash contribution to the construction or purchase of the property. The sponsor/developer has substantial resources and limited direct and contingent liabilities. The sponsor/developer's properties are diversified geographically and by property type	The sponsor/developer made a material cash contribution to the construction or purchase of the property. The sponsor/developer's financial condition allows it to support the property in the event of a cash flow shortfall. The sponsor/developer's properties are located in several geographic regions	The sponsor/developer's contribution may be immaterial or non-cash. The sponsor/developer is average to below average in financial resources	The sponsor/developer lacks capacity or willingness to support the property
Reputation and track record with similar properties.	Experienced management and high sponsors' quality. Strong reputation and lengthy and successful record with similar properties	Appropriate management and sponsors' quality. The sponsor or management has a successful record with similar properties	Moderate management and sponsors' quality. Management or sponsor track record does not raise serious concerns	Ineffective management and substandard sponsors' quality. Management and sponsor difficulties have contributed to difficulties in managing properties in the past
Relationships with relevant real estate actors	Strong relationships with leading actors such as leasing agents	Proven relationships with leading actors such as leasing agents	Adequate relationships with leasing agents and other parties providing important real estate services	Poor relationships with leasing agents and/or other parties providing important real estate services

	Strong	Good	Satisfactory	Weak
Security Package				
Nature of lien	Perfected first lien[253]	Perfected first lien[253]	Perfected first lien[253]	Ability of lender to foreclose is constrained
Assignment of rents (for projects leased to long-term tenants)	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to remit rents directly to the lender, such as a current rent roll and copies of the project's leases	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has not obtained an assignment of the leases or has not maintained the information necessary to readily provide notice to the building's tenants
Quality of the insurance coverage	Appropriate	Appropriate	Appropriate	Substandard

[253] Lenders in some markets extensively use loan structures that include junior liens. Junior liens may be indicative of this level of risk if the total LTV inclusive of all senior positions does not exceed a typical first loan LTV.

Table 3 — Supervisory Rating Grades for Object Finance Exposures

	Strong	**Good**	**Satisfactory**	**Weak**
Financial strength				
Market conditions	Demand is strong and growing, strong entry barriers, low sensitivity to changes in technology and economic outlook	Demand is strong and stable. Some entry barriers, some sensitivity to changes in technology and economic outlook	Demand is adequate and stable, limited entry barriers, significant sensitivity to changes in technology and economic outlook	Demand is weak and declining, vulnerable to changes in technology and economic outlook, highly uncertain environment
Financial ratios (debt service coverage ratio and loan-to-value ratio)	Strong financial ratios considering the type of asset. Very robust economic assumptions	Strong / acceptable financial ratios considering the type of asset. Robust project economic assumptions	Standard financial ratios for the asset type	Aggressive financial ratios considering the type of asset
Stress analysis	Stable long-term revenues, capable of withstanding severely stressed conditions through an economic cycle	Satisfactory short-term revenues. Loan can withstand some financial adversity. Default is only likely under severe economic conditions	Uncertain short-term revenues. Cash flows are vulnerable to stresses that are not uncommon through an economic cycle. The loan may default in a normal downturn	Revenues subject to strong uncertainties; even in normal economic conditions the asset may default, unless conditions improve
Market liquidity	Market is structured on a worldwide basis; assets are highly liquid	Market is worldwide or regional; assets are relatively liquid	Market is regional with limited prospects in the short term, implying lower liquidity	Local market and/or poor visibility. Low or no liquidity, particularly on niche markets
Political and legal environment				
Political risk, including transfer risk	Very low; strong mitigation instruments, if needed	Low; satisfactory mitigation instruments, if needed	Moderate; fair mitigation instruments	High; no or weak mitigation instruments

	Strong	Good	Satisfactory	Weak
Legal and regulatory risks	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is generally favourable to repossession and enforcement of contracts, even if repossession might be long and/or difficult	Poor or unstable legal and regulatory environment. Jurisdiction may make repossession and enforcement of contracts lengthy or impossible
Transaction characteristics				
Financing term compared to the economic life of the asset	Full payout profile/minimum balloon. No grace period	Balloon more significant, but still at satisfactory levels	Important balloon with potentially grace periods	Repayment in fine or high balloon
Operating risk				
Permits / licensing	All permits have been obtained; asset meets current and foreseeable safety regulations	All permits obtained or in the process of being obtained; asset meets current and foreseeable safety regulations	Most permits obtained or in process of being obtained, outstanding ones considered routine, asset meets current safety regulations	Problems in obtaining all required permits, part of the planned configuration and/or planned operations might need to be revised
Scope and nature of O & M contracts	Strong long-term O&M contract, preferably with contractual performance incentives, and/or O&M reserve accounts (if needed)	Long-term O&M contract, and/or O&M reserve accounts (if needed)	Limited O&M contract or O&M reserve account (if needed)	No O&M contract: risk of high operational cost overruns beyond mitigants
Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset

	Strong	Good	Satisfactory	Weak
Asset characteristics				
Configuration, size, design and maintenance (i.e. age, size for a plane) compared to other assets on the same market	Strong advantage in design and maintenance. Configuration is standard such that the object meets a liquid market	Above average design and maintenance. Standard configuration, maybe with very limited exceptions — such that the object meets a liquid market	Average design and maintenance. Configuration is somewhat specific, and thus might cause a narrower market for the object	Below average design and maintenance. Asset is near the end of its economic life. Configuration is very specific; the market for the object is very narrow
Resale value	Current resale value is well above debt value	Resale value is moderately above debt value	Resale value is slightly above debt value	Resale value is below debt value
Sensitivity of the asset value and liquidity to economic cycles	Asset value and liquidity are relatively insensitive to economic cycles	Asset value and liquidity are sensitive to economic cycles	Asset value and liquidity are quite sensitive to economic cycles	Asset value and liquidity are highly sensitive to economic cycles
Strength of sponsor				
Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset
Sponsors' track record and financial strength	Sponsors with excellent track record and high financial standing	Sponsors with good track record and good financial standing	Sponsors with adequate track record and good financial standing	Sponsors with no or questionable track record and/or financial weaknesses

	Strong	Good	Satisfactory	Weak
Security Package				
Asset control	Legal documentation provides the lender effective control (e.g. a first perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	Legal documentation provides the lender effective control (e.g. a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	Legal documentation provides the lender effective control (e.g. a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	The contract provides little security to the lender and leaves room to some risk of losing control on the asset
Rights and means at the lender's disposal to monitor the location and condition of the asset	The lender is able to monitor the location and condition of the asset, at any time and place (regular reports, possibility to lead inspections)	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset are limited
Insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies

Table 4 — Supervisory Rating Grades for Commodities Finance Exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Degree of over-collateralisation of trade	Strong	Good	Satisfactory	Weak
Political and legal environment				
Country risk	No country risk	Limited exposure to country risk (in particular, offshore location of reserves in an emerging country)	Exposure to country risk (in particular, offshore location of reserves in an emerging country)	Strong exposure to country risk (in particular, inland reserves in an emerging country)
Mitigation of country risks	Very strong mitigation: Strong offshore mechanisms Strategic commodity 1st class buyer	Strong mitigation: Offshore mechanisms Strategic commodity Strong buyer	Acceptable mitigation: Offshore mechanisms Less strategic commodity Acceptable buyer	Only partial mitigation: No offshore mechanisms Non-strategic commodity Weak buyer
Asset characteristics				
Liquidity and susceptibility to damage	Commodity is quoted and can be hedged through futures or OTC instruments. Commodity is not susceptible to damage	Commodity is quoted and can be hedged through OTC instruments. Commodity is not susceptible to damage	Commodity is not quoted but is liquid. There is uncertainty about the possibility of hedging. Commodity is not susceptible to damage	Commodity is not quoted. Liquidity is limited given the size and depth of the market. No appropriate hedging instruments. Commodity is susceptible to damage

	Strong	Good	Satisfactory	Weak
Strength of sponsor				
Financial strength of trader	Very strong, relative to trading philosophy and risks	Strong	Adequate	Weak
Track record, including ability to manage the logistic process	Extensive experience with the type of transaction in question. Strong record of operating success and cost efficiency	Sufficient experience with the type of transaction in question. Above average record of operating success and cost efficiency	Limited experience with the type of transaction in question. Average record of operating success and cost efficiency	Limited or uncertain track record in general. Volatile costs and profits
Trading controls and hedging policies	Strong standards for counterparty selection, hedging, and monitoring	Adequate standards for counterparty selection, hedging, and monitoring	Past deals have experienced no or minor problems	Trader has experienced significant losses on past deals
Quality of financial disclosure	Excellent	Good	Satisfactory	Financial disclosure contains some uncertainties or is insufficient
Security package				
Asset control	First perfected security interest provides the lender legal control of the assets at any time if needed	First perfected security interest provides the lender legal control of the assets at any time if needed	At some point in the process, there is a rupture in the control of the assets by the lender. The rupture is mitigated by knowledge of the trade process or a third party undertaking as the case may be	Contract leaves room for some risk of losing control over the assets. Recovery could be jeopardised

	Strong	Good	Satisfactory	Weak
Insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies

Annex 7

Illustrative Examples: Calculating the Effect of Credit Risk Mitigation under Supervisory Formula

Some examples are provided below for determining how collateral and guarantees are to be recognised under the SF.

Illustrative Example Involving Collateral ─ proportional cover

Assume an originating bank purchases a €100 securitisation exposure with a credit enhancement level in excess of K_{IRB} for which an external or inferred rating is not available. Additionally, assume that the SF capital charge on the securitisation exposure is €1.6 (when multiplied by 12.5 results in risk weighted assets of €20). Further assume that the originating bank has received €80 of collateral in the form of cash that is denominated in the same currency as the securitisation exposure. The capital requirement for the position is determined by multiplying the SF capital requirement by the ratio of adjusted exposure amount and the original exposure amount, as illustrated below.

Step 1: Adjusted Exposure Amount (E*) = max {0, [E x (1 + He) – C x (1 – Hc – Hfx)]}

E* = max {0, [100 x (1 + 0) – 80 x (1 – 0 – 0)]} = €20

where (based on the information provided above):

E* = the exposure value after risk mitigation (€20)

E = current value of the exposure (€100)

He = haircut appropriate to the exposure (This haircut is not relevant because the originating bank is not lending the securitisation exposure in exchange for collateral).

C = the current value of the collateral received (€80)

Hc = haircut appropriate to the collateral (0)

Hfx = haircut appropriate for mismatch between the collateral and exposure (0)

Step 2: Capital requirement = (E* / E) x SF capital requirement

where (based on the information provide above):

Capital requirement = €20 / €100 x €1.6 = €0.32.

Illustrative Example Involving a Guarantee ─ proportional cover

All of the assumptions provided in the illustrative example involving collateral apply except for the form of credit risk mitigant. Assume that the bank has received an eligible, unsecured guarantee in the amount of €80 from a bank. Therefore, a haircut for currency mismatch will not apply. The capital requirement is determined as follows.

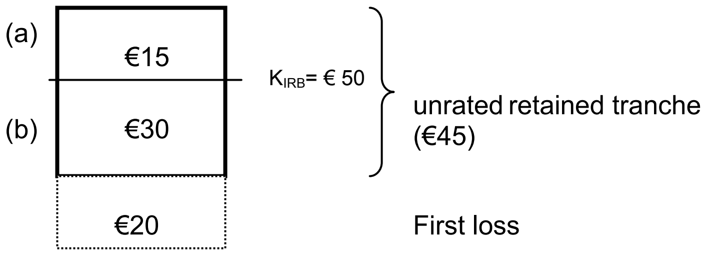
- The protected portion of the securitisation exposure (€80) is to receive the risk weight of the protection provider. The risk weight for the protection provider is equivalent to that for an unsecured loan to the guarantor bank, as determined under the IRB approach. Assume that this risk weight is 10%. Then, the capital charge on the protected portion would be: €80 x 10% x 0.08 = €0.64.
- The capital charge for the unprotected portion (€20) is derived by multiplying the capital charge on the securitisation exposure by the share of the unprotected portion to the exposure amount. The share of the unprotected portion is: €20 / €100 = 20%. Thus, the capital requirement will be: €1.6 x 20% = €0.32.

The total capital requirement for the protected and unprotected portions is:

€0.64 (protected portion) + €0.32 (unprotected portion) = €0.96 .

Illustrative example ─ the case of credit risk mitigants covering the most senior parts

Assume an originating bank that securitises a pool of loans of €1000. The K_{IRB} of this underlying pool is 5% (capital charge of €50). There is a first loss position of €20. The originator retains only the second most junior tranche: an unrated tranche of €45. We can summarise the situation as follows:



1. Capital charge without collateral or guarantees

According to this example, the capital charge for the unrated retained tranche that is straddling the K_{IRB} line is the sum of the capital requirements for tranches (a) and (b) in the graph above:

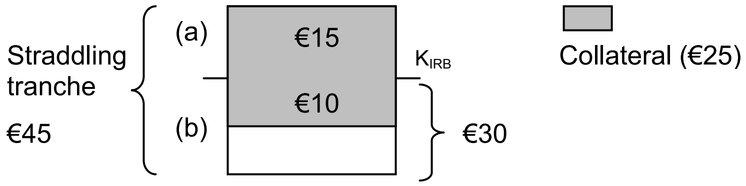
(a) Assume the SF risk weight for this subtranche is 820%. Thus, risk-weighted assets are €15 x 820% = €123. Capital charge is €123 x 8%= €9.84

(b) The subtranche below K_{IRB} must be deducted. Risk-weighted assets: €30 x 1250% = €375. Capital charge of €375 x 8% = €30

Total capital charge for the unrated straddling tranche = €9.84 + €30 = €39.84

2. Capital charge with collateral

Assume now that the originating bank has received €25 of collateral in the form of cash that is denominated in the same currency as the securitisation exposure. Because the tranche is straddling the K_{IRB} level, we must assume that the collateral is covering the most senior subtranche above K_{IRB} ((a) subtranche covered by €15 of collateral) and, only if there is some collateral left, the coverage must be applied to the subtranche below K_{IRB} beginning with the most senior portion (e.g. tranche (b) covered by €10 of collateral). Thus, we have:



The capital requirement for the position is determined by multiplying the SF capital requirement by the ratio of adjusted exposure amount and the original exposure amount, as illustrated below. We must apply this for the two subtranches.

(a) The first subtranche has an initial exposure of €15 and collateral of €15, so in this case it is completely covered. In other words:

Step 1: Adjusted Exposure Amount

E* = max {0, [E x (1 + He) – C x (1 – Hc – Hfx)]} = max {0, [15 – 15]} = €0

where:

E* = the exposure value after risk mitigation (€0)

E = current value of the exposure (€15)

C = the current value of the collateral received (€15)

He = haircut appropriate to the exposure (not relevant here, thus 0)

Hc and Hfx = haircut appropriate to the collateral and that for the mismatch between the collateral and exposure (to simplify, 0)

Step 2: Capital requirement = (E* / E) x SF capital requirement

Capital requirement = 0 x €9.84 = €0

(b) The second subtranche has an initial exposure of €30 and collateral of €10, which is the amount left after covering the subtranche above K_{IRB}. Thus, these €10 must be allocated to the most senior portion of the €30 subtranche.

Step1: Adjusted Exposure Amount

E* = max {0, [30 x (1 + 0) – 10 x (1 – 0 – 0)]} = €20

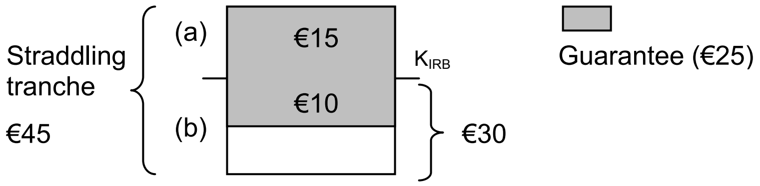
Step 2: Capital requirement = (E* / E) x SF capital requirement

Capital requirement = €20 / €30 x €30 = €20

Finally, the total capital charge for the unrated straddling tranche = €0 + €20 = €20

3. Guarantee

Assume now that instead of collateral, the bank has received an eligible, unsecured guarantee in the amount of €25 from a bank. Therefore the haircut for currency mismatch will not apply. The situation can be summarised as:



The capital requirement for the two subtranches is determined as follows:

(a) The first subtranche has an initial exposure of €15 and a guarantee of €15, so in this case it is completely covered. The €15 will receive the risk weight of the protection provider. The risk weight for the protection provider is equivalent to that for an unsecured loan to the guarantor bank, as determined under the IRB approach. Assume that this risk weight is 20%.

capital charge on the protected portion is €15 x 20% x 8% = €0.24

(b) The second subtranche has an initial exposure of €30 and guarantee of €10 which must be applied to the most senior portion of this subtranche. Accordingly, the protected part is €10 and the unprotected part is €20.

- Again, the protected portion of the securitisation exposure is to receive the risk weight of the guarantor bank.

  capital charge on the protected portion is €10 x 20% x 8% = €0.16

  The capital charge for the unprotected portion (for an unrated position below K_{IRB}) is €20 x 1250% x 8% = €20

Total capital charge for the unrated straddling tranche = €0.24 (protected portion, above K_{IRB}) + €0.16 (protected portion, below K_{IRB}) + €20 (unprotected portion, below K_{IRB}) = €20.4

Annex 8

Mapping of Business Lines

Mapping of Business Lines

Level 1	Level 2	Activity Groups
Corporate Finance	Corporate Finance	Mergers and acquisitions, underwriting, privatisations, securitisation, research, debt (government, high yield), equity, syndications, IPO, secondary private placements
	Municipal/Government Finance	
	Merchant Banking	
	Advisory Services	
Trading & Sales	Sales	Fixed income, equity, foreign exchanges, commodities, credit, funding, own position securities, lending and repos, brokerage, debt, prime brokerage
	Market Making	
	Proprietary Positions	
	Treasury	
Retail Banking	Retail Banking	Retail lending and deposits, banking services, trust and estates
	Private Banking	Private lending and deposits, banking services, trust and estates, investment advice
	Card Services	Merchant/commercial/corporate cards, private labels and retail
Commercial Banking	Commercial Banking	Project finance, real estate, export finance, trade finance, factoring, leasing, lending, guarantees, bills of exchange
Payment and Settlement[254]	External Clients	Payments and collections, funds transfer, clearing and settlement
Agency Services	Custody	Escrow, depository receipts, securities lending (customers) corporate actions
	Corporate Agency	Issuer and paying agents
	Corporate Trust	
Asset Management	Discretionary Fund Management	Pooled, segregated, retail, institutional, closed, open, private equity
	Non-Discretionary Fund Management	Pooled, segregated, retail, institutional, closed, open
Retail Brokerage	Retail Brokerage	Execution and full service

[254] Payment and settlement losses related to a bank's own activities would be incorporated in the loss experience of the affected business line.

Principles for business line mapping[255]

(a) All activities must be mapped into the eight level 1 business lines in a mutually exclusive and jointly exhaustive manner.

(b) Any banking or non-banking activity which cannot be readily mapped into the business line framework, but which represents an ancillary function to an activity included in the framework, must be allocated to the business line it supports. If more than one business line is supported through the ancillary activity, an objective mapping criteria must be used.

(c) When mapping gross income, if an activity cannot be mapped into a particular business line then the business line yielding the highest charge must be used. The same business line equally applies to any associated ancillary activity.

(d) Banks may use internal pricing methods to allocate gross income between business lines provided that total gross income for the bank (as would be recorded under the Basic Indicator Approach) still equals the sum of gross income for the eight business lines.

(e) The mapping of activities into business lines for operational risk capital purposes must be consistent with the definitions of business lines used for regulatory capital calculations in other risk categories, i.e. credit and market risk. Any deviations from this principle must be clearly motivated and documented.

(f) The mapping process used must be clearly documented. In particular, written business line definitions must be clear and detailed enough to allow third parties to replicate the business line mapping. Documentation must, among other things, clearly motivate any exceptions or overrides and be kept on record.

(g) Processes must be in place to define the mapping of any new activities or products.

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[255] **Supplementary business line mapping guidance**

There are a variety of valid approaches that banks can use to map their activities to the eight business lines, provided the approach used meets the business line mapping principles. Nevertheless, the Committee is aware that some banks would welcome further guidance. The following is therefore an example of one possible approach that could be used by a bank to map its gross income:

Gross income for retail banking consists of net interest income on loans and advances to retail customers and SMEs treated as retail, plus fees related to traditional retail activities, net income from swaps and derivatives held to hedge the retail banking book, and income on purchased retail receivables. To calculate net interest income for retail banking, a bank takes the interest earned on its loans and advances to retail customers less the weighted average cost of funding of the loans (from whatever source — retail or other deposits).

Similarly, gross income for commercial banking consists of the net interest income on loans and advances to corporate (plus SMEs treated as corporate), interbank and sovereign customers and income on purchased corporate receivables, plus fees related to traditional commercial banking activities including commitments, guarantees, bills of exchange, net income (e.g. from coupons and dividends) on securities held in the banking book, and profits/losses on swaps and derivatives held to hedge the commercial banking book. Again, the calculation of net interest income is based on interest earned on loans and advances to corporate, interbank and sovereign customers less the weighted average cost of funding for these loans (from whatever source).

For trading and sales, gross income consists of profits/losses on instruments held for trading purposes (i.e. in the mark-to-market book), net of funding cost, plus fees from wholesale broking.

For the other five business lines, gross income consists primarily of the net fees/commissions earned in each of these businesses. Payment and settlement consists of fees to cover provision of payment/settlement facilities for wholesale counterparties. Asset management is management of assets on behalf of others.

(h) Senior management is responsible for the mapping policy (which is subject to the approval by the board of directors).

(i) The mapping process to business lines must be subject to independent review.

Annex 9

Detailed Loss Event Type Classification

Event-Type Category (Level 1)	Definition	Categories (Level 2)	Activity Examples (Level 3)
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/ discrimination events, which involves at least one internal party	Unauthorised Activity	Transactions not reported (intentional) Transaction type unauthorised (w/monetary loss) Mismarking of position (intentional)
		Theft and Fraud	Fraud / credit fraud / worthless deposits Theft / extortion / embezzlement / robbery Misappropriation of assets Malicious destruction of assets Forgery Check kiting Smuggling Account take-over / impersonation / etc. Tax non-compliance / evasion (wilful) Bribes / kickbacks Insider trading (not on firm's account)
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party	Theft and Fraud	Theft/Robbery Forgery Check kiting
		Systems Security	Hacking damage Theft of information (w/monetary loss)
Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity / discrimination events	Employee Relations	Compensation, benefit, termination issues Organised labour activity
		Safe Environment	General liability (slip and fall, etc.) Employee health & safety rules events Workers compensation
		Diversity & Discrimination	All discrimination types

Event-Type Category (Level 1)	Definition	Categories (Level 2)	Activity Examples (Level 3)
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product.	Suitability, Disclosure & Fiduciary	Fiduciary breaches / guideline violations Suitability / disclosure issues (KYC, etc.) Retail customer disclosure violations Breach of privacy Aggressive sales Account churning Misuse of confidential information Lender liability
		Improper Business or Market Practices	Antitrust Improper trade / market practices Market manipulation Insider trading (on firm's account) Unlicensed activity Money laundering
		Product Flaws	Product defects (unauthorised, etc.) Model errors
		Selection, Sponsorship & Exposure	Failure to investigate client per guidelines Exceeding client exposure limits
		Advisory Activities	Disputes over performance of advisory activities
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events.	Disasters and other events	Natural disaster losses Human losses from external sources (terrorism, vandalism)
Business disruption and system failures	Losses arising from disruption of business or system failures	Systems	Hardware Software Telecommunications Utility outage / disruptions

Event-Type Category (Level 1)	Definition	Categories (Level 2)	Activity Examples (Level 3)
Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors	Transaction Capture, Execution & Maintenance	Miscommunication Data entry, maintenance or loading error Missed deadline or responsibility Model / system misoperation Accounting error / entity attribution error Other task misperformance Delivery failure Collateral management failure Reference Data Maintenance
		Monitoring and Reporting	Failed mandatory reporting obligation Inaccurate external report (loss incurred)
		Customer Intake and Documentation	Client permissions / disclaimers missing Legal documents missing / incomplete
		Customer / Client Account Management	Unapproved access given to accounts Incorrect client records (loss incurred) Negligent loss or damage of client assets
		Trade Counterparties	Non-client counterparty misperformance Misc. non-client counterparty disputes
		Vendors & Suppliers	Outsourcing Vendor disputes

Annex 10

Overview of Methodologies for the Capital Treatment of Transactions Secured by Financial Collateral under the Standardised and IRB Approaches

1. The rules set forth in the standardised approach — Credit Risk Mitigation (CRM), for collateralised transactions generally determine the treatment under both the standardised and the foundation internal ratings-based (IRB) approaches for claims in the banking book that are secured by financial collateral of sufficient quality. Banks using the advanced IRB approach will typically take financial collateral on banking book exposures into account by using their own internal estimates to adjust the exposure's loss given default (LGD). One exception for a bank using the advanced IRB approach pertains to the recognition of repo-style transactions subject to a master netting agreement, as discussed below.

2. Collateralised exposures that take the form of repo-style transactions (i.e. repo/reverse repos and securities lending/borrowing) are subject to special considerations. Such transactions that are held in the trading book are subject to a counterparty risk capital charge as described below. Further, all banks, including those using the advanced IRB approach, must follow the methodology in the CRM section, which is outlined below, for repo-style transactions booked in either the banking book or trading book that are subject to master netting agreements if they wish to recognise the effects of netting for capital purposes.

Standardised and Foundation IRB Approaches

3. Banks under the standardised approach may use either the simple approach or the comprehensive approach for determining the appropriate risk weight for a transaction secured by eligible financial collateral. Under the simple approach, the risk weight of the collateral substitutes for that of the counterparty. Apart from a few types of very low risk transactions, the risk weight floor is 20%. Under the foundation IRB approach, banks may only use the comprehensive approach.

4. Under the comprehensive approach, eligible financial collateral reduces the amount of the exposure to the counterparty. The amount of the collateral is decreased and, where appropriate, the amount of the exposure is increased through the use of haircuts, to account for potential changes in the market prices of securities and foreign exchange rates over the holding period. This results in an adjusted exposure amount, E*. Banks may either use supervisory haircuts set by the Committee or, subject to qualifying criteria, rely on their "own" estimates of haircuts. Where the supervisory holding period for calculating the haircut amounts differs from the holding period set down in the rules for that type of collateralised transaction, the haircuts are to be scaled up or down as appropriate. Once E* is calculated, the standardised bank will assign that amount a risk weight appropriate to the counterparty. For transactions secured by financial collateral other than repos subject to a master netting agreement, foundation IRB banks are to use E* to adjust the LGD on the exposure.

Special Considerations for Repo-Style Transactions

5. Repo-style transactions booked in the trading book, will, like OTC derivatives held in the trading book, be subject to a counterparty credit risk charge. In calculating this charge, a bank under the standardised approach must use the comprehensive approach to collateral; the simple approach will not be available.

6. The capital treatment for repo-style transactions that are not subject to master netting agreements is the same as that for other collateralised transactions. However, for banks using the comprehensive approach, national supervisors have the discretion to determine that a haircut of zero may be used where the transaction is with a core market participant and meets certain other criteria (so-called carve-out treatment). Where repo-style transactions are subject to a master netting agreement whether they are held in the banking book or trading book, a bank may choose not to recognise the netting effects in calculating capital. In that case, each transaction will be subject to a capital charge as if there were no master netting agreement.

7. If a bank wishes to recognise the effects of master netting agreements on repo-style transactions for capital purposes, it must apply the treatment the CRM section sets forth in that regard on a counterparty-by-counterparty basis. This treatment would apply to all repo-style transactions subject to master netting agreements, regardless of whether the bank is under the standardised, foundation IRB, or advanced IRB approach and regardless of whether the transactions are held in the banking or trading book. Under this treatment, the bank would calculate E* as the sum of the net current exposure on the contract plus an add-on for potential changes in security prices and foreign exchange rates. The add-on may be determined through the supervisory haircuts or, for those banks that meet the qualifying criteria, own estimate haircuts or an internal VaR model. The carve-out treatment for haircuts on repo-style transactions may not be used where an internal VaR model is applied.

8. The calculated E* is in effect an unsecured loan equivalent amount that would be used for the exposure amount under the standardised approach and the exposure at default (EAD) value under both the foundation and advanced IRB approaches. E* is used for EAD under the IRB approaches, thus would be treated in the same manner as the credit equivalent amount (calculated as the sum of replacement cost plus an add-on for potential future exposure) for OTC derivatives subject to master netting agreements.

Annex 10a

Supervisory Framework for the Use of "Backtesting" in Conjunction with the Internal Models Approach to Market Risk Capital Requirements

I. Introduction

1. This Annex presents the framework developed by the Committee for incorporating backtesting into the internal models approach to market risk capital requirements. It represents an elaboration of paragraph 718(LXXVI) (j) of this Framework.

2. Many banks that have adopted an internal model-based approach to market risk measurement routinely compare daily profits and losses with model-generated risk measures to gauge the quality and accuracy of their risk measurement systems. This process, known as "backtesting", has been found useful by many institutions as they have developed and introduced their risk measurement models.

3. As a technique for evaluating the quality of a firm's risk measurement model, backtesting continues to evolve. New approaches to backtesting are still being developed and discussed within the broader risk management community. At present, different banks perform different types of backtesting comparisons, and the standards of interpretation also differ somewhat across banks. Active efforts to improve and refine the methods currently in use are underway, with the goal of distinguishing more sharply between accurate and inaccurate risk models.

4. The essence of all backtesting efforts is the comparison of actual trading results with model-generated risk measures. If this comparison is close enough, the backtest raises no issues regarding the quality of the risk measurement model. In some cases, however, the comparison uncovers sufficient differences that problems almost certainly must exist, either with the model or with the assumptions of the backtest. In between these two cases is a grey area where the test results are, on their own, inconclusive.

5. The Committee believes that backtesting offers the best opportunity for incorporating suitable incentives into the internal models approach in a manner that is consistent and that will cover a variety of circumstances. Indeed, many of the public comments on the April 1995 internal models proposal stressed the need to maintain strong incentives for the continual improvement of banks' internal risk measurement models. In considering how to incorporate backtesting more closely into the internal models approach to market risk capital requirements, the Committee has sought to reflect both the fact that the industry has not yet settled on a single backtesting methodology and concerns over the imperfect nature of the signal generated by backtesting.

6. The Committee believes that the framework outlined in this document strikes an appropriate balance between recognition of the potential limitations of backtesting and the need to put in place appropriate incentives. At the same time, the Committee recognises that the techniques for risk measurement and backtesting are still evolving, and the Committee is committed to incorporating important new developments in these areas into its framework.

7. The remainder of this document describes the backtesting framework that is to accompany the internal models capital requirement. The aim of this framework is the

promotion of more rigorous approaches to backtesting and the supervisory interpretation of backtesting results. The next section deals with the nature of the backtests themselves, while the section that follows concerns the supervisory interpretation of the results and sets out the agreed standards of the Committee in this regard.

II. Description of the backtesting framework

8. The backtesting framework developed by the Committee is based on that adopted by many of the banks that use internal market risk measurement models. These backtesting programs typically consist of a periodic comparison of the bank's daily value-at-risk measures with the subsequent daily profit or loss ("trading outcome"). The value-at-risk measures are intended to be larger than all but a certain fraction of the trading outcomes, where that fraction is determined by the confidence level of the value-at-risk measure. Comparing the risk measures with the trading outcomes simply means that the bank counts the number of times that the risk measures were larger than the trading outcome. The fraction actually covered can then be compared with the intended level of coverage to gauge the performance of the bank's risk model. In some cases, this last step is relatively informal, although there are a number of statistical tests that may also be applied.

9. The supervisory framework for backtesting in this document involves all of the steps identified in the previous paragraph, and attempts to set out as consistent an interpretation of each step as is feasible without imposing unnecessary burdens. Under the value-at-risk framework, the risk measure is an estimate of the amount that could be lost on a set of positions due to general market movements over a given holding period, measured using a specified confidence level.

10. The backtests to be applied compare whether the observed percentage of outcomes covered by the risk measure is consistent with a *99% level of confidence*. That is, they attempt to determine if a bank's 99th percentile risk measures truly cover 99% of the firm's trading outcomes. While it can be argued that the extreme-value nature of the 99th percentile makes it more difficult to estimate reliably than other, lower percentiles, the Committee has concluded that it is important to align the test with the confidence level specified in the Amendment to the Capital Accord.

11. An additional consideration in specifying the appropriate risk measures and trading outcomes for backtesting arises because the value-at-risk approach to risk measurement is generally based on the sensitivity of a static portfolio to instantaneous price shocks. That is, end-of-day trading positions are input into the risk measurement model, which assesses the possible change in the value of this static portfolio due to price and rate movements over the assumed holding period.

12. While this is straightforward in theory, in practice it complicates the issue of backtesting. For instance, it is often argued that value-at-risk measures cannot be compared against actual trading outcomes, since the actual outcomes will inevitably be "contaminated" by changes in portfolio composition during the holding period. According to this view, the inclusion of fee income together with trading gains and losses resulting from changes in the composition of the portfolio should not be included in the definition of the trading outcome because they do not relate to the risk inherent in the static portfolio that was assumed in constructing the value-at-risk measure.

13. This argument is persuasive with regard to the use of value-at-risk measures based on price shocks calibrated to longer holding periods. That is, comparing the ten-day, 99th percentile risk measures from the internal models capital requirement with actual ten-day

trading outcomes would probably not be a meaningful exercise. In particular, in any given ten day period, significant changes in portfolio composition relative to the initial positions are common at major trading institutions. For this reason, *the backtesting framework described here involves the use of risk measures calibrated to a one-day holding period*. Other than the restrictions mentioned in this paper, the test would be based on how banks model risk internally.

14. Given the use of one-day risk measures, it is appropriate to employ one-day trading outcomes as the benchmark to use in the backtesting program. The same concerns about "contamination" of the trading outcomes discussed above continue to be relevant, however, even for one-day trading outcomes. That is, there is a concern that the overall one-day trading outcome is not a suitable point of comparison, because it reflects the effects of intra-day trading, possibly including fee income that is booked in connection with the sale of new products.

15. On the one hand, intra-day trading will tend to increase the volatility of trading outcomes, and may result in cases where the overall trading outcome exceeds the risk measure. This event clearly does not imply a problem with the methods used to calculate the risk measure; rather, it is simply outside the scope of what the value-at-risk method is intended to capture. On the other hand, including fee income may similarly distort the backtest, but in the other direction, since fee income often has annuity-like characteristics.

16. Since this fee income is not typically included in the calculation of the risk measure, problems with the risk measurement model could be masked by including fee income in the definition of the trading outcome used for backtesting purposes.

17. Some have argued that the actual trading outcomes experienced by the bank are the most important and relevant figures for risk management purposes, and that the risk measures should be benchmarked against this reality, even if the assumptions behind their calculations are limited in this regard. Others have also argued that the issue of fee income can be addressed sufficiently, albeit crudely, by simply removing the mean of the trading outcomes from their time series before performing the backtests. A more sophisticated approach would involve a detailed attribution of income by source, including fees, spreads, market movements, and intra-day trading results.

18. To the extent that the backtesting program is viewed purely as a statistical test of the integrity of the calculation of the value-at-risk measure, it is clearly most appropriate to employ a definition of daily trading outcome that allows for an "uncontaminated" test. To meet this standard, banks should develop the capability to perform backtests based on the hypothetical changes in portfolio value that would occur were end-of-day positions to remain unchanged.

19. Backtesting using actual daily profits and losses is also a useful exercise since it can uncover cases where the risk measures are not accurately capturing trading volatility in spite of being calculated with integrity.

20. For these reasons, *the Committee urges banks to develop the capability to perform backtests using both hypothetical and actual trading outcomes*. Although national supervisors may differ in the emphasis that they wish to place on these different approaches to backtesting, it is clear that each approach has value. In combination, the two approaches are likely to provide a strong understanding of the relation between calculated risk measures and trading outcomes.

21. The next step in specifying the backtesting program concerns the nature of the backtest itself, and the frequency with which it is to be performed. The framework adopted by

the Committee, which is also the most straightforward procedure for comparing the risk measures with the trading outcomes, is simply to calculate the number of times that the trading outcomes are not covered by the risk measures ("exceptions"). For example, over 200 trading days, a 99% daily risk measure should cover, on average, 198 of the 200 trading outcomes, leaving two exceptions.

22. With regard to the frequency of the backtest, the desire to base the backtest on as many observations as possible must be balanced against the desire to perform the test on a regular basis. The backtesting framework to be applied entails a *formal testing and accounting of exceptions on a quarterly basis using the most recent twelve months of data*.

23. The implementation of the backtesting program should formally begin on the date that the internal models capital requirement becomes effective, that is, by year-end 1997 at the latest. This implies that *the first formal accounting of exceptions under the backtesting program would occur by year-end 1998*. This of course does not preclude national supervisors from requesting backtesting results prior to that date, and in particular does not preclude their usage, at national discretion, as part of the internal model approval process.

24. Using the most recent twelve months of data yields approximately 250 daily observations for the purposes of backtesting. *The national supervisor will use the number of exceptions (out of 250) generated by the bank's model as the basis for a supervisory response.* In many cases, there will be no response. In other cases, the supervisor may initiate a dialogue with the bank to determine if there is a problem with a bank's model. In the most serious cases, the supervisor may impose an increase in a bank's capital requirement or disallow use of the model.

25. The appeal of using the number of exceptions as the primary reference point in the backtesting process is the simplicity and straightforwardness of this approach. From a statistical point of view, using the number of exceptions as the basis for appraising a bank's model requires relatively few strong assumptions. In particular, the primary assumption is that each day's test (exception/no exception) is independent of the outcome of any of the others.

26. The Committee of course recognises that tests of this type are limited in their power to distinguish an accurate model from an inaccurate model. To a statistician, this means that it is not possible to calibrate the test so that it correctly signals all the problematic models without giving false signals of trouble at many others. This limitation has been a prominent consideration in the design of the framework presented here, and should also be prominent among the considerations of national supervisors in interpreting the results of a bank's backtesting program. However, the Committee does not view this limitation as a decisive objection to the use of backtesting. Rather, conditioning supervisory standards on a clear framework, though limited and imperfect, is seen as preferable to a purely judgmental standard or one with no incentive features whatsoever.

III. Supervisory framework for the interpretation of backtesting results

A. Description of three-zone approach

27. It is with the statistical limitations of backtesting in mind that the Committee is introducing a framework for the supervisory interpretation of backtesting results that encompasses a range of possible responses, depending on the strength of the signal generated from the backtest. These responses are classified into three zones, distinguished

by colours into a hierarchy of responses. The green zone corresponds to backtesting results that do not themselves suggest a problem with the quality or accuracy of a bank's model. The yellow zone encompasses results that do raise questions in this regard, but where such a conclusion is not definitive. The red zone indicates a backtesting result that almost certainly indicates a problem with a bank's risk model.

28. The Committee has agreed to standards regarding the definitions of these zones in respect of the number of exceptions generated in the backtesting program, and these are set forth below. To place these definitions in proper perspective, however, it is useful to examine the probabilities of obtaining various numbers of exceptions under different assumptions about the accuracy of a bank's risk measurement model.

B. Statistical considerations in defining the zones

29. Three zones have been delineated and their boundaries chosen in order to balance two types of statistical error: (1) the possibility that an accurate risk model would be classified as inaccurate on the basis of its backtesting result, and (2) the possibility that an inaccurate model would not be classified that way based on its backtesting result.

30. Table 1 reports the probabilities of obtaining a particular number of exceptions from a sample of 250 independent observations under several assumptions about the actual percentage of outcomes that the model captures (that is, these are binomial probabilities). For example, the left-hand portion of Table 1 reports probabilities associated with an accurate model (that is, a true coverage level of 99%). Under these assumptions, the column labelled "exact" reports that exactly five exceptions can be expected in 6.7% of the samples.

31. The right-hand portion of Table 1 reports probabilities associated with several possible inaccurate models, namely models whose true levels of coverage are 98%, 97%, 96%, and 95%, respectively. Thus, the column labelled "exact" under an assumed coverage level of 97% shows that five exceptions would then be expected in 10.9% of the samples.

32. Table 1 also reports several important error probabilities. For the assumption that the model covers 99% of outcomes (the desired level of coverage), the table reports the probability that selecting a given number of exceptions as a threshold for rejecting the accuracy of the model will result in an erroneous rejection of an accurate model ("type 1" error). For example, if the threshold is set as low as one exception, then accurate models will be rejected fully 91.9% of the time, because they will escape rejection only in the 8.1% of cases where they generate zero exceptions. As the threshold number of exceptions is increased, the probability of making this type of error declines.

33. Under the assumptions that the model's true level of coverage is not 99%, Table 1 reports the probability that selecting a given number of exceptions as a threshold for rejecting the accuracy of the model will result in an erroneous acceptance of a model with the assumed (inaccurate) level of coverage ("type 2" error). For example, if the model's actual level of coverage is 97%, and the threshold for rejection is set at seven or more exceptions, the table indicates that this model would be erroneously accepted 37.5% of the time.

34. In interpreting the information in Table 1, it is also important to understand that although the alternative models appear close to the desired standard in probability terms (97% is close to 99%), the difference between these models in terms of the size of the risk measures generated can be substantial. That is, a bank's risk measure could be substantially less than that of an accurate model and still cover 97% of the trading outcomes. For example, in the case of normally distributed trading outcomes, the 97th percentile corresponds to 1.88 standard deviations, while the 99th percentile corresponds to 2.33

standard deviations, an increase of nearly 25%. Thus, the supervisory desire to distinguish between models providing 99% coverage, and those providing say, 97% coverage, is a very real one.

C. Definition of the green, yellow, and red zones

35. The results in Table 1 also demonstrate some of the statistical limitations of backtesting. In particular, there is no threshold number of exceptions that yields both a low probability of erroneously rejecting an accurate model and a low probability of erroneously accepting all of the relevant inaccurate models. It is for this reason that the Committee has rejected an approach that contains only a single threshold.

36. Given these limitations, the Committee has classified outcomes into three categories. In the first category, the test results are consistent with an accurate model, and the possibility of erroneously accepting an inaccurate model is low (green zone). At the other extreme, the test results are extremely unlikely to have resulted from an accurate model, and the probability of erroneously rejecting an accurate model on this basis is remote (red zone). In between these two cases, however, is a zone where the backtesting results could be consistent with either accurate or inaccurate models, and the supervisor should encourage a bank to present additional information about its model before taking action (yellow zone).

37. Table 2 sets out the Committee’s agreed boundaries for these zones and the presumptive supervisory response for each backtesting outcome, based on a sample of 250 observations. For other sample sizes, the boundaries should be deduced by calculating the binomial probabilities associated with true coverage of 99%, as in Table 1. The yellow zone begins at the point such that the probability of obtaining that number or fewer exceptions equals or exceeds 95%. Table 2 reports these cumulative probabilities for each number of exceptions. For 250 observations, it can be seen that five or fewer exceptions will be obtained 95.88% of the time when the true level of coverage is 99%. Thus, the yellow zone begins at five exceptions.

38. Similarly, the beginning of the red zone is defined as the point such that the probability of obtaining that number or fewer exceptions equals or exceeds 99.99%. Table 2 shows that for a sample of 250 observations and a true coverage level of 99%, this occurs with ten exceptions.

D. The green zone

39. The green zone needs little explanation. Since a model that truly provides 99% coverage would be quite likely to produce as many as four exceptions in a sample of 250 outcomes, there is little reason for concern raised by backtesting results that fall in this range. This is reinforced by the results in Table 1, which indicate that accepting outcomes in this range leads to only a small chance of erroneously accepting an inaccurate model.

E. The yellow zone

40. The range from five to nine exceptions constitutes the yellow zone. Outcomes in this range are plausible for both accurate and inaccurate models, although Table 1 suggests that they are generally more likely for inaccurate models than for accurate models. Moreover, the results in Table 1 indicate that the presumption that the model is inaccurate should grow as the number of exceptions increases in the range from five to nine.

41. The Committee has agreed that, within the yellow zone, the number of exceptions should generally guide the size of potential supervisory increases in a firm's capital requirement. Table 2 sets out the Committee's agreed guidelines for increases in the multiplication factor applicable to the internal models capital requirement, resulting from backtesting results in the yellow zone.

42. These guidelines help in maintaining the appropriate structure of incentives applicable to the internal models approach. In particular, the potential supervisory penalty increases with the number of exceptions. The results in Table 1 generally support the notion that nine exceptions is a more troubling result than five exceptions, and these steps are meant to reflect that.

43. These particular values reflect the general idea that the increase in the multiplication factor should be sufficient to return the model to a 99th percentile standard. For example, five exceptions in a sample of 250 implies only 98% coverage. Thus, the increase in the multiplication factor should be sufficient to transform a model with 98% coverage into one with 99% coverage. Needless to say, precise calculations of this sort require additional statistical assumptions that are not likely to hold in all cases. For example, if the distribution of trading outcomes is assumed to be normal, then the ratio of the 99th percentile to the 98th percentile is approximately 1.14, and the increase needed in the multiplication factor is therefore approximately 0.40 for a scaling factor of 3. If the actual distribution is not normal, but instead has "fat tails", then larger increases may be required to reach the 99th percentile standard. The concern about fat tails was also an important factor in the choice of the specific increments set out in Table 2.

44. It is important to stress, however, that these increases are not meant to be purely automatic. The results in Table 1 indicate that results in the yellow zone do not always imply an inaccurate model, and the Committee has no interest in penalising banks solely for bad luck. *Nevertheless, to keep the incentives aligned properly, backtesting results in the yellow zone should generally be presumed to imply an increase in the multiplication factor unless the bank can demonstrate that such an increase is not warranted.*

45. In other words, the burden of proof in these situations should not be on the supervisor to prove that a problem exists, but rather should be on the bank to prove that their model is fundamentally sound. In such a situation, there are many different types of additional information that might be relevant to an assessment of the bank's model.

46. For example, it would then be particularly valuable to see the results of backtests covering disaggregated subsets of the bank's overall trading activities. Many banks that engage in regular backtesting programs break up their overall trading portfolio into trading units organised around risk factors or product categories. Disaggregating in this fashion could allow the tracking of a problem that surfaced at the aggregate level back to its source at the level of a specific trading unit or risk model.

47. Banks should also document all of the exceptions generated from their ongoing backtesting program, including an explanation for the exception. This documentation is important to determining an appropriate supervisory response to a backtesting result in the yellow zone. Banks may also implement backtesting for confidence intervals other than the 99th percentile, or may perform other statistical tests not considered here. Naturally, this information could also prove very helpful in assessing their model.

48. In practice, there are several possible explanations for a backtesting exception, some of which go to the basic integrity of the model, some of which suggest an under-specified or low-quality model, and some of which suggest either bad luck or poor intra-day

trading results. Classifying the exceptions generated by a bank's model into these categories can be a very useful exercise.

Basic integrity of the model

(1) The bank's systems simply are not capturing the risk of the positions themselves (e.g. the positions of an overseas office are being reported incorrectly).

(2) Model volatilities and/or correlations were calculated incorrectly (e.g. the computer is dividing by 250 when it should be dividing by 225).

Model's accuracy could be improved

(3) The risk measurement model is not assessing the risk of some instruments with sufficient precision (e.g. too few maturity buckets or an omitted spread).

Bad luck or markets moved in fashion unanticipated by the model

(4) Random chance (a very low probability event).

(5) Markets moved by more than the model predicted was likely (i.e. volatility was significantly higher than expected).

(6) Markets did not move together as expected (i.e. correlations were significantly different than what was assumed by the model).

Intra-day trading

(7) There was a large (and money-losing) change in the bank's positions or some other income event between the end of the first day (when the risk estimate was calculated) and the end of the second day (when trading results were tabulated).

49. In general, problems relating to the basic integrity of the risk measurement model are potentially the most serious. If there are exceptions attributed to this category for a particular trading unit, the plus should apply. In addition, the model may be in need of substantial review and/or adjustment, and the supervisor would be expected to take appropriate action to ensure that this occurs.

50. The second category of problem (lack of model precision) is one that can be expected to occur at least part of the time with most risk measurement models. No model can hope to achieve infinite precision, and thus all models involve some amount of approximation. If, however, a particular bank's model appears more prone to this type of problem than others, the supervisor should impose the plus factor and also consider what other incentives are needed to spur improvements.

51. The third category of problems (markets moved in a fashion unanticipated by the model) should also be expected to occur at least some of the time with value-at-risk models. In particular, even an accurate model is not expected to cover 100% of trading outcomes. Some exceptions are surely the random 1% that the model can be expected not to cover. In other cases, the behaviour of the markets may shift so that previous estimates of volatility and correlation are less appropriate. No value-at-risk model will be immune from this type of problem; it is inherent in the reliance on past market behaviour as a means of gauging the risk of future market movements.

52. Finally, depending on the definition of trading outcomes employed for the purpose of backtesting, exceptions could also be generated by intra-day trading results or an unusual event in trading income other than from positioning. Although exceptions for these reasons would not necessarily suggest a problem with the bank's value-at-risk model, they could still be cause for supervisory concern and the imposition of the plus should be considered.

53. The extent to which a trading outcome exceeds the risk measure is another relevant piece of information. All else equal, exceptions generated by trading outcomes far in excess of the risk measure are a matter of greater concern than are outcomes only slightly larger than the risk measure.

54. In deciding whether or not to apply increases in a bank's capital requirement, it is envisioned that the supervisor could weigh these factors as well as others, including an appraisal of the bank's compliance with applicable qualitative standards of risk management. Based on the additional information provided by the bank, the supervisor will decide on the appropriate course of action.

55. In general, the imposition of a higher capital requirement for outcomes in the yellow zone is an appropriate response when the supervisor believes the reason for being in the yellow zone is a correctable problem in a bank's model. This can be contrasted with the case of an unexpected bout of high market volatility, which nearly all models may fail to predict. While these episodes may be stressful, they do not necessarily indicate that a bank's risk model is in need of redesign. Finally, in the case of severe problems with the basic integrity of the model, the supervisor should consider whether to disallow the use of the model for capital purposes altogether.

F. The red zone

56. Finally, in contrast to the yellow zone where the supervisor may exercise judgement in interpreting the backtesting results, outcomes in the red zone (ten or more exceptions) should generally lead to an automatic presumption that a problem exists with a bank's model. This is because it is extremely unlikely that an accurate model would independently generate ten or more exceptions from a sample of 250 trading outcomes.

57. In general, therefore, if a bank's model falls into the red zone, the supervisor should automatically increase the multiplication factor applicable to a firm's model by one (from three to four). Needless to say, the supervisor should also begin investigating the reasons why the bank's model produced such a large number of misses, and should require the bank to begin work on improving its model immediately.

58. Although ten exceptions is a very high number for 250 observations, there will on very rare occasions be a valid reason why an accurate model will produce so many exceptions. In particular, when financial markets are subjected to a major regime shift, many volatilities and correlations can be expected to shift as well, perhaps substantially. Unless a bank is prepared to update its volatility and correlation estimates instantaneously, such a regime shift could generate a number of exceptions in a short period of time. In essence, however, these exceptions would all be occurring for the same reason, and therefore the appropriate supervisory reaction might not be the same as if there were ten exceptions, but each from a separate incident. For example, one possible supervisory response in this instance would be to simply require the bank's model to take account of the regime shift as quickly as it can while maintaining the integrity of its procedures for updating the model.

59. It should be stressed, however, that the Committee believes that this exception should be allowed only under the most extraordinary circumstances, and that it is committed

to an automatic and non-discretionary increase in a bank's capital requirement for backtesting results that fall into the red zone.

IV. Conclusion

60. The above framework is intended to set out a consistent approach for incorporating backtesting into the internal models approach to market risk capital requirements. The goals of this effort have been to build appropriate and necessary incentives into a framework that relies heavily on the efforts of banks themselves to calculate the risks they face, to do so in a way that respects the inherent limitations of the available tools, and to keep the burdens and costs of the imposed procedures to a minimum.

61. The Basel Committee believes that the framework described above strikes the right balance in this regard. Perhaps more importantly, however, the Committee believes that this approach represents the first, and therefore critical, step toward a tighter integration of supervisory guidelines with verifiable measures of bank performance.

Table 1

Model is accurate		
Exceptions (our of 250)	Coverage = 99% exact	type 1
0	8.1 %	100.0 %
1	20.5 %	91.9 %
2	25.7 %	71.4 %
3	21.5 %	45.7 %
4	13.4 %	24.2 %
5	6.7 %	10.8 %
6	2.7 %	4.1 %
7	1.0 %	1.4 %
8	0.3 %	0.4 %
9	0.1 %	0.1 %
10	0.0 %	0.0 %
11	0.0 %	0.0 %
12	0.0 %	0.0 %
13	0.0 %	0.0 %
14	0.0 %	0.0 %
15	0.0 %	0.0 %

Model is inaccurate: Possible alternative levels of coverage								
Exceptions (our of 250)	Coverage = 98%		Coverage = 97%		Coverage = 96%		Coverage = 95%	
	exact	type 2	exact	type 2	exact	type 2	exact	type 2
0	0.6 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %
1	3.3 %	0.6 %	0.4 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %
2	8.3 %	3.9 %	1.5 %	0.4 %	0.2 %	0.0 %	0.0 %	0.0 %
3	14.0 %	12.2 %	3.8 %	1.9 %	0.7 %	0.2 %	0.1 %	0.0 %
4	17.7 %	26.2 %	7.2 %	5.7 %	1.8 %	0.9 %	0.3 %	0.1 %
5	17.7 %	43.9 %	10.9 %	12.8 %	3.6 %	2.7 %	0.9 %	0.5 %
6	14.8 %	61.6 %	13.8 %	23.7 %	6.2 %	6.3 %	1.8 %	1.3 %
7	10.5 %	76.4 %	14.9 %	37.5 %	9.0 %	12.5 %	3.4 %	3.1 %
8	6.5 %	86.9 %	14.0 %	52.4 %	11.3 %	21.5 %	5.4 %	6.5 %
9	3.6 %	93.4 %	11.6 %	66.3 %	12.7 %	32.8 %	7.6 %	11.9 %
10	1.8 %	97.0 %	8.6 %	77.9 %	12.8 %	45.5 %	9.6 %	19.5 %
11	0.8 %	98.7 %	5.8 %	86.6 %	11.6 %	58.3 %	11.1 %	29.1 %
12	0.3 %	99.5 %	3.6 %	92.4 %	9.6 %	69.9 %	11.6 %	40.2 %
13	0.1 %	99.8 %	2.0 %	96.0 %	7.3 %	79.5 %	11.2 %	51.8 %
14	0.0 %	99.9 %	1.1 %	98.0 %	5.2 %	86.9 %	10.0 %	62.9 %
15	0.0 %	100.0 %	0.5 %	99.1 %	3.4 %	92.1 %	8.2 %	72.9 %

Notes: The table reports both exact probabilities of obtaining a certain number of exceptions from a sample of 250 independent observations under several assumptions about the true level of coverage, as well as type 1 or type 2 error probabilities derived from these exact probabilities.

The left-hand portion of the table pertains to the case where the model is accurate and its true level of coverage is 99%. Thus, the probability of any given observation being an exception is 1% (100% - 99% = 1%). The column labelled "exact" reports the probability of obtaining exactly the number of exceptions shown under this assumption in a sample of 250 independent observations. The column labelled "type 1" reports the probability that using a given number of exceptions as the cut-off for rejecting a model will imply erroneous rejection of an accurate model using a sample of 250 independent observations. For example, if the cut-off level is set at five or more exceptions, the type 1 column reports the probability of falsely rejecting an accurate model with 250 independent observations is 10.8%.

The right-hand portion of the table pertains to models that are inaccurate. In particular, the table concentrates of four specific inaccurate models, namely models whose true levels of coverage are 98%, 97%, 96% and 95% respectively. For each inaccurate model, the "exact" column reports the probability of obtaining exactly the number of exceptions shown under this assumption in a sample of 250 independent observations. The columns labelled "type 2" report the probability that using a given number of exceptions as the cut-off for rejecting a model will imply erroneous acceptance of an inaccurate model with the assumed level of coverage using a sample of 250 independent observations. For example, if the cut-off level is set at five or more exceptions, the type 2 column for an assumed coverage level of 97% reports the probability of falsely accepting a model with only 97% coverage with 250 independent observations is 12.8%.

Table 2

Zone	Number of exceptions	Increase in scaling factor	Cumulative probability
Green Zone	0	0.00	8.11%
	1	0.00	28.58%
	2	0.00	54.32%
	3	0.00	75.81%
	4	0.00	89.22%
Yellow Zone	5	0.40	95.88%
	6	0.50	98.63%
	7	0.65	99.60%
	8	0.75	99.89%
	9	0.85	99.97%
Red Zone	10 or more	1.00	99.99%

Notes: The table defines the green, yellow and red zones that supervisors will use to assess backtesting results in conjunction with the internal models approach to market risk capital requirements. The boundaries shown in the table are based on a sample of 250 observations. For other sample sizes, the yellow zone begins at the point where the cumulative probability equals or exceeds 95%, and the red zone begins at the point where the cumulative probability equals or exceeds 99.99%.

The cumulative probability is simply the probability of obtaining a given number or fewer exceptions in a sample of 250 observations when the true coverage level is 99%. For example, the cumulative probability shown for four exceptions is the probability of obtaining between zero and four exceptions.

Note that these cumulative probabilities and the type 1 error probabilities reported in Table 1 do not sum to one because the cumulative probability for a given number of exceptions includes the possibility of obtaining exactly that number of exceptions, as does the type 1 error probability. Thus, the sum of these two probabilities exceeds one by the amount of the probability of obtaining exactly that number of exceptions.

Annex 11

The Simplified Standardised Approach[256]

I. Credit risk ─ general rules for risk weights

1. Exposures should be risk weighted net of specific provisions.

A. Claims on sovereigns and central banks

2. Claims on sovereigns and their central banks will be risk-weighted on the basis of the consensus country risk scores of export credit agencies (ECA) participating in the "Arrangement on Officially Supported Export Credits". These scores are available on the OECD's website.[257] The methodology establishes eight risk score categories associated with minimum export insurance premiums. As detailed below, each ECA risk score will correspond to a specific risk weight category.

ECA risk scores	0-1	2	3	4 to 6	7
Risk weights	0%	20%	50%	100%	150%

3. At national discretion, a lower risk weight may be applied to banks' exposures to their sovereign (or central bank) of incorporation denominated in domestic currency and funded[258] in that currency.[259] Where this discretion is exercised, other national supervisory authorities may also permit their banks to apply the same risk weight to domestic currency exposures to this sovereign (or central bank) funded in that currency.

B. Claims on other official entities

4. Claims on the Bank for International Settlements, the International Monetary Fund, the European Central Bank and the European Community will receive a 0% risk weight.

5. The following Multilateral Development Banks (MDBs) will be eligible for a 0% risk weight:

- the World Bank Group, comprised of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC),
- the Asian Development Bank (ADB),

[256] This approach should not be seen as another approach for determining regulatory capital. Rather, it collects in one place the simplest options for calculating risk-weighted assets.

[257] The consensus country risk classification is available on the OECD's website (http://www.oecd.org) in the Export Credit Arrangement web-page of the Trade Directorate.

[258] This is to say that the bank should also have liabilities denominated in the domestic currency.

[259] This lower risk weight may be extended to the risk weighting of collateral and guarantees.

- the African Development Bank (AfDB),
- the European Bank for Reconstruction and Development (EBRD),
- the Inter-American Development Bank (IADB),
- the European Investment Bank (EIB),
- the European Investment Fund (EIF),
- the Nordic Investment Bank (NIB),
- the Caribbean Development Bank (CDB),
- the Islamic Development Bank (IDB), and
- the Council of Europe Development Bank (CEDB).

6. The standard risk weight for claims on other MDBs will be 100%.

7. Claims on domestic public sector entitles (PSEs) will be risk-weighted according to the risk weight framework for claims on banks of that country. Subject to national discretion, claims on a domestic PSE may also be treated as claims on the sovereign in whose jurisdiction the PSEs are established.[260] Where this discretion is exercised, other national supervisors may allow their banks to risk weight claims on such PSEs in the same manner.

C. Claims on banks and securities firms

8. Banks will be assigned a risk weight based on the weighting of claims on the country in which they are incorporated (see paragraph 2). The treatment is summarised in the table below:

ECA risk scores for sovereigns	0-1	2	3	4 to 6	7
Risk weights	20%	50%	100%	100%	150%

[260] The following examples outline how PSEs might be categorised when focusing upon the existence of revenue raising powers. However, there may be other ways of determining the different treatments applicable to different types of PSEs, for instance by focusing on the extent of guarantees provided by the central government:

- **Regional governments and local authorities** could qualify for the same treatment as claims on their sovereign or central government if these governments and local authorities have specific revenue-raising powers and have specific institutional arrangements the effect of which is to reduce their risks of default.
- **Administrative bodies responsible to central governments, regional governments or to local authorities and other non-commercial undertakings** owned by the governments or local authorities may not warrant the same treatment as claims on their sovereign if the entities do not have revenue raising powers or other arrangements as described above. If strict lending rules apply to these entities and a declaration of bankruptcy is not possible because of their special public status, it may be appropriate to treat these claims in the same manner as claims on banks.
- **Commercial undertakings** owned by central governments, regional governments or by local authorities might be treated as normal commercial enterprises. However, if these entities function as a corporate in competitive markets even though the state, a regional authority or a local authority is the major shareholder of these entities, supervisors should decide to consider them as corporates and therefore attach to them the applicable risk weights.

9. When the national supervisor has chosen to apply the preferential treatment for claims on the sovereign as described in paragraph 3, it can also assign a risk weight that is one category less favourable than that assigned to claims on the sovereign, subject to a floor of 20%, to claims on banks of an original maturity of 3 months or less denominated and funded in the domestic currency.

10. Claims on securities firms may be treated as claims on banks provided such firms are subject to supervisory and regulatory arrangements comparable to those under this Framework (including, in particular, risk-based capital requirements).[261] Otherwise such claims would follow the rules for claims on corporates.

D. Claims on corporates

11. The standard risk weight for claims on corporates, including claims on insurance companies, will be 100%.

E. Claims included in the regulatory retail portfolios

12. Claims that qualify under the criteria listed in paragraph 13 may be considered as retail claims for regulatory capital purposes and included in a regulatory retail portfolio. Exposures included in such a portfolio may be risk-weighted at 75%, except as provided in paragraph 18 for past due loans.

13. To be included in the regulatory retail portfolio, claims must meet the following four criteria:

- Orientation criterion ─ The exposure is to an individual person or persons or to a small business;
- Product criterion ─ The exposure takes the form of any of the following: revolving credits and lines of credit (including credit cards and overdrafts), personal term loans and leases (e.g. instalment loans, auto loans and leases, student and educational loans, personal finance) and small business facilities and commitments. Securities (such as bonds and equities), whether listed or not, are specifically excluded from this category. Mortgage loans are excluded to the extent that they qualify for treatment as claims secured by residential property (see paragraph 15).
- Granularity criterion ─ The supervisor must be satisfied that the regulatory retail portfolio is sufficiently diversified to a degree that reduces the risks in the portfolio, warranting the 75% risk weight. One way of achieving this may be to set a numerical limit that no aggregate exposure to one counterpart[262] can exceed 0.2% of the overall regulatory retail portfolio.

[261] That is, capital requirements that are comparable to those applied to banks in this Framework. Implicit in the meaning of the word "comparable" is that the securities firm (but not necessarily its parent) is subject to consolidated regulation and supervision with respect to any downstream affiliates.

[262] Aggregated exposure means gross amount (i.e. not taking any credit risk mitigation into account) of all forms of debt exposures (e.g. loans or commitments) that individually satisfy the three other criteria. In addition, "on one counterpart" means one or several entities that may be considered as a single beneficiary (e.g. in the case of a small business that is affiliated to another small business, the limit would apply to the bank's aggregated exposure on both businesses).

- Low value of individual exposures. The maximum aggregated retail exposure to one counterpart cannot exceed an absolute threshold of €1 million.

14. National supervisory authorities should evaluate whether the risk weights in paragraph 12 are considered to be too low based on the default experience for these types of exposures in their jurisdictions. Supervisors, therefore, may require banks to increase these risk weights as appropriate.

F. Claims secured by residential property

15. Lending fully secured by mortgages on residential property that is or will be occupied by the borrower, or that is rented, will be risk-weighted at 35%. In applying the 35% weight, the supervisory authorities should satisfy themselves, according to their national arrangements for the provision of housing finance, that this concessionary weight is applied restrictively for residential purposes and in accordance with strict prudential criteria, such as the existence of substantial margin of additional security over the amount of the loan based on strict valuation rules. Supervisors should increase the standard risk weight where they judge the criteria are not met.

16. National supervisory authorities should evaluate whether the risk weights in paragraph 15 are considered to be too low based on the default experience for these types of exposures in their jurisdictions. Supervisors, therefore, may require banks to increase these risk weights as appropriate.

G. Claims secured by commercial real estate

17. Mortgages on commercial real estate will be risk-weighted at 100%.

H. Treatment of past due loans

18. The unsecured portion of any loan (other than a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions (including partial write-offs), will be risk-weighted as follows:[263]

- 150% risk weight when provisions are less than 20% of the outstanding amount of the loan;
- 100% risk weight when specific provisions are no less than 20% of the outstanding amount of the loan; and
- 100% risk weight when specific provisions are no less than 50% of the outstanding amount of the loan, but with supervisory discretion to reduce the risk weight to 50%.

19. For the purpose of defining the secured portion of the past due loan, eligible collateral and guarantees will be the same as for credit risk mitigation purposes (see Section II).[264] Past due retail loans are to be excluded from the overall regulatory retail

[263] Subject to national discretion, supervisors may permit banks to treat non-past due loans extended to counterparties subject to a 150% risk weight in the same way as past due loans described in paragraphs 18 to 20.

[264] There will be a transitional period of three years during which a wider range of collateral may be recognised, subject to national discretion.

portfolio when assessing the granularity criterion specified in paragraph 13, for risk-weighting purposes.

20. In addition to the circumstances described in paragraph 18, where a past due loan is fully secured by those forms of collateral that are not recognised in paragraph 50, a 100% risk weight may apply when specific provisions reach 15% of the outstanding amount of the loan. These forms of collateral are not recognised elsewhere in the simplified standardised approach. Supervisors should set strict operational criteria to ensure the quality of collateral.

21. In the case of qualifying residential mortgage loans, when such loans are past due for more than 90 days they will be risk-weighted at 100%, net of specific provisions. If such loans are past due but specific provisions are no less than 20% of their outstanding amount, the risk weight applicable to the remainder of the loan can be reduced to 50% at national discretion.

I. Higher-risk categories

22. National supervisors may decide to apply a 150% or higher risk weight reflecting the higher risks associated with some other assets, such as venture capital and private equity investments.

J. Other assets

23. The treatment of securitisation exposures is presented separately in Section III. The standard risk weight for all other assets will be 100%.[265] Investments in equity or regulatory capital instruments issued by banks or securities firms will be risk-weighted at 100%, unless deducted from the capital base according to Part 1 of the present Framework.

K. Off-balance sheet items

24. Off-balance sheet items under the simplified standardised approach will be converted into credit exposure equivalents through the use of credit conversion factors (CCF). Counterparty risk weights for OTC derivative transactions will not be subject to any specific ceiling.

25. Commitments with an original maturity up to one year and commitments with an original maturity over one year will receive a CCF of 20% and 50%, respectively. However, any commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, will receive a 0% credit conversion factor.[266]

25(i). Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances) will receive a CCF of 100%.

[265] However, at national discretion, gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities can be treated as cash and therefore risk-weighted at 0%. In addition, cash items in the process of collection can be risk-weighted at 20%.

[266] In certain countries, retail commitments are considered unconditionally cancellable if the terms permit the bank to cancel them to the full extent allowable under consumer protection and related legislation.

25(ii). Sale and repurchase agreements and asset sales with recourse,[267] where the credit risk remains with the bank will receive a CCF of 100%.

26. A CCF of 100% will be applied to the lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (i.e. repurchase/reverse repurchase and securities lending/securities borrowing transactions). See Section II for the calculation of risk-weighted assets where the credit converted exposure is secured by eligible collateral.

26(i). Forward asset purchases, forward forward deposits and partly-paid shares and securities[268], which represent commitments with certain drawdown will receive a CCF of 100%.

26(ii). Certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) will receive a CCF of 50%.

26(iii). Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) will receive a CCF of 50%.

27. For short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), a 20% credit conversion factor will be applied to both issuing and confirming banks.

28. Where there is an undertaking to provide a commitment on an off-balance sheet items, banks are to apply the lower of the two applicable CCFs.

29. The credit equivalent amount of transactions that expose banks to counterparty credit risk must be calculated under the rules specified in Section VII of Annex 4 of this Framework.

30. Banks must closely monitor securities, commodities, and foreign exchange transactions that have failed, starting the first day they fail. A capital charge to failed transactions must be calculated in accordance with Annex 3 of this Framework.

31. With regard to unsettled securities, commodities, and foreign exchange transactions, the Committee is of the opinion that banks are exposed to counterparty credit risk from trade date, irrespective of the booking or the accounting of the transaction. Therefore, banks are encouraged to develop, implement and improve systems for tracking and monitoring the credit risk exposure arising from unsettled transactions as appropriate for producing management information that facilitates action on a timely basis. Furthermore, when such transactions are not processed through a delivery-versus-payment (DvP) or payment-versus-payment (PvP) mechanism, banks must calculate a capital charge as set forth in Annex 3 of this Framework.

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[267] These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

[268] These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

II. Credit risk mitigation

A. Overarching issues

1. Introduction

32. Banks use a number of techniques to mitigate the credit risks to which they are exposed. Exposure may be collateralised in whole or in part with cash or securities, or a loan exposure may be guaranteed by a third party.

33. Where these various techniques meet the operational requirements below credit risk mitigation (CRM) may be recognised.

2. General remarks

34. The framework set out in this section is applicable to the banking book exposures under the simplified standardised approach.

35. No transaction in which CRM techniques are used should receive a higher capital requirement than an otherwise identical transaction where such techniques are not used.

36. The effects of CRM will not be double counted. Therefore, no additional supervisory recognition of CRM for regulatory capital purposes will be granted on claims for which an issue-specific rating is used that already reflects that CRM. Principal-only ratings will also not be allowed within the framework of CRM.

37. Although banks use CRM techniques to reduce their credit risk, these techniques give rise to risks (residual risks) which may render the overall risk reduction less effective. Where these risks are not adequately controlled, supervisors may impose additional capital charges or take other supervisory actions as detailed in Pillar 2.

38. While the use of CRM techniques reduces or transfers credit risk, it simultaneously may increase other risks to the bank, such as legal, operational, liquidity and market risks. Therefore, it is imperative that banks employ robust procedures and processes to control these risks, including strategy; consideration of the underlying credit; valuation; policies and procedures; systems; control of roll-off risks; and management of concentration risk arising from the bank's use of CRM techniques and its interaction with the bank's overall credit risk profile.

39. The Pillar 3 requirements must also be observed for banks to obtain capital relief in respect of any CRM techniques.

3. Legal certainty

40. In order for banks to obtain capital relief, all documentation used in collateralised transactions and for documenting guarantees must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review to verify this and have a well founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.

4. Proportional cover

41. Where the amount collateralised or guaranteed (or against which credit protection is held) is less than the amount of the exposure, and the secured and unsecured portions are of equal seniority, i.e. the bank and the guarantor share losses on a pro-rata basis, capital

relief will be afforded on a proportional basis, i.e. the protected portion of the exposure will receive the treatment applicable to the collateral or counterparty, with the remainder treated as unsecured.

B. Collateralised transactions

42. A collateralised transaction is one in which:

- banks have a credit exposure or potential credit exposure; and
- that credit exposure or potential credit exposure is hedged in whole or in part by collateral posted by the counterparty[269] or by a third party on behalf of the counterparty.

43. Under the simplified standardised approach, only the simple approach from the standardised approach will apply, which, similar to the 1988 Accord, substitutes the risk weighting of the collateral for the risk weighting of the counterparty for the collateralised portion of the exposure (generally subject to a 20% floor). Partial collateralisation is recognised. Mismatches in the maturity or currency of the underlying exposure and the collateral will not be allowed.

1. Minimum conditions

44. In addition to the general requirements for legal certainty set out in paragraph 40, the following operational requirements must be met.

45. The collateral must be pledged for at least the life of the exposure and it must be marked to market and revalued with a minimum frequency of six months.

46. In order for collateral to provide protection, the credit quality of the counterparty and the value of the collateral must not have a material positive correlation. For example, securities issued by the counterparty ─ or by any related group entity ─ would provide little protection and so would be ineligible.

47. The bank must have clear and robust procedures for the timely liquidation of collateral.

48. Where the collateral is held by a custodian, banks must take reasonable steps to ensure that the custodian segregates the collateral from its own assets.

49. Where a bank, acting as agent, arranges a repo-style transaction (i.e. repurchase/reverse repurchase and securities lending/borrowing transactions) between a customer and a third party and provides a guarantee to the customer that the third party will perform on its obligations, then the risk to the bank is the same as if the bank had entered into the transaction as principal. In such circumstances, banks will be required to calculate capital requirements as if they were themselves the principal.

[269] In this section "counterparty" is used to denote a party to whom a bank has an on- or off-balance sheet credit exposure or a potential credit exposure. That exposure may, for example, take the form of a loan of cash or securities (where the counterparty would traditionally be called the borrower), of securities posted as collateral, of a commitment or of exposure under an OTC derivative contract.

2. Eligible collateral

50. The following collateral instruments are eligible for recognition:

- Cash (as well as certificates of deposit or comparable instruments issued by the lending bank) on deposit with the bank which is incurring the counterparty exposure,[270, 271]
- Gold,
- Debt securities issued by sovereigns rated category 4 or above, [272] and
- Debt securities issued by PSE that are treated as sovereigns by the national supervisor and that are rated category 4 or above.[272]

3. Risk weights

51. Those portions of claims collateralised by the market value of recognised collateral receive the risk weight applicable to the collateral instrument. The risk weight on the collateralised portion will be subject to a floor of 20%. The remainder of the claim should be assigned to the risk weight appropriate to the counterparty. A capital requirement will be applied to banks on either side of the collateralised transaction: for example, both repos and reverse repos will be subject to capital requirements.

52. The 20% floor for the risk weight on a collateralised transaction will not be applied and a 0% risk weight can be provided where the exposure and the collateral are denominated in the same currency, and either:

- the collateral is cash on deposit; or
- the collateral is in the form of sovereign/PSE securities eligible for a 0% risk weight, and its market value has been discounted by 20%.

C. Guaranteed transactions

53. Where guarantees meet and supervisors are satisfied that banks fulfil the minimum operational conditions set out below, they may allow banks to take account of such credit protection in calculating capital requirements.

1. Minimum conditions

54. A guarantee (counter-guarantee) must represent a direct claim on the protection provider and must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible. Other than non-payment by a protection purchaser of money due in respect of the credit protection contract it must be irrevocable; there must be no clause in the contract that would increase the effective cost of

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[270] Cash funded credit linked notes issued by the bank against exposures in the banking book which fulfil the criteria for credit derivatives will be treated as cash collateralised transactions.

[271] When cash on deposit, certificates of deposit or comparable instruments issued by the lending bank are held as collateral at a third-party bank in a non-custodial arrangement, if they are openly pledged/assigned to the lending bank and if the pledge/assignment is unconditional and irrevocable, the exposure amount covered by the collateral (after any necessary haircuts for currency risk) will receive the risk weight of the third-party bank.

[272] The rating category refers to the ECA country risk score as described in paragraph 2.

cover as a result of deteriorating credit quality in the hedged exposure. It must also be unconditional; there should be no clause in the protection contract outside the control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due.

55. In addition to the legal certainty requirements in paragraph 40 above, the following conditions must be satisfied:

(a) On the qualifying default or non-payment of the counterparty, the bank may in a timely manner pursue the guarantor for any monies outstanding under the documentation governing the transaction. The guarantor may make one lump sum payment of all monies under such documentation to the bank, or the guarantor may assume the future payment obligations of the counterparty covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal actions in order to pursue the counterparty for payment.

(b) The guarantee is an explicitly documented obligation assumed by the guarantor.

(c) Except as noted in the following sentence, the guarantee covers all types of payments the underlying obligor is expected to make under the documentation governing the transaction, for example notional amount, margin payments, etc. Where a guarantee covers payment of principal only, interests and other uncovered payments should be treated as an unsecured amount

2. Eligible guarantors (counter-guarantors)

56. Credit protection given by the following entities will be recognised: sovereign entities,[273] PSEs and other entities with a risk weight of 20% or better and a lower risk weight than the counterparty.

3. Risk weights

57. The protected portion is assigned the risk weight of the protection provider. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty.

58. As specified in paragraph 3, a lower risk weight may be applied at national discretion to a bank's exposure to the sovereign (or central bank) where the bank is incorporated and where the exposure is denominated in domestic currency and funded in that currency. National authorities may extend this treatment to portions of claims guaranteed by the sovereign (or central bank), where the guarantee is denominated in the domestic currency and the exposure is funded in that currency.

59. Materiality thresholds on payments below which no payment will be made in the event of loss are equivalent to retained first loss positions and must be deducted in full from the capital of the bank purchasing the credit protection.

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[273] This includes the Bank for International Settlements, the International Monetary Fund, the European Central Bank and the European Community.

D. Other items related to the treatment of CRM techniques

Treatment of pools of CRM techniques

60. In the case where a bank has multiple CRM covering a single exposure (e.g. a bank has both collateral and guarantee partially covering an exposure), the bank will be required to subdivide the exposure into portions covered by each type of CRM tool (e.g. portion covered by collateral, portion covered by guarantee) and the risk-weighted assets of each portion must be calculated separately. When credit protection provided by a single protection provider has differing maturities, they must be subdivided into separate protection as well.

III. Credit risk — Securitisation framework

A. Scope of transactions covered under the securitisation framework

61. A traditional securitisation is a structure where the cash flow from an underlying pool of exposures is used to service at least two different stratified risk positions or tranches reflecting different degrees of credit risk. Payments to the investors depend upon the performance of the specified underlying exposures, as opposed to being derived from an obligation of the entity originating those exposures. The stratified/tranched structures that characterise securitisations differ from ordinary senior/subordinated debt instruments in that junior securitisation tranches can absorb losses without interrupting contractual payments to more senior tranches, whereas subordination in a senior/subordinated debt structure is a matter of priority of rights to the proceeds of a liquidation.

62. Banks' exposures to securitisation are referred to as "securitisation exposures".

B. Permissible role of banks

63. A bank operating under the simplified standardised approach can only assume the role of an investing bank in a traditional securitisation. An investing bank is an institution, other than the originator or the servicer that assumes the economic risk of a securitisation exposure.

64. A bank is considered to be an originator if it originates directly or indirectly credit exposures included in the securitisation. A servicer bank is one that manages the underlying credit exposures of a securitisation on a day-to-day basis in terms of collection of principal and interest, which is then forwarded to investors in securitisation exposures. A bank under the simplified standardised approach should not offer credit enhancement, liquidity facilities or other financial support to a securitisation.

C. Treatment of Securitisation Exposures

65. Banks using the simplified standardised approach to credit risk for the type of underlying exposure(s) securitised are permitted to use a simplified version of the standardised approach under the securitisation framework.

66. The standard risk weight for securitisation exposures for an investing bank will be 100%. For first loss positions acquired, deduction from capital will be required. The deduction will be taken 50% from Tier 1 and 50% from Tier 2 capital.

IV. Operational risk

67. The simplified standardised approach for operational risk is the Basic Indicator Approach under which banks must hold capital equal to a fixed percentage (15%) of average annual gross income, where positive, over the previous three years.

68. Gross income is defined as net interest income plus net non-interest income.[274] It is intended that this measure should: (i) be gross of any provisions (e.g. for unpaid interest); (ii) be gross of operating expenses, including fees paid to outsourcing service providers;[275] (iii) exclude realised profits/losses from the sale of securities in the banking book;[276] and (iv) exclude extraordinary or irregular items as well as income derived from insurance.

69. Banks using this approach are encouraged to comply with the Committee's guidance on *Sound Practices for the Management and Supervision of Operational Risk* (February 2003).

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[274] As defined by national supervisors and/or national accounting standards.

[275] In contrast to fees paid for services that are outsourced, fees received by banks that provide outsourcing services shall be included in the definition of gross income.

[276] Realised profit/losses from securities classified as "held to maturity" and "available for sale", which typically constitute items of the banking book (e.g. under certain accounting standards), are also excluded from the definition of gross income.

Basel Committee
on Banking Supervision

Basel III: Finalising post-crisis reforms

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Contents

Introduction

1. This document sets out the Basel Committee's finalisation of the Basel III framework. It complements the initial phase of Basel III reforms previously finalised by the Committee. The Basel III framework is a central element of the Basel Committee's response to the global financial crisis. It addresses a number of shortcomings with the pre-crisis regulatory framework and provides a regulatory foundation for a resilient banking system that supports the real economy.

2. A key objective of the revisions in this document is to reduce excessive variability of risk-weighted assets (RWAs). At the peak of the global financial crises, a wide range of stakeholders – including academics, analysts and market participants – lost faith in banks' reported risk-weighted capital ratios. The Committee's own empirical analyses highlighted a worrying degree of variability in the calculation of RWAs by banks.

3. A prudent and credible calculation of RWAs is an integral element of the risk-weighted capital framework. Banks' reported risk-weighted capital ratios should be sufficiently transparent and comparable to permit stakeholders to assess their risk profile. The Committee's strategic review of the regulatory framework highlighted a number of fault lines with the existing architecture, particularly the extent to which it adequately balances simplicity, comparability and risk sensitivity.

4. The revisions to the regulatory framework set out in this document will help restore credibility in the calculation of RWAs by: (i) enhancing the robustness and risk sensitivity of the standardised approaches for credit risk and operational risk, which will facilitate the comparability of banks' capital ratios; (ii) constraining the use of internally-modelled approaches; and (iii) complementing the risk-weighted capital ratio with a finalised leverage ratio and a revised and robust capital floor. An accompanying document summarises the main features of these revisions.[1]

5. In finalising these reforms, the Committee was guided by three overarching principles. First, the Committee is firmly committed to its mandate of strengthening the regulation, supervision and practices of banks worldwide, with the purpose of enhancing financial stability. A banking system that is resilient will be able to support the real economy and contribute positively to sustainable economic growth over the medium term.

6. Second, the Committee actively seeks the views of stakeholders when developing standards. For these reforms, the Committee conducted an extensive consultation process with a wide range of stakeholders. The Committee thanks all stakeholders for their constructive contributions during this process.

7. Third, the Committee conducted a comprehensive and rigorous assessment of the impact of these revisions on the banking system and the wider macro economy. As a result of this assessment, the Committee focused on not significantly increasing overall capital requirements.[2] This is reflected in the design, calibration and transitional arrangements discussed below. The Committee will continue to monitor and evaluate the effectiveness of these reforms in reducing excessive RWA variability.

8. While the revised framework will continue to permit the use of internally-modelled approaches for certain risk categories (subject to supervisory approval), a jurisdiction which does not implement some or all of the internal-modelled approaches but instead only implements the standardised approaches is compliant with the Basel framework. More generally, jurisdictions may elect to implement more

[1] The summary of the main features of the Basel III reforms is available at www.bis.org/bcbs/publ/d424_hlsummary.pdf.

[2] The quantitative impact study is available at www.bis.org/bcbs/publ/d426.htm.

conservative requirements and/or accelerated transitional arrangements, as the Basel framework constitutes minimum standards only.

Implementation dates and transitional arrangements

9. The Committee is introducing transitional arrangements to implement the new standards to ensure an orderly and timely implementation by jurisdictions and adjustment by banks. The main implementation dates are provided in the table below.

Revision	Implementation date
Revisions to standardised approach for credit risk	• 1 January 2022
Revisions to IRB framework	• 1 January 2022[3]
Revisions to CVA framework	• 1 January 2022
Revisions to operational risk framework	• 1 January 2022
Leverage ratio	• Existing exposure definition: 1 January 2018[4] • Revised exposure definition: 1 January 2022[5] • G-SIB buffer: 1 January 2022
Output floor	• 1 January 2022: 50% • 1 January 2023: 55% • 1 January 2024: 60% • 1 January 2025: 65% • 1 January 2026: 70% • 1 January 2027: 72.5%

[3] On implementation of the revisions to the risk-weighted framework outlined in this standard and the revised output floor, the 1.06 scaling factor that applies to the RWA amounts for credit risk under the IRB approach will no longer apply. More specifically, the references to the scaling factor in paragraphs 14 and 44 of the Basel II framework (June 2006), and paragraphs 49, 88, 90 and 91 of the revised securitisation framework (July 2016) will no longer apply.

[4] Based on the January 2014 definition of the leverage ratio exposure measure. Jurisdictions are free to apply the revised definition of the exposure measure at an earlier date than 1 January 2022.

[5] Based on the revised leverage ratio exposure measure set out in this document.

Standardised approach for credit risk

Introduction

1. The Committee permits banks to choose between two broad methodologies for calculating their risk-based capital requirements for credit risk. The first, the standardised approach, assigns standardised risk weights to exposures as described in paragraphs 4 to 97. To determine the risk weights in the standardised approach for certain exposure classes, in jurisdictions that allow the use of external ratings for regulatory purposes, banks may, as a starting point, use assessments by external credit assessment institutions that are recognised as eligible for capital purposes by national supervisors, in accordance with paragraphs 98 to 116. Under the standardised approach, exposures should be risk-weighted net of specific provisions (including partial write-offs).

2. The second risk-weighted capital treatment for measuring credit risk, the internal ratings-based (IRB) approach, allows banks to use their internal rating systems for credit risk, subject to the explicit approval of the bank's supervisor.

3. Securitisation exposures are addressed in the securitisation standard.[1] Credit equivalent amounts of OTC derivatives, exchange traded derivatives and long-settlement transactions that expose a bank to counterparty credit risk[2] are to be calculated under the counterparty credit risk standards.[3] Equity investments in funds and exposures to central counterparties must be treated according to their own specific frameworks.[4]

[1] The securitisation standard is available at www.bis.org/bcbs/publ/d374.pdf.

[2] Counterparty credit risk is defined as the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. An economic loss would occur if the transactions or portfolio of transactions with the counterparty has a positive economic value at the time of default. Unlike a firm's exposure to credit risk through a loan, where the exposure to credit risk is unilateral and only the lending bank faces the risk of loss, counterparty credit risk creates a bilateral risk of loss: the market value of the transaction can be positive or negative to either counterparty to the transaction. The market value is uncertain and can vary over time with the movement of underlying market factors.

[3] The counterparty credit risk standards are set out in Annex 4 of the Basel II framework (June 2006), amended to reflect the changes set out in: (i) *Basel III: A global regulatory framework for more resilient banks and banking systems (June 2011)*, available at www.bis.org/publ/bcbs189.pdf; (ii) *The standardised approach for measuring counterparty credit risk exposures (April 2014),* available at www.bis.org/publ/bcbs279.pdf; and (iii) *Capital requirements for bank exposures to central counterparties (April 2014)*, available at www.bis.org/publ/bcbs282.pdf.

[4] Standards on capital requirements for banks' equity investments in funds are available at www.bis.org/publ/bcbs266.pdf; and for capital requirements for bank exposures to central counterparties are set out in Section XI of the counterparty credit risk standards.

A. Individual exposures

Due diligence requirements

4. Consistent with the Committee's guidance on the assessment of credit risk[5] and paragraphs 733 to 735 of the Basel II framework (June 2006), banks must perform due diligence to ensure that they have an adequate understanding, at origination and thereafter on a regular basis (at least annually), of the risk profile and characteristics of their counterparties. In cases where ratings are used, due diligence is necessary to assess the risk of the exposure for risk management purposes and whether the risk weight applied is appropriate and prudent.[6] The sophistication of the due diligence should be appropriate to the size and complexity of banks' activities. Banks must take reasonable and adequate steps to assess the operating and financial performance levels and trends through internal credit analysis and/or other analytics outsourced to a third party, as appropriate for each counterparty. Banks must be able to access information about their counterparties on a regular basis to complete due diligence analyses.

5. For exposures to entities belonging to consolidated groups, due diligence should, to the extent possible, be performed at the solo entity level to which there is a credit exposure. In evaluating the repayment capacity of the solo entity, banks are expected to take into account the support of the group and the potential for it to be adversely impacted by problems in the group.

6. Banks should have in place effective internal policies, processes, systems and controls to ensure that the appropriate risk weights are assigned to counterparties. Banks must be able to demonstrate to their supervisors that their due diligence analyses are appropriate. As part of their supervisory review, supervisors should ensure that banks have appropriately performed their due diligence analyses, and should take supervisory measures where these have not been done.

1. Exposures to sovereigns

(Treatment unchanged from the Basel II framework (June 2006))

7. Exposures to sovereigns and their central banks will be risk-weighted as follows:

Risk weight table for sovereigns and central banks — Table 1

External rating	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to B–	Below B–	Unrated
Risk weight	0%	20%	50%	100%	150%	100%

5 Basel Committee on Banking Supervision, *Guidance on credit risk and accounting for expected credit losses*, December 2015, available at www.bis.org/bcbs/publ/d350.pdf.

6 The due diligence requirements do not apply to the exposures set out in paragraphs 7 to 12.

8. At national discretion, a lower risk weight may be applied to banks' exposures to their sovereign (or central bank) of incorporation denominated in domestic currency and funded[7] in that currency.[8] Where this discretion is exercised, other national supervisors may also permit their banks to apply the same risk weight to domestic currency exposures to this sovereign (or central bank) funded in that currency.

9. For the purpose of risk-weighting exposures to sovereigns, supervisors may recognise the country risk scores assigned by Export Credit Agencies (ECAs). To qualify, an ECA must publish its risk scores and subscribe to the OECD-agreed methodology. Banks may choose to use the risk scores published by individual ECAs that are recognised by their supervisor, or the consensus risk scores of ECAs participating in the "Arrangement on Officially Supported Export Credits".[9] The OECD-agreed methodology establishes eight risk score categories associated with minimum export insurance premiums. These ECA risk scores will correspond to risk weight categories as detailed below.

Risk weight table for sovereigns and central banks

Table 2

ECA risk scores	0 to 1	2	3	4 to 6	7
Risk weight	0%	20%	50%	100%	150%

10. Exposures to the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Union, the European Stability Mechanism (ESM) and the European Financial Stability Facility (EFSF) may receive a 0% risk weight.

2. Exposures to non-central government public sector entities (PSEs)

(Treatment unchanged from the Basel II framework (June 2006), only minor editorial changes have been made to remove reference to current options for banks.)

11. Exposures to domestic PSEs will be risk-weighted at national discretion, according to either of the following two options.

Risk weight table for PSEs

Option 1: Based on external rating of sovereign

Table 3

External rating of the sovereign	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to B–	Below B–	Unrated
Risk weight under Option 1	20%	50%	100%	100%	150%	100%

[7] This is to say that the bank would also have corresponding liabilities denominated in the domestic currency.

[8] This lower risk weight may be extended to the risk-weighting of collateral and guarantees under the CRM framework.

[9] The consensus country risk classification is available on the OECD's website (www.oecd.org) in the Export Credit Arrangement webpage of the Trade Directorate.

Risk weight table for PSEs

Option 2: Based on external rating of PSE — Table 4

External rating of the PSE	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to B–	Below B–	Unrated
Risk weight under Option 2	20%	50%	50%	100%	150%	50%

12. Subject to national discretion, exposures to certain domestic PSEs[10] may also be treated as exposures to the sovereigns in whose jurisdictions the PSEs are established. Where this discretion is exercised, other national supervisors may allow their banks to risk-weight exposures to such PSEs in the same manner.

3. Exposures to multilateral development banks (MDBs)

13. For the purposes of calculating capital requirements, a Multilateral Development Bank (MDB) is an institution, created by a group of countries that provides financing and professional advice for economic and social development projects. MDBs have large sovereign memberships and may include both developed countries and/or developing countries. Each MDB has its own independent legal and operational status, but with a similar mandate and a considerable number of joint owners.

14. A 0% risk weight will be applied to exposures to MDBs that fulfil to the Committee's satisfaction the eligibility criteria provided below.[11] The Committee will continue to evaluate eligibility on a case-by-case basis. The eligibility criteria for MDBs risk-weighted at 0% are:

(i) very high-quality long-term issuer ratings, ie a majority of an MDB's external ratings must be AAA;[12]

[10] The following examples outline how PSEs might be categorised when focusing on one specific feature, namely revenue-raising powers. However, there may be other ways of determining the different treatments applicable to different types of PSEs, for instance by focusing on the extent of guarantees provided by the central government:

- Regional governments and local authorities could qualify for the same treatment as claims on their sovereign or central government if these governments and local authorities have specific revenue-raising powers and have specific institutional arrangements the effect of which is to reduce their risk of default.
- Administrative bodies responsible to central governments, regional governments or to local authorities and other non-commercial undertakings owned by the governments or local authorities may not warrant the same treatment as claims on their sovereign if the entities do not have revenue-raising powers or other arrangements as described above. If strict lending rules apply to these entities and a declaration of bankruptcy is not possible because of their special public status, it may be appropriate to treat these claims according to Option 1 or 2 for PSEs.
- Commercial undertakings owned by central governments, regional governments or by local authorities may be treated as normal commercial enterprises. However, if these entities function as a corporate in competitive markets even though the state, a regional authority or a local authority is the major shareholder of these entities, supervisors should decide to consider them as corporates and therefore attach to them the applicable risk weights.

[11] MDBs currently eligible for a 0% risk weight are: the World Bank Group comprising the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Development Association (IDA), the Asian Development Bank (ADB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IADB), the European Investment Bank (EIB), the European Investment Fund (EIF), the Nordic Investment Bank (NIB), the Caribbean Development Bank (CDB), the Islamic Development Bank (IDB), the Council of Europe Development Bank (CEDB), the International Finance Facility for Immunization (IFFIm), and the Asian Infrastructure Investment Bank (AIIB).

[12] MDBs that request to be added to the list of MDBs eligible for a 0% risk weight must comply with the AAA rating criterion at the time of the application. Once included in the list of eligible MDBs, the rating may be downgraded, but in no case lower than AA–. Otherwise, exposures to such MDBs will be subject to the treatment set out in paragraph 15.

(ii) either the shareholder structure comprises a significant proportion of sovereigns with long-term issuer external ratings of AA– or better, or the majority of the MDB's fund-raising is in the form of paid-in equity/capital and there is little or no leverage;

(iii) strong shareholder support demonstrated by the amount of paid-in capital contributed by the shareholders; the amount of further capital the MDBs have the right to call, if required, to repay their liabilities; and continued capital contributions and new pledges from sovereign shareholders;

(iv) adequate level of capital and liquidity (a case-by-case approach is necessary in order to assess whether each MDB's capital and liquidity are adequate); and,

(v) strict statutory lending requirements and conservative financial policies, which would include among other conditions a structured approval process, internal creditworthiness and risk concentration limits (per country, sector, and individual exposure and credit category), large exposures approval by the board or a committee of the board, fixed repayment schedules, effective monitoring of use of proceeds, status review process, and rigorous assessment of risk and provisioning to loan loss reserve.

15. For exposures to all other MDBs, banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes will assign to their MDB exposures the corresponding "base" risk weights determined by the external ratings according to Table 5. Banks incorporated in jurisdictions that do not allow external ratings for regulatory purposes will risk-weight such exposures at 50%.

Risk weight table for MDB exposures — Table 5

External rating of counterparty	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to B–	Below B–	Unrated
"Base" risk weight	20%	30%	50%	100%	150%	50%

4. Exposures to banks

16. For the purposes of calculating capital requirements, a bank exposure is defined as a claim (including loans and senior debt instruments, unless considered as subordinated debt for the purposes of paragraph 53) on any financial institution that is licensed to take deposits from the public and is subject to appropriate prudential standards and level of supervision.[13] The treatment associated with subordinated bank debt and equities is addressed in paragraphs 49 to 53.

Risk weight determination

17. Bank exposures will be risk-weighted based on the following hierarchy:[14]

[13] For internationally active banks, appropriate prudential standards (eg capital and liquidity requirements) and level of supervision should be in accordance with the Basel framework. For domestic banks, appropriate prudential standards are determined by the national supervisors but should include at least a minimum regulatory capital requirement.

[14] With the exception of exposures giving rise to Common Equity Tier 1, Additional Tier 1 and Tier 2 items, national supervisors may allow banks belonging to the same institutional protection scheme (such as mutual, cooperatives or savings institutions)

(a) External Credit Risk Assessment Approach (ECRA): This approach is for banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes. It applies to all their exposures to banks that are rated. Banks will apply paragraphs 98 to 116 to determine which rating can be used and for which exposures.

(b) Standardised Credit Risk Assessment Approach (SCRA): This approach is for all exposures of banks incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes. For exposures to banks that are unrated, this approach also applies to banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes.

(a) External Credit Risk Assessment Approach (ECRA)

18. Banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes will assign to their rated bank exposures[15] the corresponding "base" risk weights determined by the external ratings according to Table 6. Such ratings must not incorporate assumptions of implicit government support, unless the rating refers to a public bank owned by its government.[16] Banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes must only apply SCRA for their unrated bank exposures, in accordance with paragraph 21.

Risk weight table for bank exposures

External Credit Risk Assessment Approach — Table 6

External rating of counterparty	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to B–	Below B–
"Base" risk weight	20%	30%	50%	100%	150%
Risk weight for short-term exposures	20%	20%	20%	50%	150%

19. Exposures to banks with an original maturity of three months or less, as well as exposures to banks that arise from the movement of goods across national borders with an original maturity of six months or less[17] can be assigned a risk weight that correspond to the risk weights for short term exposures in Table 6.

in their jurisdictions to apply a lower risk weight than that indicated by the ECRA and SCRA to their intra-group or in-network exposures provided that both counterparties to the exposures are members of the same effective institutional protection scheme that is a contractual or statutory arrangement set up to protect those institutions and seeks to ensure their liquidity and solvency to avoid bankruptcy.

15 An exposure is rated from the perspective of a bank if the exposure is rated by a recognised "eligible credit assessment institution" (ECAI) which has been nominated by the bank (ie the bank has informed its supervisor of its intention to use the ratings of such ECAI for regulatory purposes in a consistent manner (paragraphs 103). In other words, if an external rating exists but the credit rating agency is not a recognised ECAI by the national supervisor, or the rating has been issued by an ECAI which has not been nominated by the bank, the exposure would be considered as being unrated from the perspective of the bank.

16 Implicit government support refers to the notion that the government would act to prevent bank creditors from incurring losses in the event of a bank default or bank distress. National supervisors may continue to allow banks to use external ratings which incorporate assumptions of implicit government support for up to a period of five years, from the date of implementation of this standard, when assigning the "base" risk weights in Table 6 to their bank exposures.

17 This may include on-balance sheet exposures such as loans and off-balance sheet exposures such as self-liquidating trade-related contingent items.

20. Banks must perform due diligence to ensure that the external ratings appropriately and conservatively reflect the creditworthiness of the bank counterparties. If the due diligence analysis reflects higher risk characteristics than that implied by the external rating bucket of the exposure (ie AAA to AA–; A+ to A– etc), the bank must assign a risk weight at least one bucket higher than the "base" risk weight determined by the external rating. Due diligence analysis must never result in the application of a lower risk weight than that determined by the external rating.

(b) Standardised Credit Risk Assessment Approach (SCRA)

21. Banks incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes will apply the SCRA to all their bank exposures. The SCRA also applies to unrated bank exposures for banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes. The SCRA requires bank to classify bank exposures into one of three risk-weight buckets (ie Grades A, B and C) and assign the corresponding risk weights in Table 7. For the purposes of the SCRA only, "published minimum regulatory requirements" in paragraphs 22 to 29 excludes liquidity standards.

Risk weight table for bank exposures

Standardised Credit Risk Assessment Approach Table 7

Credit risk assessment of counterparty	Grade A	Grade B	Grade C
"Base" risk weight	40%[18]	75%	150%
Risk weight for short-term exposures	20%	50%	150%

Grade A

22. Grade A refers to exposures to banks, where the counterparty bank has adequate capacity to meet their financial commitments (including repayments of principal and interest) in a timely manner, for the projected life of the assets or exposures and irrespective of the economic cycles and business conditions.

23. A counterparty bank classified into Grade A must meet or exceed the published minimum regulatory requirements and buffers established by its national supervisor as implemented in the jurisdiction where it is incorporated, except for bank-specific minimum regulatory requirements or buffers that may be imposed through supervisory actions (eg via Pillar 2) and not made public. If such minimum regulatory requirements and buffers (other than bank-specific minimum requirements or buffers) are not publicly disclosed or otherwise made available by the counterparty bank then the counterparty bank must be assessed as Grade B or lower.

24. If as part of its due diligence, a bank assesses that a counterparty bank does not meet the definition of Grade A in paragraphs 22 and 23, exposures to the counterparty bank must be classified as Grade B or Grade C.

Grade B

25. Grade B refers to exposures to banks, where the counterparty bank is subject to substantial credit risk, such as repayment capacities that are dependent on stable or favourable economic or business conditions.

26. A counterparty bank classified into Grade B must meet or exceed the published minimum regulatory requirements (excluding buffers) established by its national supervisor as implemented in the

[18] Under the Standardised Credit Risk Assessment Approach, exposures to banks without an external credit rating may receive a risk weight of 30%, provided that the counterparty bank has a CET1 ratio which meets or exceeds 14% and a Tier 1 leverage ratio which meets or exceeds 5%. The counterparty bank must also satisfy all the requirements for Grade A classification.

jurisdiction where it is incorporated, except for bank-specific minimum regulatory requirements that may be imposed through supervisory actions (eg via Pillar 2) and not made public. If such minimum regulatory requirements are not publicly disclosed or otherwise made available by the counterparty bank then the counterparty bank must be assessed as Grade C.

27. Banks will classify all exposures that do not meet the requirements outlined in paragraphs 22 and 23 into Grade B, unless the exposure falls within Grade C under paragraphs 28 and 29.

Grade C

28. Grade C refers to higher credit risk exposures to banks, where the counterparty bank has material default risks and limited margins of safety. For these counterparties, adverse business, financial, or economic conditions are very likely to lead, or have led, to an inability to meet their financial commitments.

29. At a minimum, if any of the following triggers is breached, a bank must classify the exposure into Grade C:

- The counterparty bank does not meet the criteria for being classifed as Grade B with respect to its published minimum regulatory requirements, as set out in paragraphs 25 and 26; or
- Where audited financial statements are required, the external auditor has issued an adverse audit opinion or has expressed substantial doubt about the counterparty bank's ability to continue as a going concern in its financial statements or audited reports within the previous 12 months.

Even if these triggers are not breached, a bank may assess that the counterparty bank meets the definition in paragraph 28. In that case, the exposure to such counterparty bank must be classified into Grade C.

30. Exposures to banks with an original maturity of three months or less, as well as exposures to banks that arise from the movement of goods across national borders with an original maturity of six months or less,[19] can be assigned a risk weight that correspond to the risk weights for short term exposures in Table 7.

31. To reflect transfer and convertibility risk under the SCRA, a risk-weight floor based on the risk weight applicable to exposures to the sovereign of the country where the bank counterparty is incorporated will be applied to the risk weight assigned to bank exposures. The sovereign floor applies when the exposure is not in the local currency of the jurisdiction of incorporation of the debtor bank and for a borrowing booked in a branch of the debtor bank in a foreign jurisdiction, when the exposure is not in the local currency of the jurisdiction in which the branch operates. The sovereign floor will not apply to short-term (ie with a maturity below one year) self-liquidating, trade-related contingent items that arise from the movement of goods.[20]

5. Exposures to covered bonds

32. Covered bonds are bonds issued by a bank or mortgage institution that are subject by law to special public supervision designed to protect bond holders. Proceeds deriving from the issue of these bonds must be invested in conformity with the law in assets which, during the whole period of the validity of the bonds, are capable of covering claims attached to the bonds and which, in the event of the failure of the issuer, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest.

[19] This may include on-balance sheet exposures such as loans and off-balance sheet exposures such as self-liquidating trade-related contingent items.

[20] Basel Committee on Banking Supervision, *Treatment of trade finance under the Basel capital framework*, October 2011, available at http://www.bis.org/publ/bcbs205.pdf.

Eligible assets

33. In order to be eligible for the risk weights set out in paragraph 35, the underlying assets (the cover pool) of covered bonds as defined in paragraph 32 shall meet the requirements set out in paragraph 34 and shall include any of the following:

- claims on, or guaranteed by, sovereigns, their central banks, public sector entities or multilateral development banks;
- claims secured by residential real estate that meet the criteria set out in paragraph 60 and with a loan-to-value ratio of 80% or lower;
- claims secured by commercial real estate that meets the criteria set out in paragraph 60 and with a loan-to-value ratio of 60% or lower; or
- claims on, or guaranteed by banks that qualify for a 30% or lower risk weight. However, such assets cannot exceed 15% of covered bond issuances.

The nominal value of the pool of assets assigned to the covered bond instrument(s) by its issuer should exceed its nominal outstanding value by at least 10%. The value of the pool of assets for this purpose does not need to be that required by the legislative framework. However, if the legislative framework does not stipulate a requirement of at least 10%, the issuing bank needs to publicly disclose on a regular basis that their cover pool meets the 10% requirement in practice. In addition to the primary assets listed in this paragraph, additional collateral may include substitution assets (cash or short term liquid and secure assets held in substitution of the primary assets to top up the cover pool for management purposes) and derivatives entered into for the purposes of hedging the risks arising in the covered bond program.

The conditions set out in this paragraph must be satisfied at the inception of the covered bond and throughout its remaining maturity.

Disclosure requirements

34. Exposures in the form of covered bonds are eligible for the treatment set out in paragraph 35, provided that the bank investing in the covered bonds can demonstrate to its national supervisors that:

(a) it receives portfolio information at least on: (i) the value of the cover pool and outstanding covered bonds; (ii) the geographical distribution and type of cover assets, loan size, interest rate and currency risks; (iii) the maturity structure of cover assets and covered bonds; and (iv) the percentage of loans more than 90 days past due;

(b) the issuer makes the information referred to in point (a) available to the bank at least semi-annually.

35. Covered bonds that meet the criteria set out in the paragraphs 33 and 34 shall be risk-weighted based on the issue-specific rating or the issuer's risk weight according to the rules outlined in paragraphs 98 to 116. For covered bonds with issue-specific ratings,[21] the risk weight shall be determined according to Table 8. For unrated covered bonds, the risk weight would be inferred from the issuer's ECRA or SCRA risk weight according to Table 9.

[21] An exposure is rated from the perspective of a bank if the exposure is rated by a recognised "eligible credit assessment institution" (ECAI) which has been nominated by the bank (ie the bank has informed its supervisor of its intention to use the ratings of such ECAI for regulatory purposes in a consistent manner (see paragraphs 103). In other words, if an external rating exists but the credit rating agency is not a recognised ECAI by the national supervisor, or the rating has been issued by an ECAI which has not been nominated by the bank, the exposure would be considered as being unrated from the perspective of the bank.

Risk weight table for rated covered bond exposures					Table 8
Issue-specific rating of the covered bond	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to B–	Below B–
"Base" risk weight	10%	20%	20%	50%	100%

Risk weight table for unrated covered bond exposures							Table 9
Risk weight of the issuing bank	20%	30%	40%	50%	75%	100%	150%
"Base" risk weight	10%	15%	20%	25%	35%	50%	100%

36. Banks must perform due diligence to ensure that the external ratings appropriately and conservatively reflect the creditworthiness of the covered bond and the issuing bank. If the due diligence analysis reflects higher risk characteristics than that implied by the external rating bucket of the exposure (ie AAA to AA–; A+ to A– etc), the bank must assign a risk weight at least one bucket higher than the "base" risk weight determined by the external rating. Due diligence analysis must never result in the application of a lower risk weight than that determined by the external rating.

6. Exposures to securities firms and other financial institutions

37. Exposures to securities firms and other financial institutions will be treated as exposures to banks provided that these firms are subject to prudential standards and a level of supervision equivalent to those applied to banks (including capital and liquidity requirements). National supervisors should determine whether the regulatory and supervisory framework governing securities firms and other financial institutions in their own jurisdictions is equivalent to that which is applied to banks in their own jurisdictions. Where the regulatory and supervisory framework governing securities firms and other financial institutions is determined to be equivalent to that applied to banks in a jurisdiction, other national supervisors may allow their banks to risk weight such exposures to securities firms and other financial institutions as exposures to banks. Exposures to all other securities firms and financial institutions will be treated as exposures to corporates.

7. Exposures to corporates

38. For the purposes of calculating capital requirements, exposures to corporates include exposures (loans, bonds, receivables, etc) to incorporated entities, associations, partnerships, proprietorships, trusts, funds and other entities with similar characteristics, except those which qualify for one of the other exposure classes. The treatment associated with subordinated debt and equities of these counterparties is addressed in paragraphs 49 to 53. The corporate exposure class includes exposures to insurance companies and other financial corporates that do not meet the definitions of exposures to banks, or securities firms and other financial institutions, as determined in paragraphs 16 and 37 respectively. The corporate exposure class does not include exposures to individuals. The corporate exposure class differentiates between the following subcategories:

(i) General corporate exposures;

(ii) Specialised lending exposures, as defined in paragraph 44.

7.1 General corporate exposures

Risk weight determination

39. For corporate exposures of banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes, banks will assign "base" risk weights according to Table 10.[22] Banks must perform due diligence to ensure that the external ratings appropriately and conservatively reflect the creditworthiness of the counterparties. Banks which have assigned risk weights to their rated bank exposures based on paragraph 18 must assign risk weights for all their corporate exposures according to Table 10. If the due diligence analysis reflects higher risk characteristics than that implied by the external rating bucket of the exposure (ie AAA to AA–; A+ to A– etc), the bank must assign a risk weight at least one bucket higher than the "base" risk weight determined by the external rating. Due diligence analysis must never result in the application of a lower risk weight than that determined by the external rating.

40. Unrated corporate exposures of banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes will receive a 100% risk weight, with the exception of unrated exposures to corporate small and medium entities (SMEs), as described in paragraph 43.

Risk weight table for corporate exposures

Jurisdictions that use external ratings for regulatory purposes — Table 10

External rating of counterparty	AAA to AA–	A+ to A–	BBB+ to BBB–	BB+ to BB–	Below BB–	Unrated
"Base" risk weight	20%	50%	75%	100%	150%	100%

41. For corporate exposures of banks incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes, banks will assign a 100% risk weight to all corporate exposures, with the exception of:

- exposures to corporates identified as "investment grade" in paragraph 42; and
- exposures to corporate SMEs in paragraph 43.

Banks must apply the treatment set out in this paragraph to their corporate exposures if they have assigned risk weights to their rated bank exposures based on paragraph 21.

42. Banks in jurisdictions that do not allow the use of external ratings for regulatory purposes may assign a 65% risk weight to exposures to "investment grade" corporates. An "investment grade" corporate is a corporate entity that has adequate capacity to meet its financial commitments in a timely manner and its ability to do so is assessed to be robust against adverse changes in the economic cycle and business conditions. When making this determination, the bank should assess the corporate entity against the investment grade definition taking into account the complexity of its business model, performance against industry and peers, and risks posed by the entity's operating environment. Moreover, the corporate entity (or its parent company) must have securities outstanding on a recognised securities exchange.

43. For unrated exposures to corporate SMEs (defined as corporate exposures where the reported annual sales for the consolidated group of which the corporate counterparty is a part is less than or equal to €50 million for the most recent financial year), an 85% risk weight will be applied. Exposures to SMEs that meet the criteria in paragraph 55 will be treated as regulatory retail SME exposures and risk weighted at 75%.

[22] An exposure is rated from the perspective of a bank if the exposure is rated by a recognised "eligible credit assessment institution" (ECAI) which has been nominated by the bank (ie the bank has informed its supervisor of its intention to use the ratings of such ECAI for regulatory purposes in a consistent manner (paragraphs 103). In other words, if an external rating exists but the credit rating agency is not a recognised ECAI by the national supervisor, or the rating has been issued by an ECAI which has not been nominated by the bank, the exposure would be considered as being unrated from the perspective of the bank.

7.2 Specialised lending

44. A corporate exposure will be treated as a specialised lending exposure if such lending possesses some or all of the following characteristics, either in legal form or economic substance:

- The exposure is not related to real estate and is within the definitions of object finance, project finance or commodities finance under paragraph 45. If the activity is related to real estate, the treatment would be determined in accordance with paragraphs 59 to 75;
- The exposure is typically to an entity (often a special purpose vehicle (SPV)) that was created specifically to finance and/or operate physical assets;
- The borrowing entity has few or no other material assets or activities, and therefore little or no independent capacity to repay the obligation, apart from the income that it receives from the asset(s) being financed. The primary source of repayment of the obligation is the income generated by the asset(s), rather than the independent capacity of the borrowing entity; and
- The terms of the obligation give the lender a substantial degree of control over the asset(s) and the income that it generates.

45. Exposures described in paragraph 44 will be classified in one of the following three subcategories of specialised lending:

(i) Project finance refers to the method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the loan. This type of financing is usually for large, complex and expensive installations such as power plants, chemical processing plants, mines, transportation infrastructure, environment, media, and telecoms. Project finance may take the form of financing the construction of a new capital installation, or refinancing of an existing installation, with or without improvements.

(ii) Object finance refers to the method of funding the acquisition of equipment (eg ships, aircraft, satellites, railcars, and fleets) where the repayment of the loan is dependent on the cash flows generated by the specific assets that have been financed and pledged or assigned to the lender.

(iii) Commodities finance refers to short-term lending to finance reserves, inventories, or receivables of exchange-traded commodities (eg crude oil, metals, or crops), where the loan will be repaid from the proceeds of the sale of the commodity and the borrower has no independent capacity to repay the loan.

46. Banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes will assign to their specialised lending exposures the risk weights determined by the *issue-specific* external ratings, if these are available, according to Table 10. Issuer ratings must not be used (ie paragraph 107 does not apply in the case of specialised lending exposures).

47. For specialised lending exposures for which an issue-specific external rating is not available, and for all specialised lending exposures of banks incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes, the following risk weights will apply:

- Object and commodities finance exposures will be risk-weighted at 100%;
- Project finance exposures will be risk-weighted at 130% during the pre-operational phase and 100% during the operational phase. Project finance exposures in the operational phase which are deemed to be high quality, as described in paragraph 48, will be risk weighted at 80%. For this purpose, operational phase is defined as the phase in which the entity that was specifically created to finance the project has (i) a positive net cash flow that is sufficient to cover any remaining contractual obligation, and (ii) declining long term debt.

48. A high quality project finance exposure refers to an exposure to a project finance entity that is able to meet its financial commitments in a timely manner and its ability to do so is assessed to be robust

against adverse changes in the economic cycle and business conditions. The following conditions must also be met:

- The project finance entity is restricted from acting to the detriment of the creditors (eg by not being able to issue additional debt without the consent of existing creditors);
- The project finance entity has sufficient reserve funds or other financial arrangements to cover the contingency funding and working capital requirements of the project;
- The revenues are availability-based[23] or subject to a rate-of-return regulation or take-or-pay contract;
- The project finance entity's revenue depends on one main counterparty and this main counterparty shall be a central government, PSE or a corporate entity with a risk weight of 80% or lower;
- The contractual provisions governing the exposure to the project finance entity provide for a high degree of protection for creditors in case of a default of the project finance entity;
- The main counterparty or other counterparties which similarly comply with the eligibility criteria for the main counterparty will protect the creditors from the losses resulting from a termination of the project;
- All assets and contracts necessary to operate the project have been pledged to the creditors to the extent permitted by applicable law; and
- Creditors may assume control of the project finance entity in case of its default.

8. Subordinated debt, equity and other capital instruments

49. The treatment described in paragraphs 50 to 53 applies to subordinated debt, equity and other regulatory capital instruments issued by either corporates or banks, provided that such instruments are not deducted from regulatory capital or risk-weighted at 250% according to paragraphs 87 to 90 of the Basel III framework (June 2011). Equity exposures are defined on the basis of the economic substance of the instrument. They include both direct and indirect ownership interests,[24] whether voting or non-voting, in the assets and income of a commercial enterprise or of a financial institution that is not consolidated or deducted. An instrument is considered to be an equity exposure if it meets all of the following requirements:

- It is irredeemable in the sense that the return of invested funds can be achieved only by the sale of the investment or sale of the rights to the investment or by the liquidation of the issuer;
- It does not embody an obligation on the part of the issuer; and
- It conveys a residual claim on the assets or income of the issuer.

Additionally any of the following instruments must be categorised as an equity exposure:

[23] Availability-based revenues mean that once construction is completed, the project finance entity is entitled to payments from its contractual counterparties (eg the government), as long as contract conditions are fulfilled. Availability payments are sized to cover operating and maintenance costs, debt service costs and equity returns as the project finance entity operates the project. Availability payments are not subject to swings in demand, such as traffic levels, and are adjusted typically only for lack of performance or lack of availability of the asset to the public.

[24] Indirect equity interests include holdings of derivative instruments tied to equity interests, and holdings in corporations, partnerships, limited liability companies or other types of enterprises that issue ownership interests and are engaged principally in the business of investing in equity instruments.

- An instrument with the same structure as those permitted as Tier 1 capital for banking organisations.
- An instrument that embodies an obligation on the part of the issuer and meets any of the following conditions:
  1) The issuer may defer indefinitely the settlement of the obligation;
  2) The obligation requires (or permits at the issuer's discretion) settlement by issuance of a fixed number of the issuer's equity shares;
  3) The obligation requires (or permits at the issuer's discretion) settlement by issuance of a variable number of the issuer's equity shares and (ceteris paribus) any change in the value of the obligation is attributable to, comparable to, and in the same direction as, the change in the value of a fixed number of the issuer's equity shares;[25] or,
  4) The holder has the option to require that the obligation be settled in equity shares, unless either (i) in the case of a traded instrument, the supervisor is content that the bank has demonstrated that the instrument trades more like the debt of the issuer than like its equity, or (ii) in the case of non-traded instruments, the supervisor is content that the bank has demonstrated that the instrument should be treated as a debt position. In cases (i) and (ii), the bank may decompose the risks for regulatory purposes, with the consent of the supervisor.

Debt obligations and other securities, partnerships, derivatives or other vehicles structured with the intent of conveying the economic substance of equity ownership are considered an equity holding.[26] This includes liabilities from which the return is linked to that of equities.[27] Conversely, equity investments that are structured with the intent of conveying the economic substance of debt holdings or securitisation exposures would not be considered an equity holding.[28]

[25] For certain obligations that require or permit settlement by issuance of a variable number of the issuer's equity shares, the change in the monetary value of the obligation is equal to the change in the fair value of a fixed number of equity shares multiplied by a specified factor. Those obligations meet the conditions of item 3 if both the factor and the referenced number of shares are fixed. For example, an issuer may be required to settle an obligation by issuing shares with a value equal to three times the appreciation in the fair value of 1,000 equity shares. That obligation is considered to be the same as an obligation that requires settlement by issuance of shares equal to the appreciation in the fair value of 3,000 equity shares.

[26] Equities that are recorded as a loan but arise from a debt/equity swap made as part of the orderly realisation or restructuring of the debt are included in the definition of equity holdings. However, these instruments may not attract a lower capital charge than would apply if the holdings remained in the debt portfolio.

[27] Supervisors may decide not to require that such liabilities be included where they are directly hedged by an equity holding, such that the net position does not involve material risk.

[28] The national supervisor has the discretion to re-characterise debt holdings as equites for regulatory purposes and to otherwise ensure the proper treatment of holdings under Pillar 2.

50. Banks will assign a risk weight of 400% to speculative unlisted equity exposures described in paragraph 51 and a risk weight of 250% to all other equity holdings, with the exception of those equity holdings referred to in paragraph 52.[29]

51. Speculative unlisted equity exposures are defined as equity investments in unlisted companies that are invested for short-term resale purposes or are considered venture capital or similar investments which are subject to price volatility and are acquired in anticipation of significant future capital gains.[30]

52. National supervisors may allow banks to assign a risk weight of 100% to equity holdings made pursuant to national legislated programmes that provide significant subsidies for the investment to the bank and involve government oversight and restrictions on the equity investments. Such treatment can only be accorded to equity holdings up to an aggregate of 10% of the bank's combined Tier 1 and Tier 2 capital. Example of restrictions are limitations on the size and types of businesses in which the bank is investing, allowable amounts of ownership interests, geographical location and other pertinent factors that limit the potential risk of the investment to the bank.

53. Banks will assign a risk weight of 150% to subordinated debt and capital instruments other than equities. Any liabilities that meet the definition of "other TLAC liabilities" in paragraphs 66b and 66c of the amended version of Basel III set out in the TLAC holdings standard (October 2016) and that are not deducted from regulatory capital are considered to be subordinated debt for the purposes of this paragraph.

9. Retail exposures

54. Retail exposures are exposures to an individual person or persons, or to regulatory retail SMEs.[31] Retail exposures secured by real estate will be treated according to paragraphs 59 to 75. All other retail exposures will be treated as outlined in paragraphs 55 to 58.

55. Retail exposures that meet all of the criteria listed below will be classified as "regulatory retail" exposures and risk-weighted at 75%. Defaulted retail exposures are to be excluded from the overall regulatory retail portfolio when assessing the granularity criterion.

- Product criterion: the exposure takes the form of any of the following: revolving credits and lines of credit (including credit cards, charge cards and overdrafts), personal term loans and leases (eg instalment loans, auto loans and leases, student and educational loans, personal finance) and

[29] The risk weight treatment described in paragraph 50, excluding equity holdings referred to in paragraph 52, will be subject to a five-year linear phase-in arrangement from the date of implementation of this standard. For speculative unlisted equity exposures, the applicable risk weight will start at 100% and increase by 60 percentage points at the end of each year until the end of Year 5. For all other equity holdings, the applicable risk weight will start at 100% and increase by 30 percentage points at the end of each year until the end of Year 5.

[30] For example, investments in unlisted equities of corporate clients with which the bank has or intends to establish a long-term business relationship and debt-equity swaps for corporate restructuring purposes would be excluded.

[31] Regulatory retail SMEs are SMEs, defined in accordance to paragraph 43, that meet the requirements set out in paragraph 55. In some jurisdictions (eg emerging economies), national supervisors might deem it appropriate to define SMEs in a more conservative manner (ie with a lower level of sales).

small business facilities and commitments. Mortgage loans, derivatives and other securities (such as bonds and equities), whether listed or not, are specifically excluded from this category.

- Low value of individual exposures: the maximum aggregated exposure to one counterparty cannot exceed an absolute threshold of €1 million.
- Granularity criterion: no aggregated exposure to one counterparty[32] can exceed 0.2%[33] of the overall regulatory retail portfolio, unless national supervisors have determined another method to ensure satisfactory diversification of the regulatory retail portfolio.

56. "Regulatory retail" exposures which meet the criteria in paragraph 55 that arise from obligors who qualify as transactors will be risk-weighted at 45%. Transactors are obligors in relation to facilities such as credit cards and charge cards where the balance has been repaid in full at each scheduled repayment date for the previous 12 months. Obligors in relation to overdraft facilities would also be considered as transactors if there has been no drawdowns over the previous 12 months.

57. "Other retail": exposures to an individual person or persons that do not meet all of the criteria in paragraph 55 will be risk-weighted at 100%.

58. Exposures to SMEs that do not meet all of the criteria in paragraph 55 will be treated as corporate SMEs exposures under paragraph 43, unless secured by real estate.

10. Real estate exposure class

59. The risk weights in Tables 11, 12, 13 and 14 and the approaches set out in paragraphs 65 and 71 will apply to jurisdictions where structural factors result in sustainably low credit losses associated with the exposures to the real estate market. National supervisors should evaluate whether the risk weights in the corresponding risk weight tables are too low for these types of exposures in their jurisdictions based on default experience and other factors such as market price stability. Supervisors may require banks in their jurisdictions to increase these risk weights as appropriate.

60. To apply the risk-weights in Tables 11, 12, 13 and 14 and the approaches set out in paragraphs 65 and 71, the loan must meet the following requirements:

- Finished property: the property securing the exposure must be fully completed. This requirement does not apply to forest and agricultural land. Subject to national discretion, supervisors may apply the risk-weight treatment described in paragraphs 64 and 65 for loans to individuals that are secured by residential property under construction or land upon which residential property would be constructed, provided that: (i) the property is a one-to-four family residential housing unit that will be the primary residence of the borrower and the lending to the individual is not, in

[32] Aggregated exposure means gross amount (ie not taking any credit risk mitigation into account) of all forms of retail exposures, excluding residential real estate exposures. In case of off-balance sheet claims, the gross amount would be calculated after applying credit conversion factors. In addition, "to one counterparty" means one or several entities that may be considered as a single beneficiary (eg in the case of a small business that is affiliated to another small business, the limit would apply to the bank's aggregated exposure on both businesses).

[33] To avoid circular calculations, the granularity criterion will be verified only once. The calculation must be done on the portfolio of retail exposures that meet the product and orientation criteria as well as the low value of the exposure.

effect, indirectly financing land acquisition, development and construction exposures described in paragraph 74; or (ii) where the sovereign or PSEs involved have the legal powers and ability to ensure that the property under construction will be finished.

- Legal enforceability: any claim on the property taken must be legally enforceable in all relevant jurisdictions. The collateral agreement and the legal process underpinning it must be such that they provide for the bank to realise the value of the property within a reasonable time frame.
- Claims over the property: the loan is a claim over the property where the lender bank holds a first lien over the property, or a single bank holds the first lien and any sequentially lower ranking lien(s) (ie there is no intermediate lien from another bank) over the same property. However, in jurisdictions where junior liens provide the holder with a claim for collateral that is legally enforceable and constitute an effective credit risk mitigant, junior liens held by a different bank than the one holding the senior lien may also be recognised.[34] In order to meet the above requirements, the national frameworks governing liens should ensure the following: (i) each bank holding a lien on a property can initiate the sale of the property independently from other entities holding a lien on the property; and (ii) where the sale of the property is not carried out by means of a public auction, entities holding a senior lien take reasonable steps to obtain a fair market value or the best price that may be obtained in the circumstances when exercising any power of sale on their own (ie it is not possible for the entity holding the senior lien to sell the property on its own at a discounted value in detriment of the junior lien).[35]
- Ability of the borrower to repay: the borrower must meet the requirements set according to paragraph 61.
- Prudent value of property: the property must be valued according to the criteria in paragraph 62 for determining the value in the loan to value (LTV) ratio. Moreover, the value of the property must not depend materially on the performance of the borrower.

[34] Likewise, this would apply to junior liens held by the same bank that holds the senior lien in case there is an intermediate lien from another bank (ie the senior and junior liens held by the bank are not in sequential ranking order).

[35] In certain jurisdictions, the majority of bank loans to individuals for the purchase of residential property are not provided as mortgages in legal form. Instead, they are typically provided as loans that are guaranteed by a highly rated monoline guarantor that is required to repay the bank in full if the borrower defaults, and where the bank has legal right to take a mortgage on the property in the event that the guarantor fails. These loans may be treated as residential real estate exposures (rather than guaranteed loans) if the following additional conditions are met:

(i) the borrower shall be contractually committed not to grant any mortgage lien without the consent of the bank that granted the loan;

(ii) the guarantor shall be either a bank or a financial institution subject to capital requirements comparable to those applied to banks or an insurance undertaking;

(iii) the guarantor shall establish a fully-funded mutual guarantee fund or equivalent protection for insurance undertakings to absorb credit risk losses, whose calibration shall be periodically reviewed by its supervisors and subject to periodic stress testing; and

(iv) the bank shall be contractually and legally allowed to take a mortgage on the property in the event that the guarantor fails.

- Required documentation: all the information required at loan origination and for monitoring purposes must be properly documented, including information on the ability of the borrower to repay and on the valuation of the property.

61. National supervisors should ensure that banks put in place underwriting policies with respect to the granting of mortgage loans that include the assessment of the ability of the borrower to repay. Underwriting policies must define a metric(s) (such as the loan's debt service coverage ratio) and specify its (their) corresponding relevant level(s) to conduct such assessment.[36] Underwriting policies must also be appropriate when the repayment of the mortgage loan depends materially on the cash flows generated by the property, including relevant metrics (such as an occupancy rate of the property). National supervisors may provide guidance on appropriate definitions and levels for these metrics in their jurisdictions.

62. The LTV ratio is the amount of the loan divided by the value of the property. The value of the property will be maintained at the value measured at origination unless national supervisors elect to require banks to revise the property value downward.[37] The value must be adjusted if an extraordinary, idiosyncratic event occurs resulting in a permanent reduction of the property value. Modifications made to the property that unequivocally increase its value could also be considered in the LTV. When calculating the LTV ratio, the loan amount will be reduced as the loan amortises.

The LTV ratio must be prudently calculated in accordance with the following requirements:

- Amount of the loan: includes the outstanding loan amount and any undrawn committed amount of the mortgage loan.[38] The loan amount must be calculated gross of any provisions and other risk mitigants, except for pledged deposits accounts with the lending bank that meet all requirements for on-balance sheet netting and have been unconditionally and irrevocably pledged for the sole purposes of redemption of the mortgage loan.[39]

[36] Metrics and levels for measuring the ability to repay should mirror the FSB *Principles for sound residential mortgage underwriting practices (April 2012)*.

[37] If the value has been adjusted downwards, a subsequent upwards adjustment can be made but not to a higher value than the value at origination.

[38] If a bank grants different loans secured by the same property and they are sequential in ranking order (ie there is no intermediate lien from another bank), the different loans should be considered as a single exposure for risk-weighting purposes, and the amount of the loans should be added to calculate the LTV ratio.

[39] In jurisdictions where junior liens held by a different bank than that holding the senior lien are recognised (in accordance with paragraph 60), the loan amount of the junior liens must include all other loans secured with liens of equal or higher ranking than the bank's lien securing the loan for purposes of defining the LTV bucket and risk weight for the junior lien. If there is insufficient information for ascertaining the ranking of the other liens, the bank should assume that these liens rank pari passu with the junior lien held by the bank. This treatment does not apply to exposures that are risk weighted according to paragraphs 65 and 71, where the junior lien would be taken into account in the calculation of the value of the property. The bank will first determine the "base" risk weight based on Tables 11, 12, 13 or 14 as applicable and adjust the "base" risk weight by a multiplier of 1.25, for application to the loan amount of the junior lien. If the "base" risk weight corresponds to the lowest LTV bucket, the multiplier will not be applied. The resulting risk weight of multiplying the "base" risk weight by 1.25 will be capped at the risk weight applied to the exposure when the requirements in paragraph 60 are not met.

- Value of the property: the valuation must be appraised independently[40] using prudently conservative valuation criteria. To ensure that the value of the property is appraised in a prudently conservative manner, the valuation must exclude expectations on price increases and must be adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan. National supervisors should provide guidance setting out prudent valuation criteria where such guidance does not already exist under national law. If a market value can be determined, the valuation should not be higher than the market value.[41]

A guarantee or financial collateral may be recognised as a credit risk mitigant in relation to exposures secured by real estate if it qualifies as eligible collateral under the credit risk mitigation framework. This may include mortgage insurance[42] if it meets the operational requirements of the credit risk mitigation framework for a guarantee. Banks may recognise these risk mitigants in calculating the exposure amount; however, the LTV bucket and risk weight to be applied to the exposure amount must be determined before the application of the appropriate credit risk mitigation technique.

10.1 Exposures secured by residential real estate

63. A residential real estate exposure is an exposure secured by an immovable property that has the nature of a dwelling and satisfies all applicable laws and regulations enabling the property to be occupied for housing purposes (ie residential property).[43]

64. Where the requirements in paragraph 60 are met and provided that paragraphs 67, 74 and 75 are not applicable, the risk weight to be assigned to the total exposure amount will be determined based on the exposure's LTV ratio in Table 11.

Risk weight table for residential real estate exposures

(Repayment is not materially dependent on cash flows generated by property) Table 11

	LTV ≤ 50%	50% < LTV ≤ 60%	60% < LTV ≤ 80%	80% < LTV ≤ 90%	90% < LTV ≤ 100%	LTV > 100%
Risk weight	20%	25%	30%	40%	50%	70%

65. As an alternative to the approach in paragraph 64, where the requirements in paragraph 60 are met and provided that paragraphs 67, 74 and 75 are not applicable, jurisdictions may apply a risk weight of 20% to the part of the exposure up to 55% of the property value and the risk weight of the counterparty as prescribed in footnote 45 to the residual exposure.[44] Where there are liens on the property that are not held by the bank, the treatment is as follows:

- Case 1: the bank holds the junior lien and there are senior liens not held by the bank. When the value of all liens exceeds 55% of the property value, the amount of the bank's lien that is eligible for the 20% risk weight should be calculated as the maximum of: (i) 55% of the property value minus the amount of the senior liens; and (ii) zero. For example, for a loan of €70,000 to an

40 The valuation must be done independently from the bank's mortgage acquisition, loan processing and loan decision process.

41 In the case where the mortgage loan is financing the purchase of the property, the value of the property for LTV purposes will not be higher than the effective purchase price.

42 A bank's use of mortgage insurance should mirror the *FSB Principles for sound residential mortgage underwriting* (April 2012).

43 For residential property under construction described in paragraph 60, this means there should be an expectation that the property will satisfy all applicable laws and regulations enabling the property to be occupied for housing purposes

44 For example, for a loan of €70,000 to an individual secured on a property valued at €100,000, the bank will apply a risk weight of 20% to €55,000 of the exposure and, according to footnote 45, a risk weight of 75% to the residual exposure of €15,000. This gives total risk weighted assets for the exposure of €22,250 =(0.20 * €55,000) + (0.75 * €15,000).

individual secured on a property valued at €100,000, where there is also a senior ranking lien of €10,000 held by another institution, the bank will apply a risk weight of 20% to €45,000 (=max(€55,000 - €10,000, 0)) of the exposure and, according to footnote 45, a risk weight of 75% to the residual exposure of €25,000. When the value of all liens does not exceed 55% of the property value, a risk weight of 20% will be applied to the bank's exposure.

- Case 2: there are liens not held by the bank that rank pari passu with the bank's lien and there are no other senior or junior liens. When the value of all liens exceeds 55% of the property value, the part of the bank's exposure that is eligible for the 20% risk weight should be calculated as the product of: (i) 55% of the property value; and (ii) the bank's exposure divided by the sum of all pari passu liens. For example, for a loan of €70,000 to an individual secured on a property valued at €100,000, where there is also a pari passu ranking lien of €10,000 held by another institution, the bank will apply a risk weight of 20% to €48,125 (=€55,000 * €70,000/€80,000) of the exposure and, according to footnote 45, a risk weight of 75% to the residual exposure of €21,875. When the value of all liens does not exceed 55% of the property value, a risk weight of 20% will be applied to the bank's exposure.

66. For exposures where any of the requirements in paragraph 60 are not met and paragraphs 67, 74 and 75 are not applicable, the risk weight applicable will be the risk weight of the counterparty.[45]

67. When the prospects for servicing the loan materially depend[46] on the cash flows generated by the property securing the loan rather than on the underlying capacity of the borrower to service the debt from other sources, and provided that paragraphs 74 and 75 are not applicable, the exposure will be risk-weighted as follows:

- if the requirements in paragraph 60 are met, according to the LTV ratio as set out in Table 12 below; and
- if any of the requirements of paragraph 60 are not met, at 150%.

The primary source of these cash flows would generally be lease or rental payments, or the sale of the residential property. The distinguishing characteristic of these exposures compared to other residential real estate exposures is that both the servicing of the loan and the prospects for recovery in the event of default depend materially on the cash flows generated by the property securing the exposure.

Risk weight table for residential real estate exposures

(Repayment is materially dependent on cash flows generated by property) Table 12

	LTV ≤ 50%	50% < LTV ≤ 60%	60% < LTV ≤ 80%	80% < LTV ≤ 90%	90% < LTV ≤ 100%	LTV > 100%
Risk weight	30%	35%	45%	60%	75%	105%

68. The following types of exposures are excluded from the treatment described in paragraph 67 and instead, subject to the treatment described in paragraphs 64 to 66:

- An exposure secured by a property that is the borrower's primary residence;

45 For exposures to individuals the risk weight applied will be 75%. For exposures to SMEs, the risk weight applied will be 85%. For exposures to other counterparties, the risk weight applied is the risk weight that would be assigned to an unsecured exposure to that counterparty.

46 It is expected that the material dependence condition would predominantly apply to loans to corporates, SMEs or SPVs, but is not restricted to those borrower types. As an example, a loan may be considered materially dependent if more than 50% of the income from the borrower used in the bank's assessment of its ability to service the loan is from cash flows generated by the residential property. National supervisors may provide further guidance setting out criteria on how material dependence should be assessed for specific exposure types.

- An exposure secured by an income-producing residential housing unit, to an individual who has mortgaged less than a certain number of properties or housing units, as specified by national supervisors;
- An exposure secured by residential real estate property to associations or cooperatives of individuals that are regulated under national law and exist with the only purpose of granting its members the use of a primary residence in the property securing the loans; and
- An exposure secured by residential real estate property to public housing companies and not-for-profit associations regulated under national law that exist to serve social purposes and to offer tenants long-term housing.

10.2 Exposures secured by commercial real estate

69. A commercial real estate exposure is an exposure secured by any immovable property that is not a residential real estate as defined in paragraph 63.

70. Where the requirements in paragraph 60 are met and provided that paragraphs 73, 74 and 75 are not applicable, the risk weight to be assigned to the total exposure amount will be determined based on the exposure's LTV ratio in Table 13. For the purpose of paragraphs 70 to 72, "risk weight of the counterparty" refers to 75% for exposures to individuals, 85% for exposures to SMEs and for exposures to other counterparties, the risk weight applied is the risk weight that would be assigned to an unsecured exposure to that counterparty.

Risk weight table for commercial real estate exposures

(Repayment is not materially dependent on cash flows generated by property) Table 13

	LTV ≤ 60%	LTV > 60%
Risk weight	Min (60%, RW of counterparty)	RW of counterparty

71. As an alternative to the approach in paragraph 70, where the requirements in paragraph 60 are met and provided that paragraphs 73, 74 and 75 are not applicable, jurisdictions may apply a risk weight of 60% or the risk weight of the counterparty, whichever is lower, to the part of the exposure up to 55% of the property value[47], and the risk weight of the counterparty to the residual exposure.

72. Where any of the requirements in paragraph 60 are not met and paragraphs 73, 74 and 75 are not applicable, the risk weight applied will be the risk weight of the counterparty.

73. When the prospects for servicing the loan materially depend[48] on the cash flows generated by the property securing the loan rather than on the underlying capacity of the borrower to service the debt

[47] Where there are liens on the property that are not held by the bank, the part of the exposure up to 55% of the property value should be reduced by the amount of the senior liens not held by the bank and by a pro-rata percentage of any liens pari passu with the bank's lien but not held by the bank. See paragraph 65 for examples of how this methodology applies in the case of residential retail exposures.

[48] It is expected that the material dependence condition would predominantly apply to loans to corporates, SMEs or SPVs, but is not restricted to those borrower types. As an example: a loan may be considered materially dependent if more than 50% of the income from the borrower used in the bank's assessment of its ability to service the loan is from cash flows generated by the

from other sources,[49] and provided that paragraphs 74 and 75 is not applicable, the exposure will be risk-weighted as follows:[50]

- if the requirements in paragraph 60 are met, according to the LTV ratio as set out in the risk-weight Table 14 below; and
- if any of the requirements of paragraph 60 are not met, at 150%.

The primary source of these cash flows would generally be lease or rental payments, or the sale, of the commercial property. The distinguishing characteristic of these exposures compared to other commercial real estate exposures is that both the servicing of the loan and the recovery in the event of default depend materially on the cash flows generated by the property securing the exposure.

Risk weight table for commercial real estate exposures

(Repayment is materially dependent on cash flows generated by property) Table 14

	LTV ≤ 60%	60% < LTV ≤ 80%	LTV > 80%
Risk weight	70%	90%	110%

10.3 Land acquisition, development and construction exposures

74. Land acquisition, development and construction (ADC) exposures[51] refers to loans to companies or SPVs financing any of the land acquisition for development and construction purposes, or development and construction of any residential or commercial property. ADC exposures will be risk-weighted at 150%, unless they meet the criteria in paragraph 75.

75. ADC exposures to residential real estate may be risk weighted at 100%, provided that the following criteria are met:

- prudential underwriting standards meet the requirements in paragraph 60 where applicable;
- pre-sale or pre-lease contracts amount to a signficant portion of total contracts or substantial equity at risk.[52] Pre-sale or pre-lease contracts must be legally binding written contracts and the purchaser/renter must have made a substantial cash deposit which is subject to forfeiture if the contract is terminated. Equity at risk should be determined as an appropriate amount of borrower-contributed equity to the real estate's appraised as-completed value.

commercial property. National supervisors may provide further guidance setting out criteria on how material dependence should be assessed for specific exposure types.

49 For such exposures, national supervisors may allow banks to apply the treatment described in paragraphs 70 to 71 subject to the following conditions: (i) the losses stemming from commercial real estate lending up to 60% of LTV must not exceed 0.3% of the outstanding loans in any given year and (ii) overall losses stemming from commercial real estate lending must not exceed 0.5% of the outstanding loans in any given year. If either of these tests are not satisfied in a given year, the eligibility of the exemption will cease and the exposures where the prospect for servicing the loan materially depend on cash flows generated by the property securing the loan rather than the underlying capacity of the borrower to service the debt from other sources will again be risk weighted according to paragraph 73 until both tests are satisfied again in the future. Jurisdictions applying such treatment must publicly disclose whether these conditions are met.

50 National supervisors may require that the risk weight treatment described in paragraph 73 be applied to exposures where the servicing of the loan materially depends on the cash flows generated by a portfolio of properties owned by the borrower.

51 ADC exposures do not include the acquisition of forest or agricultural land, where there is no planning consent or intention to apply for planning consent.

52 National supervisors will give further guidance on the appropriate levels of pre-sale or pre-lease contracts and/or equity at risk to be applied in their jurisdictions.

11. Risk weight multiplier to certain exposures with currency mismatch

76. For unhedged retail and residential real estate exposures to individuals where the lending currency differs from the currency of the borrower's source of income, banks will apply a 1.5 times multiplier to the applicable risk weight according to paragraphs 54 to 58 and 63 to 68, subject to a maximum risk weight of 150%.

77. For the purposes of paragraph 76, an unhedged exposure refers to an exposure to a borrower that has no natural or financial hedge against the foreign exchange risk resulting from the currency mismatch between the currency of the borrower's income and the currency of the loan. A natural hedge exists where the borrower, in its normal operating procedures, receives foreign currency income that matches the currency of a given loan (eg remittances, rental incomes, salaries). A financial hedge generally includes a legal contract with a financial institution (eg forward contract). For the purposes of application of the multiplier, only these natural or financial hedges are considered sufficient where they cover at least 90% of the loan instalment, regardless of the number of hedges.

12. Off-balance sheet items

78. Off-balance sheet items will be converted into credit exposure equivalents through the use of credit conversion factors (CCF). In the case of commitments, the committed but undrawn amount of the exposure would be multiplied by the CCF. For these purposes, commitment means any contractual arrangement that has been offered by the bank and accepted by the client to extend credit, purchase assets or issue credit substitutes.[53] It includes any such arrangement that can be unconditionally cancelled by the bank at any time without prior notice to the obligor. It also includes any such arrangement that can be cancelled by the bank if the obligor fails to meet conditions set out in the facility documentation, including conditions that must be met by the obligor prior to any initial or subsequent drawdown under the arrangement. Counterparty risk weightings for OTC derivative transactions will not be subject to any specific ceiling.

79. A 100% CCF will be applied to the following items:

- Direct credit substitutes, eg general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).

[53] At national discretion, a jurisdiction may exempt certain arrangements from the definition of commitments provided that the following conditions are met: (i) the bank receives no fees or commissions to establish or maintain the arrangements; (ii) the client is required to apply to the bank for the initial and each subsequent drawdown; (iii) the bank has full authority, regardless of the fulfilment by the client of the conditions set out in the facility documentation, over the execution of each drawdown; and (iv) the bank's decision on the execution of each drawdown is only made after assessing the creditworthiness of the client immediately prior to drawdown. Exempted arrangements that meet the above criteria are limited to certain arrangements for corporates and SMEs, where counterparties are closely monitored on an ongoing basis.

- Sale and repurchase agreements and asset sales with recourse[54] where the credit risk remains with the bank.
- The lending of banks' securities or the posting of securities as collateral by banks, including instances where these arise out of repo-style transactions (ie repurchase/reverse repurchase and securities lending/securities borrowing transactions). The risk-weighting treatment for counterparty credit risk must be applied in addition to the credit risk charge on the securities or posted collateral, where the credit risk of the securities lent or posted as collateral remains with the bank. This paragraph does not apply to posted collateral related to derivative transactions that is treated in accordance with the counterparty credit risk standards.
- Forward asset purchases, forward forward deposits and partly paid shares and securities,[55] which represent commitments with certain drawdown.
- Off-balance sheet items that are credit substitutes not explicitly included in any other category.

80. A 50% CCF will be applied to note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) regardless of the maturity of the underlying facility.

81. A 50% CCF will be applied to certain transaction-related contingent items (eg performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions).

82. A 40% CCF will be applied to commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF.

83. A 20% CCF will be applied to both the issuing and confirming banks of short-term[56] self-liquidating trade letters of credit arising from the movement of goods (eg documentary credits collateralised by the underlying shipment).

84. A 10% CCF will be applied to commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. National supervisors should evaluate various factors in the jurisdiction, which may constrain banks' ability to cancel the commitment in practice, and consider applying a higher CCF to certain commitments as appropriate.

85. Where there is an undertaking to provide a commitment on an off-balance sheet item, banks are to apply the lower of the two applicable CCFs.[57]

86. The credit equivalent amount of SFTs that expose a bank to counterparty credit risk is to be calculated under the comprehensive approach in paragraphs 155 to 178. The credit equivalent amount of OTC derivatives that expose a bank to counterparty credit risk is to be calculated under the rules for counterparty credit risk in paragraph 189. As an alternative for both SFTs and OTC derivatives, banks may use the Internal Model Method as set out the counterparty credit risk standards for calculating the credit equivalent amount, subject to supervisory approval.

[54] These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

[55] These items are to be weighted according to the type of asset and not according to the type of counterparty with whom the transaction has been entered into.

[56] That is, with a maturity below one year. For further details see Basel Committee on Banking Supervision, *Treatment of trade finance under the Basel capital framework*, October 2011, www.bis.org/publ/bcbs205.pdf.

[57] For example, if a bank has a commitment to open short-term self-liquidating trade letters of credit arising from the movement of goods, a 20% CCF will be applied (instead of a 40% CCF); and if a bank has an unconditionally cancellable commitment described in paragraph 84 to issue direct credit substitutes, a 10% CCF will be applied (instead of a 100% CCF).

87. Banks must closely monitor securities, commodities and foreign exchange transactions that have failed, starting from the first day they fail. A capital charge on failed transactions must be calculated in accordance with Annex 3 of the Basel II framework (June 2006).

88. Banks are exposed to the risk associated with unsettled securities, commodities, and foreign exchange transactions from trade date. Irrespective of the booking or the accounting of the transaction, unsettled transactions must be taken into account for regulatory capital requirements purposes. Where they do not appear on the balance sheet (ie settlement date accounting), the unsettled exposure amount will receive a 100% CCF. Banks are encouraged to develop, implement and improve systems for tracking and monitoring the credit risk exposure arising from unsettled transactions as appropriate so that they can produce management information that facilitates timely action. Furthermore, when such transactions are not processed through a delivery-versus-payment (DvP) or payment-versus-payment (PvP) mechanism, banks must calculate a capital charge as set forth in Annex 3 of the Basel II framework (June 2006).

89. A bank providing credit protection through a first-to-default or second-to-default credit derivative is subject to capital requirements on such instruments. For first-to-default credit derivatives, the risk weights of the assets included in the basket must be aggregated up to a maximum of 1250% and multiplied by the nominal amount of the protection provided by the credit derivative to obtain the risk-weighted asset amount. For second-to-default credit derivatives, the treatment is similar; however, in aggregating the risk weights, the asset with the lowest risk-weighted amount can be excluded from the calculation. This treatment applies respectively for n^{th}-to-default credit derivatives, for which the n-1 assets with the lowest risk-weighted amounts can be excluded from the calculation.

13. Defaulted exposures

90. For risk-weighting purposes under the standardised approach, a defaulted exposure is defined as one that is past due for more than 90 days, or is an exposure to a defaulted borrower. A defaulted borrower is a borrower in respect of whom any of the following events have occurred:

- Any material credit obligation that is past due for more than 90 days. Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than current outstandings;
- Any material credit obligation is on non-accrued status (eg the lending bank no longer recognises accrued interest as income or, if recognised, makes an equivalent amount of provisions);
- A write-off or account-specific provision is made as a result of a significant perceived decline in credit quality subsequent to the bank taking on any credit exposure to the borrower;
- Any credit obligation is sold at a material credit-related economic loss;
- A distressed restructuring of any credit obligation (ie a restructuring that may result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or (where relevant) fees) is agreed by the bank;
- The borrower's bankruptcy or a similar order in respect of any of the borrower's credit obligations to the banking group has been filed;
- The borrower has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of any of the credit obligations to the banking group; or
- Any other situation where the bank considers that the borrower is unlikely to pay its credit obligations in full without recourse by the bank to actions such as realising security.

91. For retail exposures, the definition of default can be applied at the level of a particular credit obligation, rather than at the level of the borrower. As such, default by a borrower on one obligation does not require a bank to treat all other obligations to the banking group as defaulted.

92. With the exception of residential real estate exposures treated under paragraph 93, the unsecured or unguaranteed portion of a defaulted exposure shall be risk-weighted net of specific provisions and partial write-offs as follows:

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of the loan; and
- 100% risk weight when specific provisions are equal or greater than 20% of the outstanding amount of the loan.[58]

93. Defaulted residential real estate exposures where repayments do not materially depend on cash flows generated by the property securing the loan shall be risk-weighted net of specific provisions and partial write-offs at 100%. Guarantees or financial collateral which are eligible according to the credit risk mitigation framework might be taken into account in the calculation of the exposure in accordance with paragraph 62.

94. For the purpose of defining the secured or guaranteed portion of the defaulted exposure, eligible collateral and guarantees will be the same as for credit risk mitigation purposes (see Section D).

14. Other assets

95. The standard risk weight for all other assets will be 100%, with the exception of exposures mentioned in paragraphs 96 and 97.

96. A 0% risk weight will apply to (i) cash owned and held at the bank or in transit; and (ii) gold bullion held at the bank or held in another bank on an allocated basis, to the extent the gold bullion assets are backed by gold bullion liabilities.

97. A 20% risk weight will apply to cash items in the process of collection.

B. Recognition of external ratings by national supervisors

1. The recognition process

98. In jurisdictions that allow the use of external ratings for regulatory purposes, only credit assessments from credit rating agencies recognised as external credit assessment institutions (ECAIs) will be allowed. National supervisors are responsible for determining on a continuous basis whether an ECAI meets the criteria listed in paragraph 99 and recognition should only be provided in respect of ECAI ratings for types of claim where all criteria and conditions are met. National supervisors should also take into account the criteria and conditions provided in the IOSCO *Code of Conduct Fundamentals for Credit Rating Agencies*[59] when determining ECAI eligibility. The supervisory process for recognising ECAIs should be made public to avoid unnecessary barriers to entry.

[58] National supervisors have discretion to reduce the risk weight to 50% when specific provisions are no less than 50% of the outstanding amount of the loan.

[59] Available at www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf.

2. Eligibility criteria

99. An ECAI must satisfy each of the following eight criteria.

- ***Objectivity***: The methodology for assigning external ratings must be rigorous, systematic, and subject to some form of validation based on historical experience. Moreover, external ratings must be subject to ongoing review and responsive to changes in financial condition. Before being recognised by supervisors, a rating methodology for each market segment, including rigorous backtesting, must have been established for at least one year and preferably three years.
- ***Independence***: An ECAI should be independent and should not be subject to political or economic pressures that may influence the rating. In particular, an ECAI should not delay or refrain from taking a rating action based on its potential effect (economic, political or otherwise). The rating process should be as free as possible from any constraints that could arise in situations where the composition of the board of directors or the shareholder structure of the CRA may be seen as creating a conflict of interest. Furthermore, an ECAI should separate operationally, legally and, if practicable, physically its rating business from other businesses and analysts.
- ***International access/transparency***: The individual ratings, the key elements underlining the assessments and whether the issuer participated in the rating process should be publicly available on a non-selective basis, unless they are private ratings, which should be at least available to both domestic and foreign insitutions with legitimate interest and on equivalent terms. In addition, the ECAI's general procedures, methodologies and assumptions for arriving at ratings should be publicly available.
- ***Disclosure***: An ECAI should disclose the following information: its code of conduct; the general nature of its compensation arrangements with assessed entities; any conflict of interest,[60] the ECAI's compensation arrangements,[61] its assessment methodologies, including the definition of default, the time horizon, and the meaning of each rating; the actual default rates experienced in each assessment category; and the transitions of the ratings, eg the likelihood of AA ratings becoming A over time. A rating should be disclosed as soon as practicably possible after issuance.

[60] At a minimum, the following situations and their influence on the ECAI's credit rating methodologies or credit rating actions shall be disclosed:

- The ECAI is being paid to issue a credit rating by the rated entity or by the obligor, originator, underwriter, or arranger of the rated obligation;
- The ECAI is being paid by subscribers with a financial interest that could be affected by a credit rating action of the ECAI;
- The ECAI is being paid by rated entities, obligors, originators, underwriters, arrangers, or subscribers for services other than issuing credit ratings or providing access to the ECAI's credit ratings;
- The ECAI is providing a preliminary indication or similar indication of credit quality to an entity, obligor, originator, underwriter, or arranger prior to being hired to determine the final credit rating for the entity, obligor, originator, underwriter, or arranger; and
- The ECAI has a direct or indirect ownership interest in a rated entity or obligor, or a rated entity or obligor has a direct or indirect ownership interest in the ECAI.

[61] An ECAI should disclose the general nature of its compensation arrangements with rated entities, obligors, lead underwriters, or arrangers.

When the ECAI receives from a rated entity, obligor, originator, lead underwriter, or arranger compensation unrelated to its credit rating services, the ECAI should disclose such unrelated compensation as a percentage of total annual compensation received from such rated entity, obligor, lead underwriter, or arranger in the relevant credit rating report or elsewhere, as appropriate.

An ECAI should disclose in the relevant credit rating report or elsewhere, as appropriate, if it receives 10% or more of its annual revenue from a single client (eg a rated entity, obligor, originator, lead underwriter, arranger, or subscriber, or any of their affiliates).

When disclosing a rating, the information should be provided in plain language, indicating the nature and limitation of credit ratings and the risk of unduly relying on them to make investments.

- ***Resources***: An ECAI should have sufficient resources to carry out high-quality credit assessments. These resources should allow for substantial ongoing contact with senior and operational levels within the entities assessed in order to add value to the credit assessments. In particular, ECAIs should assign analysts with appropriate knowledge and experience to assess the creditworthiness of the type of entity or obligation being rated. Such assessments should be based on methodologies combining qualitative and quantitative approaches.
- ***Credibility***: To some extent, credibility is derived from the criteria above. In addition, the reliance on an ECAI's external ratings by independent parties (investors, insurers, trading partners) is evidence of the credibility of the ratings of an ECAI. The credibility of an ECAI is also underpinned by the existence of internal procedures to prevent the misuse of confidential information. In order to be eligible for recognition, an ECAI does not have to assess firms in more than one country.
- ***No abuse of unsolicited ratings***: ECAIs must not use unsolicited ratings to put pressure on entities to obtain solicited ratings. Supervisors should consider whether to continue recognising such ECAIs as eligible for capital adequacy purposes, if such behaviour is identified.
- ***Cooperation with the supervisor:*** ECAIs should notify the supervisor of significant changes to methodologies and provide access to external ratings and other relevant data in order to support intial and continued determination of eligibility.

C. Implementation considerations in jurisdictions that allow use of external ratings for regulatory purposes

1. The mapping process

100. Supervisors will be responsible for assigning eligible ECAIs' ratings to the risk weights available under the standardised risk weighting framework, ie deciding which rating categories correspond to which risk weights. The mapping process should be objective and should result in a risk weight assignment consistent with that of the level of credit risk reflected in the tables above. It should cover the full spectrum of risk weights.

101. When conducting such a mapping process, factors that supervisors should assess include, among others, the size and scope of the pool of issuers that each ECAI covers, the range and meaning of the ratings that it assigns, and the definition of default used by the ECAI.

102. In order to promote a more consistent mapping of ratings into the available risk weights and help supervisors in conducting such a process, Annex 2 of the Basel II framework (June 2006) provides guidance as to how such a mapping process may be conducted.

103. Banks must use the chosen ECAIs and their ratings consistently for all types of claim where they have been recognised by their supervisor as an eligible ECAI, for both risk-weighting and risk management purposes. Banks will not be allowed to "cherry-pick" the ratings provided by different ECAIs and to arbitrarily change the use of ECAIs.

2. Multiple external ratings

104. If there is only one rating by an ECAI chosen by a bank for a particular claim, that rating should be used to determine the risk weight of the exposure.

105. If there are two ratings by ECAIs chosen by a bank that map into different risk weights, the higher risk weight will be applied.

106. If there are three or more ratings with different risk weights, the two ratings that correspond to the lowest risk weights should be referred to. If these give rise to the same risk weight, that risk weight should be applied. If different, the higher risk weight should be applied.

3. Determination of whether an exposure is rated: Issue-specific and issuer ratings

107. Where a bank invests in a particular issue that has an issue-specific rating, the risk weight of the exposure will be based on this rating. Where the bank's exposure is not an investment in a specific rated issue, the following general principles apply.

- In circumstances where the borrower has a specific rating for an issued debt – but the bank's exposure is not an investment in this particular debt – a high-quality credit rating (one which maps into a risk weight lower than that which applies to an unrated claim) on that specific debt may only be applied to the bank's unrated exposure if this claim ranks in all respects *pari passu* or senior to the claim with a rating. If not, the external rating cannot be used and the unassessed claim will receive the risk weight for unrated exposures.
- In circumstances where the borrower has an issuer rating, this rating typically applies to senior unsecured claims on that issuer. Consequently, only senior claims on that issuer will benefit from a high-quality issuer rating. Other unassessed exposures of a highly rated issuer will be treated as unrated. If either the issuer or a single issue has a low-quality rating (mapping into a risk weight equal to or higher than that which applies to unrated exposures), an unassessed exposure to the same counterparty that ranks *pari passu* or is subordinated to either the senior unsecured issuer rating or the exposure with a low-quality rating will be assigned the same risk weight as is applicable to the low-quality assessment.
- In circumstances where the issuer has a specific high-quality rating (one which maps into a lower risk weight) that only applies to a limited class of liabilities (such as a deposit assessment or a counterparty risk assessment), this may only be used in respect of exposures that fall within that class.

108. Whether the bank intends to rely on an issuer- or an issue-specific rating, the rating must take into account and reflect the entire amount of credit risk exposure the bank has with regard to all payments owed to it.[62]

[62] For example, if a bank is owed both principal and interest, the assessment must fully take into account and reflect the credit risk associated with repayment of both principal and interest.

109. In order to avoid any double-counting of credit enhancement factors, no supervisory recognition of credit risk mitigation techniques will be taken into account if the credit enhancement is already reflected in the issue specific rating (see paragraph 121).

4. Domestic currency and foreign currency ratings

110. Where exposures are risk-weighted based on the rating of an equivalent exposure to that borrower, the general rule is that foreign currency ratings would be used for exposures in foreign currency. Domestic currency ratings, if separate, would only be used to risk-weight exposures denominated in the domestic currency.[63]

5. Short-term/long-term ratings

111. For risk-weighting purposes, short-term ratings are deemed to be issue-specific. They can only be used to derive risk weights for exposures arising from the rated facility. They cannot be generalised to other short-term exposures, except under the conditions of paragraph 113. In no event can a short-term rating be used to support a risk weight for an unrated long-term exposure. Short-term ratings may only be used for short-term exposures against banks and corporates. The table below provides a framework for banks' exposures to specific short-term facilities, such as a particular issuance of commercial paper:

Risk weight table for specific short-term ratings

Table 15

External rating	A-1/P-1[64]	A-2/P-2	A-3/P-3	Others[65]
Risk weight	20%	50%	100%	150%

112. If a short-term rated facility attracts a 50% risk-weight, unrated short-term exposures cannot attract a risk weight lower than 100%. If an issuer has a short-term facility with an external rating that warrants a risk weight of 150%, all unrated exposures, whether long-term or short-term, should also receive a 150% risk weight, unless the bank uses recognised credit risk mitigation techniques for such exposures.

113. In cases where short-term ratings are available, the following interaction with the general preferential treatment for short-term exposures to banks as described in paragraph 19 will apply:

- The general preferential treatment for short-term exposures applies to all exposures to banks of up to three months original maturity when there is no specific short-term claim assessment.
- When there is a short-term rating and such a rating maps into a risk weight that is more favourable (ie lower) or identical to that derived from the general preferential treatment, the short-term rating should be used for the specific exposure only. Other short-term exposures would benefit from the general preferential treatment.

[63] However, when an exposure arises through a bank's participation in a loan that has been extended, or has been guaranteed against convertibility and transfer risk, by certain MDBs, its convertibility and transfer risk can be considered by national supervisors to be effectively mitigated. To qualify, MDBs must have preferred creditor status recognised in the market and be included in footnote 11 (in paragraph 14). In such cases, for risk-weighting purposes, the borrower's domestic currency rating may be used instead of its foreign currency rating. In the case of a guarantee against convertibility and transfer risk, the local currency rating can be used only for the portion that has been guaranteed. The portion of the loan not benefiting from such a guarantee will be risk-weighted based on the foreign currency rating.

[64] The notations follow the methodology used by Standard & Poor's and by Moody's Investors Service. The A-1 rating of Standard & Poor's includes both A-1+ and A-1–.

[65] This category includes all non-prime and B or C ratings.

- When a specific short-term rating for a short term exposure to a bank maps into a less favourable (higher) risk weight, the general short-term preferential treatment for interbank exposures cannot be used. All unrated short-term exposures should receive the same risk weighting as that implied by the specific short-term rating.

114. When a short-term rating is to be used, the institution making the assessment needs to meet all of the eligibility criteria for recognising ECAIs, as described in paragraph 99, in terms of its short-term ratings.

6. Level of application of the rating

115. External ratings for one entity within a corporate group cannot be used to risk-weight other entities within the same group.

7. Use of unsolicited ratings

116. As a general rule, banks should use solicited ratings from eligible ECAIs. National supervisors may allow banks to use *unsolicited* ratings in the same way as solicited ratings if they are satisfied that the credit assessments of unsolicited ratings are not inferior in quality to the general quality of solicited ratings.

D. Credit risk mitigation techniques for exposures risk-weighted under the standardised approach

1. Overarching issues

(i) Introduction

117. Banks use a number of techniques to mitigate the credit risks to which they are exposed. For example, exposures may be collateralised by first-priority claims, in whole or in part with cash or securities, a loan exposure may be guaranteed by a third party, or a bank may buy a credit derivative to offset various forms of credit risk. Additionally banks may agree to net loans owed to them against deposits from the same counterparty.[66]

118. The framework set out in this section is applicable to banking book exposures that are risk-weighted under the standardised approach.

(ii) General requirements

119. No transaction in which CRM techniques are used shall receive a higher capital requirement than an otherwise identical transaction where such techniques are not used.

120. The Pillar 3 requirements must be fulfilled for banks to obtain capital relief in respect of any CRM techniques.

121. The effects of CRM must not be double-counted. Therefore, no additional supervisory recognition of CRM for regulatory capital purposes will be granted on exposures for which the risk weight already

[66] In this section, "counterparty" is used to denote a party to whom a bank has an on- or off-balance sheet credit exposure. That exposure may, for example, take the form of a loan of cash or securities (where the counterparty would traditionally be called the borrower), of securities posted as collateral, of a commitment or of exposure under an OTC derivatives contract.

reflects that CRM. Consistent with paragraph 108, principal-only ratings will also not be allowed within the CRM framework.

122. While the use of CRM techniques reduces or transfers credit risk, it may simultaneously increase other risks (ie residual risks). Residual risks include legal, operational, liquidity and market risks. Therefore, banks must employ robust procedures and processes to control these risks, including strategy; consideration of the underlying credit; valuation; policies and procedures; systems; control of roll-off risks; and management of concentration risk arising from the bank's use of CRM techniques and its interaction with the bank's overall credit risk profile. Where these risks are not adequately controlled, supervisors may impose additional capital charges or take other supervisory actions as outlined in Pillar 2.

123. In order for CRM techniques to provide protection, the credit quality of the counterparty must not have a material positive correlation with the employed CRM technique or with the resulting residual risks (as defined in paragraph 122). For example, securities issued by the counterparty (or by any counterparty-related entity) provide little protection as collateral and are thus ineligible.

124. In the case where a bank has multiple CRM techniques covering a single exposure (eg a bank has both collateral and a guarantee partially covering an exposure), the bank must subdivide the exposure into portions covered by each type of CRM technique (eg portion covered by collateral, portion covered by guarantee) and the risk-weighted assets of each portion must be calculated separately. When credit protection provided by a single protection provider has differing maturities, they must be subdivided into separate protection as well.

(iii) Legal requirements

125. In order for banks to obtain capital relief for any use of CRM techniques, all documentation used in collateralised transactions, on-balance sheet netting agreements, guarantees and credit derivatives must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review to verify this and have a well-founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.

(iv) General treatment of maturity mismatches

126. For the purposes of calculating risk-weighted assets, a maturity mismatch occurs when the residual maturity of a credit protection arrangement (eg hedge) is less than that of the underlying exposure.

127. In the case of financial collateral, maturity mismatches are not allowed under the simple approach (see paragraph 147).

128. Under the other approaches, when there is a maturity mismatch the credit protection arrangement may only be recognised if the original maturity of the arrangement is greater than or equal to one year, and its residual maturity is greater than or equal to three months. In such cases, credit risk mitigation may be partially recognised as detailed below in paragraph 129.

129. When there is a maturity mismatch with recognised credit risk mitigants, the following adjustment applies

$$P_a = P \cdot \frac{t - 0.25}{T - 0.25}$$

where:

- P_a = value of the credit protection adjusted for maturity mismatch
- P = credit protection amount (eg collateral amount, guarantee amount) adjusted for any haircuts
- t = min {T, residual maturity of the credit protection arrangement expressed in years}

- T =min {five years, residual maturity of the exposure expressed in years}

130. The maturity of the underlying exposure and the maturity of the hedge must both be defined conservatively. The effective maturity of the underlying must be gauged as the longest possible remaining time before the counterparty is scheduled to fulfil its obligation, taking into account any applicable grace period. For the hedge, (embedded) options that may reduce the term of the hedge must be taken into account so that the shortest possible effective maturity is used. For example: where, in the case of a credit derivative, the protection seller has a call option, the maturity is the first call date. Likewise, if the protection buyer owns the call option and has a strong incentive to call the transaction at the first call date, for example because of a step-up in cost from this date on, the effective maturity is the remaining time to the first call date.

(v) Currency mismatches

131. Currency mismatches are allowed under all approaches. Under the simple approach there is no specific treatment for currency mismatches, given that a minimum risk weight of 20% (floor) is generally applied. Under the comprehensive approach and in case of guarantees and credit derivatives, a specific adjustment for currency mismatches is prescribed in paragraphs 165 and 204, respectively.

2. Overview of credit risk mitigation techniques[67]

(i) Collateralised transactions

132. A collateralised transaction is one in which:

- banks have a credit exposure or a potential credit exposure; and
- that credit exposure or potential credit exposure is hedged in whole or in part by collateral posted by a counterparty or by a third party on behalf of the counterparty.

Where banks take eligible financial collateral, they may reduce their regulatory capital requirements through the application of CRM techniques.[68]

133. Banks may opt for either:

(i) The simple approach, which replaces the risk weight of the counterparty with the risk weight of the collateral for the collateralised portion of the exposure (generally subject to a 20% floor); or

(ii) The comprehensive approach, which allows a more precise offset of collateral against exposures, by effectively reducing the exposure amount by a volatility-adjusted value ascribed to the collateral.

Detailed operational requirements for both approaches are given in paragraphs 146 to 178. Banks may operate under either, but not both, approaches in the banking book.

134. For collateralised OTC transactions, exchange traded derivatives and long settlement transactions, banks may use the standardised approach for counterparty credit risk (SA-CCR) or the Internal Model Method to calculate the exposure amount, in accordance with paragraph 189.

[67] See Annex 10 of Basel II (June 2006) for an overview of methodologies for the capital treatment of transactions secured by financial collateral under the standardised and IRB approaches.

[68] Alternatively, banks with appropriate supervisory approval may instead use the Internal Model Method to determine the exposure amount, taking into account collateral.

(ii) On-balance sheet netting

135. Where banks have legally enforceable netting arrangements for loans and deposits that meet the conditions in paragraph 190 they may calculate capital requirements on the basis of net credit exposures as set out in that paragraph.

(iii) Guarantees and credit derivatives

136. Where guarantees or credit derivatives fulfil the minimum operational conditions set out in paragraphs 191 to 193, banks may take account of the credit protection offered by such credit risk mitigation techniques in calculating capital requirements.

137. A range of guarantors and protection providers are recognised and a substitution approach applies for capital requirement calculations. Only guarantees issued by or protection provided by entities with a lower risk weight than the counterparty lead to reduced capital charges for the guaranteed exposure, since the protected portion of the counterparty exposure is assigned the risk weight of the guarantor or protection provider, whereas the uncovered portion retains the risk weight of the underlying counterparty.

138. Detailed conditions and operational requirements for guarantees and credit derivatives are given in paragraphs 191 to 205.

3. Collateralised transactions

(i) General requirements

139. Before capital relief is granted in respect of any form of collateral, the standards set out below in paragraphs 140 to 145 must be met, irrespective of whether the simple or the comprehensive approach is used. Banks that lend securities or post collateral must calculate capital requirements for both of the following: (i) the credit risk or market risk of the securities, if this remains with the bank; and (ii) the counterparty credit risk arising from the risk that the borrower of the securities may default.

140. The legal mechanism by which collateral is pledged or transferred must ensure that the bank has the right to liquidate or take legal possession of it, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined credit events set out in the transaction documentation) of the counterparty (and, where applicable, of the custodian holding the collateral). Additionally, banks must take all steps necessary to fulfil those requirements under the law applicable to the bank's interest in the collateral for obtaining and maintaining an enforceable security interest, eg by registering it with a registrar, or for exercising a right to net or set off in relation to the title transfer of the collateral.

141. Banks must have clear and robust procedures for the timely liquidation of collateral to ensure that any legal conditions required for declaring the default of the counterparty and liquidating the collateral are observed, and that collateral can be liquidated promptly.

142. Banks must ensure that sufficient resources are devoted to the orderly operation of margin agreements with OTC derivative and securities-financing counterparties, as measured by the timeliness and accuracy of its outgoing margin calls and response time to incoming margin calls. Banks must have collateral risk management policies in place to control, monitor and report:

- the risk to which margin agreements expose them (such as the volatility and liquidity of the securities exchanged as collateral);
- the concentration risk to particular types of collateral;
- the reuse of collateral (both cash and non-cash) including the potential liquidity shortfalls resulting from the reuse of collateral received from counterparties; and

- the surrender of rights on collateral posted to counterparties.

143. Where the collateral is held by a custodian, banks must take reasonable steps to ensure that the custodian segregates the collateral from its own assets.

144. A capital requirement must be applied on both sides of a transaction. For example, both repos and reverse repos will be subject to capital requirements. Likewise, both sides of a securities lending and borrowing transaction will be subject to explicit capital charges, as will the posting of securities in connection with derivatives exposures or with any other borrowing transaction.

145. Where a bank, acting as an agent, arranges a repo-style transaction (ie repurchase/reverse repurchase and securities lending/borrowing transactions) between a customer and a third party and provides a guarantee to the customer that the third party will perform on its obligations, then the risk to the bank is the same as if the bank had entered into the transaction as a principal. In such circumstances, a bank must calculate capital requirements as if it were itself the principal.

(ii) The simple approach

General requirements for the simple approach

146. Under the simple approach, the risk weight of the counterparty is replaced by the risk weight of the collateral instrument collateralising or partially collateralising the exposure.

147. For collateral to be recognised in the simple approach, it must be pledged for at least the life of the exposure and it must be marked to market and revalued with a minimum frequency of six months. Those portions of exposures collateralised by the market value of recognised collateral receive the risk weight applicable to the collateral instrument. The risk weight on the collateralised portion is subject to a floor of 20% except under the conditions specified in paragraphs 150 to 154. The remainder of the exposure must be assigned the risk weight appropriate to the counterparty. Maturity mismatches are not allowed under the simple approach (see paragraphs 126 and 127).

Eligible financial collateral under the simple approach

148. The following collateral instruments are eligible for recognition in the simple approach:

(a) Cash (as well as certificates of deposit or comparable instruments issued by the lending bank) on deposit with the bank that is incurring the counterparty exposure.[69, 70]

(b) Gold.

(c) In jurisdictions that allow the use of external ratings for regulatory purposes:

  (i) Debt securities rated by a recognised ECAI where these are either:

    – at least BB– when issued by sovereigns or PSEs that are treated as sovereigns by the national supervisor; or

    – at least BBB– when issued by other entities (including banks and other prudentially regulated financial institutions); or

    – at least A-3/P-3 for short-term debt instruments.

[69] Cash-funded credit-linked notes issued by the bank against exposures in the banking book that fulfil the criteria for credit derivatives are treated as cash-collateralised transactions.

[70] When cash on deposit, certificates of deposit or comparable instruments issued by the lending bank are held as collateral at a third-party bank in a non-custodial arrangement, if they are openly pledged/assigned to the lending bank and if the pledge/assignment is unconditional and irrevocable, the exposure amount covered by the collateral (after any necessary haircuts for currency risk) receives the risk weight of the third-party bank.

(ii) Debt securities not rated by a recognised ECAI where these are:

– issued by a bank; and

– listed on a recognised exchange; and

– classified as senior debt; and

– all rated issues of the same seniority by the issuing bank are rated at least BBB– or A-3/P-3 by a recognised ECAI; and

– the bank holding the securities as collateral has no information to suggest that the issue justifies a rating below BBB– or A-3/P-3 (as applicable); and

– the supervisor is sufficiently confident that the market liquidity of the security is adequate.

(d) In jurisdictions that do not allow the use of external ratings for regulatory purposes, the following securities will be eligible provided that the supervisor is sufficiently confident that the market liquidity of the security is adequate:

(i) Debt securities issued by sovereigns or PSEs that are treated as sovereigns by the national supervisor;

(ii) Debt securities issued by banks assigned to Grade A under the SCRA;

(iii) Other debt securities issued by "investment grade" entities as defined in paragraph 197, and

(iv) Securitisation exposures with a risk weight of less than 100%.

(e) Equities (including convertible bonds) that are included in a main index.

(f) Undertakings for Collective Investments in Transferable Securities (UCITS) and mutual funds where:

- a price for the units is publicly quoted daily; and
- the UCITS/mutual fund is limited to investing in the instruments listed in this paragraph.[71]

149. Resecuritisations as defined in the securitisation framework are not eligible financial collateral.

Exemptions under the simple approach to the risk-weight floor

150. Repo-style transactions that fulfil all of the following conditions are exempted from the risk-weight floor under the simple approach:

(a) Both the exposure and the collateral are cash or a sovereign security or PSE security qualifying for a 0% risk weight under the standardised approach;

(b) Both the exposure and the collateral are denominated in the same currency;

(c) Either the transaction is overnight or both the exposure and the collateral are marked to market daily and are subject to daily remargining;

(d) Following a counterparty's failure to remargin, the time that is required between the last mark-to-market before the failure to remargin and the liquidation of the collateral is considered to be no more than four business days;

(e) The transaction is settled across a settlement system proven for that type of transaction;

[71] However, the use or potential use by a UCITS/mutual fund of derivative instruments solely to hedge investments listed in this paragraph and paragraph 159 shall not prevent units in that UCITS/mutual fund from being eligible financial collateral.

(f) The documentation covering the agreement is standard market documentation for repo-style transactions in the securities concerned;

(g) The transaction is governed by documentation specifying that if the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults, then the transaction is immediately terminable; and

(h) Upon any default event, regardless of whether the counterparty is insolvent or bankrupt, the bank has the unfettered, legally enforceable right to immediately seize and liquidate the collateral for its benefit.

151. *Core market participants* may include, at the discretion of the national supervisor, the following entities:

(a) Sovereigns, central banks and PSEs;

(b) Banks and securities firms;

(c) Other financial companies (including insurance companies) eligible for a 20% risk weight in the standardised approach;

(d) Regulated mutual funds that are subject to capital or leverage requirements;

(e) Regulated pension funds; and

(f) Qualifying central counterparties (QCCPs).

152. Repo transactions that fulfil the requirement in paragraph 150 receive a 10% risk weight, as an exemption to the risk weight floor described in paragraph 147. If the counterparty to the transaction is a core market participant, banks may apply a risk weight of 0% to the transaction.

153. OTC derivative transactions subject to daily mark-to-market, collateralised by cash and where there is no currency mismatch may receive a 0% risk weight. Such transactions collateralised by sovereign or PSE securities qualifying for a 0% risk weight in the standardised approach may receive a 10% risk weight.

154. The 20% floor for the risk weight on a collateralised transaction does not apply and a 0% risk weight may be applied where the exposure and the collateral are denominated in the same currency, and either:

- the collateral is cash on deposit as defined in paragraph 148(a); or
- the collateral is in the form of sovereign/PSE securities eligible for a 0% risk weight, and its market value has been discounted by 20%.

(iii) The comprehensive approach

(a) General requirements for the comprehensive approach

155. In the comprehensive approach, when taking collateral, banks must calculate their adjusted exposure to a counterparty in order to take account of the risk mitigating effect of that collateral. Banks must use the applicable supervisory haircuts to adjust both the amount of the exposure to the counterparty and the value of any collateral received in support of that counterparty to take account of possible future fluctuations in the value of either,[72] as occasioned by market movements. Unless either side of the transaction is cash or a zero haircut is applied, the volatility-adjusted exposure amount is higher than the nominal exposure and the volatility-adjusted collateral value is lower than the nominal collateral value.

[72] Exposure amounts may vary where, for example, securities are being lent.

156. The size of the individual haircuts depends on the type of instrument, type of transaction, residual maturity and the frequency of marking to market and remargining as provided in paragraphs 163 and 164. Haircuts must be scaled up using the square root of time formula depending on the frequency of remargining or marking to market. This formula is included in paragraph 172.

157. Additionally, where the exposure and collateral are held in different currencies, banks must apply an additional haircut to the volatility-adjusted collateral amount in accordance with paragraphs 165 and 204 to take account of possible future fluctuations in exchange rates.

158. The effect of master netting agreements covering repo-style transactions can be recognised for the calculation of capital requirements subject to the conditions and requirements in paragraphs 175 to 178.

(b) Eligible financial collateral under the comprehensive approach

159. The following collateral instruments are eligible for recognition in the comprehensive approach:

(a) All of the instruments listed in paragraph 148;

(b) Equities and convertible bonds that are not included in a main index but which are listed on a recognised security exchange;

(c) UCITS/mutual funds which include the instruments in point (b).

(c) Calculation of capital requirement for transactions secured by financial collateral

160. For a collateralised transaction, the exposure amount after risk mitigation is calculated as follows:

$$E^{*} = max\left\{0, E \cdot \left(1 + H_{e}\right) - C \cdot \left(1 - H_{c} - H_{fx}\right)\right\}$$

where:

E^* = the exposure value after risk mitigation

E = current value of the exposure

H_e = haircut appropriate to the exposure

C = the current value of the collateral received

H_c = haircut appropriate to the collateral

H_{fx} = haircut appropriate for currency mismatch between the collateral and exposure

161. In the case of maturity mismatches, the value of the collateral received (collateral amount) must be adjusted in accordance with paragraphs 126 to 130.

162. The exposure amount after risk mitigation (E^*) must be multiplied by the risk weight of the counterparty to obtain the risk-weighted asset amount for the collateralised transaction.

163. In jurisdictions that allow the use of external ratings for regulatory purposes, the following supervisory haircuts (assuming daily mark-to-market, daily remargining and a 10-business day holding period), expressed as percentages, must be used to determine the haircuts appropriate to the collateral (Hc) and to the exposure (He):

Supervisory haircuts for comprehensive approach

Jurisdictions that allow the use of external ratings for regulatory purposes — Table 14

Issue rating for debt securities	Residual maturity	Sovereigns[73]	Other issuers[74]	Securitisation exposures[75]
AAA to AA–/A-1	≤ 1 year	0.5	1	2
	>1 year, ≤ 3 years	2	3	8
	>3 years, ≤ 5 years		4	
	>5 years, ≤ 10 years	4	6	16
	> 10 years		12	
A+ to BBB–/ A-2/A-3/P-3 and unrated bank securities per para. 148(c)(ii)	≤ 1 year	1	2	4
	>1 year, ≤ 3 years	3	4	12
	>3 years, ≤ 5 years		6	
	>5 years, ≤ 10 years	6	12	24
	> 10 years		20	
BB+ to BB–	All	15	Not eligible	Not eligible
Main index equities (including convertible bonds) and gold		20		
Other equities and convertible bonds listed on a recognised exchange		30		
UCITS/mutual funds		Highest haircut applicable to any security in which the fund can invest, unless the bank can apply the look-through approach (LTA) for equity investments in funds, in which case the bank may use a weighted average of haircuts applicable to instruments held by the fund.		
Cash in the same currency[76]		0		

164. In jurisdictions that do not allow the use of external ratings for regulatory purposes, the following supervisory haircuts (assuming daily mark-to-market, daily remargining and a 10-business day holding period), expressed as percentages, must be used to determine the haircuts appropriate to the collateral (Hc) and to the exposure (He):

73 Includes: PSEs that are treated as sovereigns by the national supervisor, as well as multilateral development banks receiving a 0% risk weight.

74 Includes PSEs that are not treated as sovereigns by the national supervisor.

75 Those exposures that meet the definition set forth in the securitisation framework.

76 Eligible cash collateral specified in paragraph 148(a).

Supervisory haircuts for comprehensive approach

Jurisdictions that do not allow the use of external ratings for regulatory purposes — Table 15

	Residual maturity	Issuer's risk weight (only for securities issued by sovereigns[77])			Other investment-grade securities, consistent with paragraphs 148(d)(iii)[78]	
		0%	20% or 50%	100%	Non-securitisation exposures	Senior securitisation exposures with risk weight < 100%
Debt securities	≤ 1 year	0.5	1	15	2	4
	>1 year, ≤ 3 years	2	3	15	4	12
	>3 years, ≤ 5 years				6	
	>5 years, ≤ 10 years	4	6	15	12	24
	> 10 years				20	
Main index equities (including convertible bonds) and gold	20					
Other equities and convertible bonds listed on a recognised exchange	30					
UCITS/mutual funds	Highest haircut applicable to any security in which the fund can invest, unless the bank can apply the look-through approach (LTA) for equity investments in funds, in which case the bank may use a weighted average of haircuts applicable to instruments held by the fund.					
Cash in the same currency[79]	0					
Other exposure types	30					

165. The haircut for currency risk (Hfx) where exposure and collateral are denominated in different currencies is 8% (also based on a 10-business day holding period and daily mark-to-market).

166. For SFTs and secured lending transactions, a haircut adjustment may need to be applied in accordance with paragraphs 169 to 172.

167. For SFTs in which the bank lends, or posts as collateral, non-eligible instruments, the haircut to be applied on the exposure must be 30%. For transactions in which the bank borrows non-eligible instruments, credit risk mitigation may not be applied.

168. Where the collateral is a basket of assets, the haircut on the basket must be $H = \sum_i a_i H_i$, where a_i is the weight of the asset (as measured by units of currency) in the basket and H_i the haircut applicable to that asset.

(d) Adjustment for different holding periods and non-daily mark-to-market or remargining

169. For some transactions, depending on the nature and frequency of the revaluation and remargining provisions, different holding periods and thus different haircuts must be applied. The framework for collateral haircuts distinguishes between repo-style transactions (ie repo/reverse repos and

77 Includes: PSEs that are treated as sovereigns by the national supervisor, as well as multilateral development banks receiving a 0% risk weight.

78 Includes PSEs that are not treated as sovereigns by the national supervisor.

79 Eligible cash collateral specified in paragraph 148(a).

securities lending/borrowing), "other capital markets-driven transactions" (ie OTC derivatives transactions and margin lending) and secured lending. In capital-market-driven transactions and repo-style transactions, the documentation contains remargining clauses; in secured lending transactions, it generally does not.

170. The minimum holding period for various products is summarised in the following table:

Adjustment to supervisory haircuts

For different holding periods and non-daily mark-to-market or remargining Table 16

Transaction type	Minimum holding period	Condition
Repo-style transaction	five business days	daily remargining
Other capital market transactions	10 business days	daily remargining
Secured lending	20 business days	daily revaluation

171. Where a bank has a transaction or netting set that meets the criteria outlined in paragraphs 41(i) or 41(ii) of the counterparty credit risk standards, the minimum holding period must be the margin period of risk that would apply under those paragraphs.

172. When the frequency of remargining or revaluation is longer than the minimum, the minimum haircut numbers must be scaled up depending on the actual number of business days between remargining or revaluation. The 10-business day haircuts provided in paragraphs 163 and 164 are the default haircuts and these haircuts must be scaled up or down using the formula below:

$$H = H_{10}\sqrt{\frac{N_R + (T_M - 1)}{10}}$$

where:

H = haircut

H_{10} = 10-business day haircut for instrument

N_R = actual number of business days between remargining for capital market transactions or revaluation for secured transactions

T_M = minimum holding period for the type of transaction.

(e) Exemptions under the comprehensive approach for qualifying repo-style transactions involving core market participants

173. For repo-style transactions with core market participants as defined in paragraph 151 and that satisfy the conditions in paragraph 150 supervisors may apply a haircut of zero.

174. Where, under the comprehensive approach, a supervisor applies a specific carve-out to repo-style transactions in securities issued by its domestic government, other supervisors may choose to allow banks incorporated in their jurisdiction to adopt the same approach to the same transactions.

(f) Treatment under the comprehensive approach of SFTs covered by master netting agreements

175. The effects of bilateral netting agreements covering repo-style transactions may be recognised on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

(a) provide the non-defaulting party the right to terminate and close out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;

(b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;

(c) allow for the prompt liquidation or set-off of collateral upon the event of default; and

(d) be, together with the rights arising from the provisions required in (a) to (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of the counterparty's insolvency or bankruptcy.

176. Netting across positions in the banking and trading book may only be recognised when the netted transactions fulfil the following conditions:

- All transactions are marked to market daily;[80] and
- The collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

177. The formula in paragraph 178 will be used to calculate the counterparty credit risk capital requirements for transactions with netting agreements. This formula includes the current exposure, an amount for systematic exposure of the securities based on the net exposure, an amount for the idiosyncratic exposure of the securities based on the gross exposure, and an amount for currency mismatch. All other rules regarding the calculation of haircuts under the comprehensive approach stated in paragraphs 155 to 174 equivalently apply for banks using bilateral netting agreements for repo-style transactions.

178. Banks using standard supervisory haircuts for repo-style transactions conducted under a master netting agreement must use the following formula to calculate their exposure amount:

$$E^* = max\left\{0; \sum_i E_i - \sum_i C_j + 0.4 \cdot net\,exposure + 0.6 \cdot \frac{gross\,exposure}{\sqrt{N}} + \sum_{fx}\left(E_{fx} \cdot H_{fx}\right)\right\}$$

where:

E^* = exposure value of the netting set after risk mitigation

E_i = current value of all cash and securities lent, sold with an agreement to repurchase or otherwise posted to the counterparty under the netting agreement

C_j = current value of all cash and securities borrowed, purchased with an agreement to resell or otherwise held by the bank under the netting agreement

$$net\,exposure = \left|\sum_s E_s H_s\right|$$

$$gross\,exposure = \sum_s E_s \left|H_s\right|$$

E_s = The net current value of each security issuance under the netting set (always a positive value)

H_s = haircut appropriate to E_s as described in tables of paragraphs 163 or 164, as applicable,

[80] The holding period for the haircuts depends, as in other repo-style transactions, on the frequency of margining.

– H_s has a positive sign if the security is lent, sold with an agreement to repurchased, or transacted in manner similar to either securities lending or a repurchase agreement

– H_s has a negative sign if the security is borrowed, purchased with an agreement to resell, or transacted in a manner similar to either a securities borrowing or reverse repurchase agreement

N is the number of security issues contained in the netting set (except that issuances where the value E_s is less than one tenth of the value of the largest E_s in the netting set are not included the count)

E_{fx} = absolute value of the net position in each currency *fx* different from the settlement currency

H_{fx} = haircut appropriate for currency mismatch of currency *fx*.

(iv) Minimum haircut floors for SFTs

179. Paragraphs 180 to 188 specify the treatment of certain non-centrally cleared SFTs with certain counterparties. The requirements are not applicable to banks in jurisdictions that are prohibited from conducting such transactions below the minimum haircut floors specified in paragraph 184 below.

180. The haircut floors found in paragraph 184 below apply to the following transactions:

- Non-centrally cleared SFTs in which the financing (ie the lending of cash) against collateral other than government securities is provided to counterparties who are not supervised by a regulator that imposes prudential requirements consistent with international norms.
- Collateral upgrade transactions with these same counterparties. A collateral upgrade transaction is when a bank lends a security to its counterparty and the counterparty pledges a lower quality security as collateral, thus allowing the counterparty to exchange a lower quality security for a higher quality security. For these transactions, the floors must be calculated according to the formula set out in paragraph 187.

181. SFTs with central banks are not subject to the haircut floors.

182. Cash-collateralised securities lending transactions are exempted from the haircut floors where:

- Securities are lent (to the bank) at long maturities and the lender of securities reinvests or employs the cash at the same or shorter maturity, therefore not giving rise to material maturity or liquidity mismatch.
- Securities are lent (to the bank) at call or at short maturities, giving rise to liquidity risk, only if the lender of the securities reinvests the cash collateral into a reinvestment fund or account subject to regulations or regulatory guidance meeting the minimum standards for reinvestment of cash collateral by securities lenders set out in Section 3.1 of the *Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos*.[81] For this purpose, banks may rely on representations by securities lenders that their reinvestment of cash collateral meets the minimum standards.

183. Banks that lend securities are exempted from the haircut floors on collateral upgrade transactions if they are unable to re-use, or provide representations that they do not and will not reuse, the securities received as collateral against the securities lent.

[81] Financial Stability Board, *Strengthening oversight and regulation of shadow banking, Policy framework for addressing shadow banking risks in securities lending and repos*, 29 August 2013, www.fsb.org/wp-content/uploads/r_130829b.pdf.

184. These are the haircut floors for SFTs referred to above (herein referred to as "in-scope SFTs"), expressed as percentages:

Residual maturity of collateral	Haircut level	
	Corporate and other issuers	Securitised products
≤ 1 year debt securities, and floating rate notes (FRNs)	0.5%	1%
> 1 year, ≤ 5 years debt securities	1.5%	4%
> 5 years, ≤ 10 years debt securities	3%	6%
> 10 years debt securities	4%	7%
Main index equities	6%	
Other assets within the scope of the framework	10%	

185. In-scope SFTs which do not meet the haircut floors must be treated as unsecured loans to the counterparties.

186. To determine whether the treatment in paragraph 185 applies to an in-scope SFT (or a netting set of SFTs in the case of portfolio-level haircuts), we must compare the collateral haircut H (real or calculated as per the rules below) and a haircut floor f (from paragraph 184 above or calculated as per the below rules).

187. For a single in-scope SFT not included in a netting set, the values of H and f are computed as:

- For a single cash-lent-for-collateral SFT, H and f are known since H is simply defined by the amount of collateral received and f is given in paragraph 184. For the purposes of this calculation, collateral that is called by either counterparty can be treated collateral received from the moment that it is called (ie the treatment is independent of the settlement period).

  For example, consider an in-scope SFT where 100 cash is lent against 101 of a corporate debt security with a 12-year maturity, H is 1% [(101-100)/100] and f is 4% (per paragraph 184). Therefore, the SFT in question would be subject to the treatment in paragraph 185.

- For a single collateral-for-collateral SFT, lending collateral A and receiving collateral B, the H is still be defined by the amount of collateral received but the effective floor of the transaction must integrate the floor of the two types of collateral and can be computed as:

$$f = \left[\left(\frac{1}{1+f_A} \right) \Big/ \left(\frac{1}{1+f_B} \right) \right] - 1 = \frac{1+f_B}{1+f_A} - 1$$

  which will be compared to the effective haircut of the transaction, ie $\frac{C_B}{C_A} - 1$.

  For example, consider an in-scope SFT where 102 of a corporate debt security with a 10-year maturity is exchanged against 104 of equity, the effective haircut H of the transaction is 104/102 – 1 = 1.96% which has to be compared with the effective floor f of 1.06/1.03 – 1 =2.91%. Therefore, the SFT in question would be subject to the treatment in paragraph 185.

188. For a netting of SFTs an effective "portfolio" floor of the transaction must be computed as:

$$f_{Portfolio} = \left[\left(\frac{\sum_s E_s}{\sum_s E_s \times (1+f_s)} \right) \Big/ \left(\frac{\sum_t C_t}{\sum_t C_t \times (1+f_t)} \right) \right] - 1$$

where E_s is the net position in each security (or cash) s that is net lent, C_t the net position that is net borrowed, and f_s and f_t are the haircut floors for the securities that are net lent and net borrowed respectively. This calculation is therefore the weighted average floor of the portfolio. Then the portfolio does not breach the floor where:

$$\frac{\sum C_t - \sum E_s}{\sum E_s} \geq f_{Portfolio}$$

If the portfolio haircut does breach the floor, then the netting set of SFTs is subject to the treatment in paragraph 185. This treatment should be applied to all trades for which the security received appears in the table in paragraph 184 and for which, within the netting set, the bank is also a net receiver in that security. For the purposes of this calculation, collateral that is called by either counterparty can be treated collateral received from the moment that it is called (ie the treatment is independent of the settlement period).

The following portfolio of trades gives an example of how this methodology works (it shows a portfolio that does not breach the floor).

Actual trades	Cash	Sovereign debt	Collateral A	Collateral B
Floor (f_s)	*0%*	*0%*	*6%*	*10%*
Portfolio of trades	50	100	-400	250
E_s	50	100	0	250
C_t	0	0	400	0

$f_{Portfolio}$	-0.0024
$\frac{\sum C_t - \sum E_s}{\sum E_s}$	0

(v) Collateralised OTC derivatives transactions

189. Under the standardised approach for counterparty credit risk (SA-CCR), the calculation of the counterparty credit risk charge for an individual contact will be as follows:

$$Exposure\ amount = alpha \cdot (RC + PFE)$$

where:

Alpha = 1.4,

RC = the replacement cost calculated according to paragraphs 130 to 145 of the counterparty credit risk standards, and

PFE = the amount for potential future exposure calculated according to paragraphs 146 to 187 of the counterparty credit risk standards.

As an alternative to the SA-CCR for the calculation of the counterparty credit risk charge, banks may also use the Internal Model Method as set out in the counterparty credit risk standards, subject to supervisory approval.

4. On-balance sheet netting

190. Where a bank:

(a) has a well founded legal basis for concluding that the netting or offsetting agreement is enforceable in each relevant jurisdiction regardless of whether the counterparty is insolvent or bankrupt;

(b) is able at any time to determine those assets and liabilities with the same counterparty that are subject to the netting agreement;

(c) monitors and controls its roll-off risks; and

(d) monitors and controls the relevant exposures on a net basis,

it may use the net exposure of loans and deposits as the basis for its capital adequacy calculation in accordance with the formula in paragraph 160. Assets (loans) are treated as exposure and liabilities (deposits) as collateral. The haircuts are zero except when a currency mismatch exists. A 10-business day holding period applies when daily mark-to-market is conducted. For on-balance sheet netting, the requirements in paragraphs 163 and 172 and 126 to 130 must be applied.

5. Guarantees and credit derivatives

(i) Operational requirements for guarantees and credit derivatives

191. If conditions set below are met, banks can substitute the risk weight of the counterparty with the risk weight of the guarantor.

192. A guarantee (counter-guarantee) or credit derivative must satisfy the following requirements:

(a) it represents a direct claim on the protection provider;

(b) it is explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible;

(c) other than non-payment by a protection purchaser of money due in respect of the credit protection contract it is irrevocable; there is no clause in the contract that would allow the protection provider unilaterally to cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure;[82]

(d) it must be unconditional; there should be no clause in the protection contract outside the direct control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the underlying counterparty fails to make the payment(s) due.

193. In the case of maturity mismatches, the amount of credit protection that is provided must be adjusted in accordance with paragraphs 126 to 130.

(ii) Specific operational requirements for guarantees

194. In addition to the legal certainty requirements in paragraph 125, in order for a guarantee to be recognised, the following requirements must be satisfied:

(a) On the qualifying default/non-payment of the counterparty, the bank may in a timely manner pursue the guarantor for any monies outstanding under the documentation governing the transaction. The guarantor may make one lump sum payment of all monies under such documentation to the bank, or the guarantor may assume the future payment obligations of the counterparty covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal action in order to pursue the counterparty for payment.

[82] There must be no possibility for the protection provider to change the maturity agreed *ex post*.

(b) The guarantee is an explicitly documented obligation assumed by the guarantor.

(c) Except as noted in the following sentence, the guarantee covers all types of payments the underlying counterparty is expected to make under the documentation governing the transaction, for example notional amount, margin payments, etc. Where a guarantee covers payment of principal only, interests and other uncovered payments must be treated as an unsecured amount in accordance with the rules for proportional cover described in paragraph 202.

(iii) Specific operational requirements for credit derivatives

195. In addition to the legal certainty requirements in paragraph 125, in order for a credit derivative contract to be recognised, the following requirements must be satisfied:

(a) The credit events specified by the contracting parties must at a minimum cover:

- failure to pay the amounts due under terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with the grace period in the underlying obligation);
- bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events; and
- restructuring[83] of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event (ie write-off, specific provision or other similar debit to the profit and loss account).

(b) If the credit derivative covers obligations that do not include the underlying obligation, section (g) below governs whether the asset mismatch is permissible.

(c) The credit derivative shall not terminate prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay. In the case of a maturity mismatch, the provisions of paragraphs 126 to 130 must be applied.

(d) Credit derivatives allowing for cash settlement are recognised for capital purposes insofar as a robust valuation process is in place in order to estimate loss reliably. There must be a clearly specified period for obtaining post-credit-event valuations of the underlying obligation. If the reference obligation specified in the credit derivative for purposes of cash settlement is different from the underlying obligation, section (g) below governs whether the asset mismatch is permissible.

(e) If the protection purchaser's right/ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation must provide that any required consent to such transfer may not be unreasonably withheld.

(f) The identity of the parties responsible for determining whether a credit event has occurred must be clearly defined. This determination must not be the sole responsibility of the protection seller. The protection buyer must have the right/ability to inform the protection provider of the occurrence of a credit event.

[83] When hedging corporate exposures, this particular credit event is not required to be specified provided that (i) A 100% vote is needed to amend maturity, principal, coupon, currency or seniority status of the underlying corporate exposure; (ii) The legal domicile in which the corporate exposure is governed has a well-established bankruptcy code that allows for a company to reorganise/restructure and provides for an orderly settlement of creditor claims. If these conditions are not met, then the treatment in paragraph 196 may be eligible.

(g) A mismatch between the underlying obligation and the reference obligation under the credit derivative (ie the obligation used for purposes of determining cash settlement value or the deliverable obligation) is permissible if (1) the reference obligation ranks pari passu with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation share the same obligor (ie the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.

(h) A mismatch between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible if (1) the latter obligation ranks pari passu with or is junior to the underlying obligation, and (2) the underlying obligation and reference obligation share the same obligor (ie the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place.

196. When the restructuring of the underlying obligation is not covered by the credit derivative, but the other requirements in paragraph 195 are met, partial recognition of the credit derivative will be allowed. If the amount of the credit derivative is less than or equal to the amount of the underlying obligation, 60% of the amount of the hedge can be recognised as covered. If the amount of the credit derivative is larger than that of the underlying obligation, then the amount of eligible hedge is capped at 60% of the amount of the underlying obligation.

(iv) Range of eligible guarantors (counter-guarantors)/protection providers and credit derivatives

197. Credit protection given by the following entities can be recognised when they have a lower risk weight than the counterparty:

- Sovereign entities,[84] PSEs, MDBs, banks, securities firms and other prudentially regulated financial institutions with a lower risk weight than the counterparty;[85]
- In jurisdictions that allow the use of external ratings for regulatory purposes:
  - other entities that are externally rated except when credit protection is provided to a securitisation exposure. This would include credit protection provided by a parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor;
  - when credit protection is provided to a securitisation exposure, other entities that currently are externally rated BBB– or better and that were externally rated A– or better at the time the credit protection was provided. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.
- In jurisdictions that do not allow the use of external ratings for regulatory purposes:
  - Other entities, defined as "investment grade" meaning they have adequate capacity to meet their financial commitments (including repayments of principal and interest) in a timely manner, irrespective of the economic cycle and business conditions.

[84] This includes the Bank for International Settlements, the International Monetary Fund, the European Central Bank, the European Union, the European Stability Mechanism (ESM) and the European Financial Stability Facility (EFSF), as well as MDBs eligible for a 0% risk weight as defined in paragraph 14 and referred to in footnote 11.

[85] A prudentially regulated financial institution is defined as: a legal entity supervised by a regulator that imposes prudential requirements consistent with international norms or a legal entity (parent company or subsidiary) included in a consolidated group where any substantial legal entity in the consolidated group is supervised by a regulator that imposes prudential requirements consistent with international norms. These include, but are not limited to, prudentially regulated insurance companies, broker/dealers, thrifts and futures commission merchants, and qualifying central counterparties as defined in Basel Committee on Banking Supervision, *Regulatory capital requirements framework for bank exposures to central counterparties*, July 2012, www.bis.org/publ/bcbs227.pdf.

When making this determination, the bank should assess the entity against the investment grade definition taking into account the complexity of its business model, performance against industry and peers, and risks posed by the entity's operating environment.

Moreover, the following conditions will have to be met:

- o For corporate entities (or the entity's parent company), they must have securities outstanding on a recognised securities exchange;
- o The creditworthiness of these "investment grade entities" is not positively correlated with the credit risk of the exposures for which they provided guarantees.

– Parent, subsidiary and affiliate companies of the obligor where their creditworthiness is not positively correlated with the credit risk of the exposures for which they provided guarantees. For an intra-group company to be recognised as eligible guarantor, the credit risk of the whole group should be taken into account.

198. Only credit default swaps and total return swaps that provide credit protection equivalent to guarantees are eligible for recognition.[86] The following exception applies: where a bank buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record offsetting deterioration in the value of the asset that is protected (either through reductions in fair value or by an addition to reserves), the credit protection will not be recognised.

199. First-to-default and all other nth-to-default credit derivatives (ie by which a bank obtains credit protection for a basket of reference names and where the first- or nth–to-default among the reference names triggers the credit protection and terminates the contract) are not eligible as a credit risk mitigation technique and therefore cannot provide any regulatory capital relief. In transactions in which a bank provided credit protection through such instruments, it shall apply the treatment described in paragraph 89.

(v) Risk-weight treatment of transactions in which eligible credit protection is provided

General risk-weight treatment

200. The protected portion is assigned the risk weight of the protection provider. The uncovered portion of the exposure is assigned the risk weight of the underlying counterparty.

201. Materiality thresholds on payments below which the protection provider is exempt from payment in the event of loss are equivalent to retained first-loss positions. The portion of the exposure that is below a materiality threshold must be assigned a risk weight of 1250% by the bank purchasing the credit protection.

Proportional cover

202. Where losses are shared pari passu on a pro rata basis between the bank and the guarantor, capital relief is afforded on a proportional basis, ie the protected portion of the exposure receives the treatment applicable to eligible guarantees/credit derivatives, with the remainder treated as unsecured.

Tranched cover

203. Where the bank transfers a portion of the risk of an exposure in one or more tranches to a protection seller or sellers and retains some level of the risk of the loan, and the risk transferred and the risk retained are of different seniority, banks may obtain credit protection for either the senior tranches

[86] Cash-funded credit-linked notes issued by the bank against exposures in the banking book that fulfil all minimum requirements for credit derivatives are treated as cash-collateralised transactions. However, in this case the limitations regarding the protection provider as set out in paragraph 197 do not apply.

(eg the second-loss portion) or the junior tranche (eg the first-loss portion). In this case the rules as set out in the securitisation standard apply.

(vi) Currency mismatches

204. Where the credit protection is denominated in a currency different from that in which the exposure is denominated – ie there is a currency mismatch – the amount of the exposure deemed to be protected must be reduced by the application of a haircut H_{FX}, ie

$$G_A = G \cdot \left(1 - H_{FX}\right)$$

where:

G = nominal amount of the credit protection

H_{FX} = haircut appropriate for currency mismatch between the credit protection and underlying obligation.

The currency mismatch haircut for a 10-business day holding period (assuming daily marking to market) is 8%. This haircut must be scaled up using the square root of time formula, depending on the frequency of revaluation of the credit protection as described in paragraph 172.

(vii) Sovereign guarantees and counter-guarantees

205. As specified in paragraph 8, a lower risk weight may be applied at national discretion to a bank's exposures to the sovereign (or central bank) where the bank is incorporated and where the exposure is denominated in domestic currency and funded in that currency. National supervisors may extend this treatment to portions of exposures guaranteed by the sovereign (or central bank), where the guarantee is denominated in the domestic currency and the exposure is funded in that currency. An exposure may be covered by a guarantee that is indirectly counter-guaranteed by a sovereign. Such an exposure may be treated as covered by a sovereign guarantee provided that:

(a) the sovereign counter-guarantee covers all credit risk elements of the exposure;

(b) both the original guarantee and the counter-guarantee meet all operational requirements for guarantees, except that the counter-guarantee need not be direct and explicit to the original exposure; and

(c) the supervisor is satisfied that the cover is robust and that no historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct sovereign guarantee.

Internal ratings-based approach for credit risk

A. Overview

1. This section describes the IRB approach for credit risk. Subject to certain minimum conditions and disclosure requirements, banks that have received supervisory approval to use the IRB approach may rely on their own internal estimates of risk components in determining the capital requirement for a given exposure. The risk components include measures of the probability of default (PD), loss given default (LGD), the exposure at default (EAD), and effective maturity (M). In some cases, banks may be required to use a supervisory value as opposed to an internal estimate for one or more of the risk components.

2. The IRB approach is based on measures of unexpected losses (UL) and expected losses (EL). The risk-weight functions produce capital requirements for the UL portion. Expected losses are treated separately, as outlined in paragraph 43 of the Basel II framework (June 2006)[1] and Section G below.

3. In this section, the asset classes are defined first. Adoption of the IRB approach across asset classes is also discussed early in this section. The risk components, each of which is defined later in this section, serve as inputs to the risk-weight functions that have been developed for separate asset classes. For example, there is a risk-weight function for corporate exposures and another one for qualifying revolving retail exposures. The treatment of each asset class begins with a presentation of the relevant risk-weight function(s) followed by the risk components and other relevant factors, such as the treatment of credit risk mitigants. The legal certainty standards for recognising CRM as set out in paragraphs 117 to 205 of the standardised approach apply for both the foundation and advanced IRB approaches. The minimum requirements that banks must satisfy to use the IRB approach are presented at the end of this section starting at Section H, paragraph 154.

B. Mechanics of the IRB approach

4. In Section 1 that follows, the asset classes (eg corporate exposures and retail exposures) eligible for the IRB approach are defined. Section 2 provides a description of the risk components to be used by banks by asset class. Section 3 discusses a bank's adoption of the IRB approach at the asset class level and the related roll-out requirements. In cases where an IRB treatment is not specified, the risk weight for those other exposures is 100%, except when a 0% risk weight applies under the standardised approach, and the resulting risk-weighted assets are assumed to represent UL only.

1. Categorisation of exposures

5. Under the IRB approach, banks must categorise banking-book exposures into broad classes of assets with different underlying risk characteristics, subject to the definitions set out below. The classes of assets are (a) corporate, (b) sovereign, (c) bank, (d) retail, and (e) equity. Within the corporate asset class, five sub-classes of specialised lending are separately identified. Within the retail asset class, three sub-classes are separately identified. Within the corporate and retail asset classes, a distinct treatment for purchased receivables may also apply provided certain conditions are met. For the equity asset class the IRB approach is not permitted, as outlined further below.

[1] References to the Basel II framework (June 2006) are to the comprehensive version available at: www.bis.org/publ/bcbs128.pdf.

6. The classification of exposures in this way is broadly consistent with established bank practice. However, some banks may use different definitions in their internal risk management and measurement systems. While it is not the intention of the Committee to require banks to change the way in which they manage their business and risks, banks are required to apply the appropriate treatment to each exposure for the purposes of deriving their minimum capital requirement. Banks must demonstrate to supervisors that their methodology for assigning exposures to different classes is appropriate and consistent over time.

7. For the treatment of securitisation exposures, see the Committee's *Revisions to the securitisation framework*.[2]

(i) Definition of corporate exposures

8. In general, a corporate exposure is defined as a debt obligation of a corporation, partnership, or proprietorship. Banks are permitted to distinguish separately exposures to small- and medium-sized entities (SME), as defined in paragraph 54.

9. In addition to general corporates, within the corporate asset class, five sub-classes of specialised lending (SL) are identified. Such lending possesses all the following characteristics, either in legal form or economic substance:

- The exposure is typically to an entity (often a special purpose entity (SPE)) which was created specifically to finance and/or operate physical assets;
- The borrowing entity has little or no other material assets or activities, and therefore little or no independent capacity to repay the obligation, apart from the income that it receives from the asset(s) being financed;
- The terms of the obligation give the lender a substantial degree of control over the asset(s) and the income that it generates; and
- As a result of the preceding factors, the primary source of repayment of the obligation is the income generated by the asset(s), rather than the independent capacity of a broader commercial enterprise.

10. The five sub-classes of specialised lending (SL) are project finance, object finance, commodities finance, income-producing real estate, and high-volatility commercial real estate. Each of these sub-classes is defined below.

Project finance

11. Project finance (PF) is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. This type of financing is usually for large, complex and expensive installations that might include, for example, power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements.

12. In such transactions, the lender is usually paid solely or almost exclusively out of the money generated by the contracts for the facility's output, such as the electricity sold by a power plant. The borrower is usually an SPE that is not permitted to perform any function other than developing, owning, and operating the installation. The consequence is that repayment depends primarily on the project's cash flow and on the collateral value of the project's assets. In contrast, if repayment of the exposure depends

[2] Basel Committee on Banking Supervision, *Revisions to the securitisation framework*, 11 December 2014 (revised July 2016), www.bis.org/bcbs/publ/d374.pdf.

primarily on a well-established, diversified, credit-worthy, contractually obligated end user for repayment, it is considered a secured exposure to that end-user.

Object finance

13. Object finance (OF) refers to a method of funding the acquisition of physical assets (eg ships, aircraft, satellites, railcars, and fleets) where the repayment of the exposure is dependent on the cash flows generated by the specific assets that have been financed and pledged or assigned to the lender. A primary source of these cash flows might be rental or lease contracts with one or several third parties. In contrast, if the exposure is to a borrower whose financial condition and debt-servicing capacity enables it to repay the debt without undue reliance on the specifically pledged assets, the exposure should be treated as a collateralised corporate exposure.

Commodities finance

14. Commodities finance (CF) refers to structured short-term lending to finance reserves, inventories, or receivables of exchange-traded commodities (eg crude oil, metals, or crops), where the exposure will be repaid from the proceeds of the sale of the commodity and the borrower has no independent capacity to repay the exposure. This is the case when the borrower has no other activities and no other material assets on its balance sheet. The structured nature of the financing is designed to compensate for the weak credit quality of the borrower. The exposure's rating reflects its self-liquidating nature and the lender's skill in structuring the transaction rather than the credit quality of the borrower.

15. The Committee believes that such lending can be distinguished from exposures financing the reserves, inventories, or receivables of other more diversified corporate borrowers. Banks are able to rate the credit quality of the latter type of borrowers based on their broader ongoing operations. In such cases, the value of the commodity serves as a risk mitigant rather than as the primary source of repayment.

Income-producing real estate

16. Income-producing real estate (IPRE) refers to a method of providing funding to real estate (such as, office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, and hotels) where the prospects for repayment and recovery on the exposure depend primarily on the cash flows generated by the asset. The primary source of these cash flows would generally be lease or rental payments or the sale of the asset. The borrower may be, but is not required to be, an SPE, an operating company focused on real estate construction or holdings, or an operating company with sources of revenue other than real estate. The distinguishing characteristic of IPRE versus other corporate exposures that are collateralised by real estate is the strong positive correlation between the prospects for repayment of the exposure and the prospects for recovery in the event of default, with both depending primarily on the cash flows generated by a property.

High-volatility commercial real estate

17. High-volatility commercial real estate (HVCRE) lending is the financing of commercial real estate that exhibits higher loss rate volatility (ie higher asset correlation) compared to other types of SL. HVCRE includes:

- Commercial real estate exposures secured by properties of types that are categorised by the national supervisor as sharing higher volatilities in portfolio default rates;
- Loans financing any of the land acquisition, development and construction (ADC) phases for properties of those types in such jurisdictions; and
- Loans financing ADC of any other properties where the source of repayment at origination of the exposure is either the future uncertain sale of the property or cash flows whose source of repayment is substantially uncertain (eg the property has not yet been leased to the occupancy

rate prevailing in that geographic market for that type of commercial real estate), unless the borrower has substantial equity at risk. Commercial ADC loans exempted from treatment as HVCRE loans on the basis of certainty of repayment of borrower equity are, however, ineligible for the additional reductions for SL exposures described in paragraph 58.

18. Where supervisors categorise certain types of commercial real estate exposures as HVCRE in their jurisdictions, they are required to make public such determinations. Other supervisors need to ensure that such treatment is then applied equally to banks under their supervision when making such HVCRE loans in that jurisdiction.

(ii) Definition of sovereign exposures

19. This asset class covers all exposures to counterparties treated as sovereigns under the standardised approach. This includes sovereigns (and their central banks), certain PSEs identified as sovereigns in the standardised approach, MDBs that meet the criteria for a 0% risk weight and referred to in footnote 11 of the standardised approach, and the entities referred to in paragraph 10 of the standardised approach. The treatment of sovereign exposures is unchanged from the Basel II framework (June 2006).

(iii) Definition of bank exposures

20. This asset class covers exposures to banks as defined in paragraph 16 of the standardised approach for credit risk and those securities firms and other financial institutions set out in paragraph 37 of the standardised approach for credit risk that are treated as exposures to banks. Bank exposures also include claims on all domestic PSEs that are not treated as exposures to sovereigns under the standardised approach, and MDBs that do not meet the criteria for a 0% risk weight under the standardised approach (ie MDBs that are not listed in footnote 11 of the standardised approach).

(iv) Definition of retail exposures

21. An exposure is categorised as a retail exposure if it meets all of the following criteria:

Nature of borrower or low value of individual exposures

- Exposures to individuals – such as revolving credits and lines of credit (eg credit cards, overdrafts, and retail facilities secured by financial instruments) as well as personal term loans and leases (eg instalment loans, auto loans and leases, student and educational loans, personal finance, and other exposures with similar characteristics) – are generally eligible for retail treatment regardless of exposure size, although supervisors may wish to establish exposure thresholds to distinguish between retail and corporate exposures.
- Residential mortgage loans[3] (including first and subsequent liens, term loans and revolving home equity lines of credit) are eligible for retail treatment regardless of exposure size so long as the credit is:
  - (i) an exposure to an individual;[4] or
  - (ii) an exposure to associations or cooperatives of individuals that are regulated under national law and exist with the only purpose of granting its members the use of a primary residence in the property securing the loan.

[3] Loans that meet the conditions set out in footnote 35 of paragraph 60 of the standardised approach for credit risk are also eligible to be included in the IRB retail residential mortgage sub-class.

[4] At national discretion, supervisors may exclude from the retail residential mortgage sub-asset class loans to individuals that have mortgaged more than a specified number of properties or housing units, and treat such loans as corporate exposures.

- Loans extended to small businesses and managed as retail exposures are eligible for retail treatment provided the total exposure of the banking group to a small business borrower (on a consolidated basis where applicable) is less than €1 million. Small business loans extended through or guaranteed by an individual are subject to the same exposure threshold.
- It is expected that supervisors provide flexibility in the practical application of such thresholds such that banks are not forced to develop extensive new information systems simply for the purpose of ensuring perfect compliance. It is, however, important for supervisors to ensure that such flexibility (and the implied acceptance of exposure amounts in excess of the thresholds that are not treated as violations) is not being abused.

Large number of exposures

22. The exposure must be one of a large pool of exposures, which are managed by the bank on a pooled basis.

- Small business exposures below €1 million may be treated as retail exposures if the bank treats such exposures in its internal risk management systems consistently over time and in the same manner as other retail exposures. This requires that such an exposure be originated in a similar manner to other retail exposures. Furthermore, it must not be managed individually in a way comparable to corporate exposures, but rather as part of a portfolio segment or pool of exposures with similar risk characteristics for purposes of risk assessment and quantification. However, this does not preclude retail exposures from being treated individually at some stages of the risk management process. The fact that an exposure is rated individually does not by itself deny the eligibility as a retail exposure.

23. Within the retail asset class category, banks are required to identify separately three sub-classes of exposures: (a) residential mortgage loans, as defined above, (b) qualifying revolving retail exposures, as defined in the following paragraph, and (c) all other retail exposures.

(v) Definition of qualifying revolving retail exposures

24. All of the following criteria must be satisfied for a sub-portfolio to be treated as a qualifying revolving retail exposure (QRRE). These criteria must be applied at a sub-portfolio level consistent with the bank's segmentation of its retail activities generally. Segmentation at the national or country level (or below) should be the general rule.

(a) The exposures are revolving, unsecured, and uncommitted (both contractually and in practice). In this context, revolving exposures are defined as those where customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the bank.

(b) The exposures are to individuals.

(c) The maximum exposure to a single individual in the sub-portfolio is €100,000 or less.

(d) Because the asset correlation assumptions for the QRRE risk-weight function are markedly below those for the other retail risk-weight function at low PD values, banks must demonstrate that the use of the QRRE risk-weight function is constrained to portfolios that have exhibited low volatility of loss rates, relative to their average level of loss rates, especially within the low PD bands. Supervisors will review the relative volatility of loss rates across the QRRE subportfolios, as well as the aggregate QRRE portfolio, and intend to share information on the typical characteristics of QRRE loss rates across jurisdictions.

(e) Data on loss rates for the sub-portfolio must be retained in order to allow analysis of the volatility of loss rates.

(f) The supervisor must concur that treatment as a qualifying revolving retail exposure is consistent with the underlying risk characteristics of the sub-portfolio.

25. The QRRE sub-class is split into exposures to transactors and revolvers. A QRRE transactor is an exposure to an obligor that meets the definition set out in paragraph 56 of the standardised approach. That is, the exposure is to an obligor in relation to a facility such as credit card or charge card where the balance has been repaid in full at each scheduled repayment date for the previous 12 months, or the exposure is in relation to an overdraft facility if there have been no drawdowns over the previous 12 months. All exposures that are not QRRE transactors are QRRE revolvers.

(vi) Definition of equity exposures

26. This asset class covers exposures to equities as defined in paragraph 49 of the standardised approach for credit risk.

(vii) Definition of eligible purchased receivables

27. Eligible purchased receivables are divided into retail and corporate receivables as defined below.

Retail receivables

28. Purchased retail receivables, provided the purchasing bank complies with the IRB rules for retail exposures, are eligible for the top-down approach as permitted within the existing standards for retail exposures. The bank must also apply the minimum operational requirements as set forth in Sections F and H.

Corporate receivables

29. In general, for purchased corporate receivables, banks are expected to assess the default risk of individual obligors as specified in Section C.1 (starting with paragraph 52) consistent with the treatment of other corporate exposures. However, the top-down approach may be used, provided that the purchasing bank's programme for corporate receivables complies with both the criteria for eligible receivables and the minimum operational requirements of this approach. The use of the top-down purchased receivables treatment is limited to situations where it would be an undue burden on a bank to be subjected to the minimum requirements for the IRB approach to corporate exposures that would otherwise apply. Primarily, it is intended for receivables that are purchased for inclusion in asset-backed securitisation structures, but banks may also use this approach, with the approval of national supervisors, for appropriate on-balance sheet exposures that share the same features.

30. Supervisors may deny the use of the top-down approach for purchased corporate receivables depending on the bank's compliance with minimum requirements. In particular, to be eligible for the proposed 'top-down' treatment, purchased corporate receivables must satisfy the following conditions:

- The receivables are purchased from unrelated, third party sellers, and as such the bank has not originated the receivables either directly or indirectly.

- The receivables must be generated on an arm's-length basis between the seller and the obligor. (As such, intercompany accounts receivable and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible.[5])
- The purchasing bank has a claim on all proceeds from the pool of receivables or a pro-rata interest in the proceeds.[6]
- National supervisors must also establish concentration limits above which capital charges must be calculated using the minimum requirements for the bottom-up approach for corporate exposures. Such concentration limits may refer to one or a combination of the following measures: the size of one individual exposure relative to the total pool, the size of the pool of receivables as a percentage of regulatory capital, or the maximum size of an individual exposure in the pool.

31. The existence of full or partial recourse to the seller does not automatically disqualify a bank from adopting this top-down approach, as long as the cash flows from the purchased corporate receivables are the primary protection against default risk as determined by the rules in paragraphs 132 to 135 for purchased receivables and the bank meets the eligibility criteria and operational requirements.

2. Foundation and advanced approaches

32. For each of the asset classes covered under the IRB framework, there are three key elements:

- Risk components: estimates of risk parameters provided by banks, some of which are supervisory estimates.
- Risk-weight functions: the means by which risk components are transformed into risk-weighted assets and therefore capital requirements.
- Minimum requirements: the minimum standards that must be met in order for a bank to use the IRB approach for a given asset class.

33. For many of the asset classes, the Committee has made available two broad approaches: a foundation and an advanced approach. Under the foundation approach (F-IRB approach), as a general rule, banks provide their own estimates of PD and rely on supervisory estimates for other risk components. Under the advanced approach (A-IRB approach), banks provide more of their own estimates of PD, LGD and EAD, and their own calculation of M, subject to meeting minimum standards. For both the foundation and advanced approaches, banks must always use the risk-weight functions provided in this Framework for the purpose of deriving capital requirements. The full suite of approaches is described below.

34. For exposures to equities, defined in paragraph 26 above, the IRB approaches are not permitted (see paragraph 42). In addition, the A-IRB approach cannot be used for the following:

(i) Exposures to general corporates belonging to a group with total consolidated annual revenues greater than €500m.

(ii) Exposures in the bank asset class (paragraph 20), and other securities firms and financial institutions (including insurance companies and any other financial institutions in the corporate asset class).

In making the assessment above for the revenue threshold, the amounts must be as reported in the audited financial statements of the corporates or, for corporates that are part of consolidated groups,

5 Contra-accounts involve a customer buying from and selling to the same firm. The risk is that debts may be settled through payments in kind rather than cash. Invoices between the companies may be offset against each other instead of being paid. This practice can defeat a security interest when challenged in court.

6 Claims on tranches of the proceeds (first loss position, second loss position, etc) would fall under the securitisation treatment.

their consolidated groups (according to the accounting standard applicable to the ultimate parent of the consolidated group). The figures must be based on the average amounts calculated over the prior three years, or on the latest amounts updated every three years by the bank.

(i) Corporate and bank exposures

35. Under the foundation approach, banks must provide their own estimates of PD associated with each of their borrower grades, but must use supervisory estimates for the other relevant risk components. The other risk components are LGD, EAD and M.[7]

36. Under the advanced approach, banks must calculate the effective maturity (M)[8] and provide their own estimates of PD, LGD and EAD.

37. There is an exception to this general rule for the five sub-classes of assets identified as SL.

The SL categories: PF, OF, CF, IPRE and HVCRE

38. Banks that do not meet the requirements for the estimation of PD under the corporate foundation approach for their SL exposures are required to map their internal risk grades to five supervisory categories, each of which is associated with a specific risk weight. This version is termed the 'supervisory slotting criteria approach'.

39. Banks that meet the requirements for the estimation of PD are able to use the foundation approach to corporate exposures to derive risk weights for all classes of SL exposures except HVCRE. At national discretion, banks meeting the requirements for HVCRE exposure are able to use a foundation approach that is similar in all respects to the corporate approach, with the exception of a separate risk-weight function as described in paragraph 64.

40. Banks that meet the requirements for the estimation of PD, LGD and EAD are able to use the advanced approach to corporate exposures to derive risk weights for all classes of SL exposures except HVCRE. At national discretion, banks meeting these requirements for HVCRE exposure are able to use an advanced approach that is similar in all respects to the corporate approach, with the exception of a separate risk-weight function as described in paragraph 64.

(ii) Retail exposures

41. For retail exposures, banks must provide their own estimates of PD, LGD and EAD. There is no foundation approach for this asset class.

(iii) Equity exposures

42. All equity exposures are subject to the standardised approach set out in paragraph 50[9] of the standardised approach for credit risk, with the exception of equity investments in funds that are subject to the requirements set out in the standard published by the Basel Committee in December 2013.[10]

[7] As noted in paragraph 107, some supervisors may require banks using the foundation approach to calculate M using the definition provided in paragraphs 109 to 114.

[8] At the discretion of the national supervisor, certain domestic exposures may be exempt from the calculation of M (see paragraph 108).

[9] The prohibition on the use of the IRB approach for equity exposures will be subject to a five-year linear phase-in arrangement from the date of implementation of this standard. During the phase-in period, the risk weight for equity exposures will be the greater of: (i) the risk weight as calculated under the IRB approach; and (ii) the risk weight set for the linear phase-in arrangement under the standardised approach for credit risk (see paragraph 50 footnote 29 of the standardised approach). Alternatively, supervisory authorities may require banks to apply the fully phased-in standardised approach treatment from the date of implementation of this standard.

[10] Final standards on capital requirements for banks' equity investments in funds are available at www.bis.org/publ/bcbs266.pdf.

(iv) Eligible purchased receivables

43. The treatment potentially straddles two asset classes. For eligible corporate receivables, both a foundation and advanced approach are available subject to certain operational requirements being met. As noted in paragraph 29, for corporate purchased receivables banks are in general expected to assess the default risk of individual obligors. The bank may use the A-IRB treatment for purchased corporate receivables (paragraphs 134 and 135) only for exposures to individual corporate obligors that are eligible for the A-IRB approach according to paragraph 34. Otherwise, the F-IRB treatment for purchased corporate receivables should be used. For eligible retail receivables, as with the retail asset class, only the A-IRB approach is available.

3. Adoption of the IRB approach for asset classes

44. Once a bank adopts an IRB approach for part of its holdings within an asset class, it is expected to extend it across all holdings within that asset class. In this context, the relevant assets classes are as follows:

- Banks
- Corporates (excluding specialised lending and purchased receivables)
- Specialised lending
- Corporate purchased receivables
- Qualifying revolving retail exposures
- Retail residential mortgages
- Other retail (excluding purchased receivables)
- Retail purchased receivables

The Committee recognises however, that, for many banks, it may not be practicable for various reasons to implement the IRB approach for an entire asset class across all business units at the same time. Furthermore, once on IRB, data limitations may mean that banks can meet the standards for the use of own estimates of LGD and EAD for some but not all of their exposures within an asset classes at the same time (for example, exposures that are in the same asset class, but are in different business units).

45. As such, supervisors may allow banks to adopt a phased rollout of the IRB approach across an asset class. The phased rollout includes: (i) adoption of IRB across the asset class within the same business unit; (ii) adoption of IRB for the asset class across business units in the same banking group; and (iii) move from the foundation approach to the advanced approach for certain risk components where use of the advanced approach is permitted. However, when a bank adopts an IRB approach for an asset class within a particular business unit, it must apply the IRB approach to all exposures within that asset class in that unit.

46. If a bank intends to adopt an IRB approach to an asset class, it must produce an implementation plan, specifying to what extent and when it intends to roll out the IRB approaches within the asset class and business units. The plan should be realistic, and must be agreed with the supervisor. It should be driven by the practicality and feasibility of moving to the more advanced approaches, and not motivated by a desire to adopt a Pillar 1 approach that minimises its capital charge. During the roll-out period, supervisors will ensure that no capital relief is granted for intra-group transactions which are designed to reduce a banking group's aggregate capital charge by transferring credit risk among entities on the standardised approach, foundation and advanced IRB approaches. This includes, but is not limited to, asset sales or cross guarantees.

47. Some exposures that are immaterial in terms of size and perceived risk profile within their asset class may be exempt from the requirements in the previous two paragraphs, subject to supervisory approval. Capital requirements for such operations will be determined according to the standardised approach, with the national supervisor determining whether a bank should hold more capital under Pillar 2 for such positions.

48. Banks adopting an IRB approach for an asset class are expected to continue to employ an IRB approach for that asset class. A voluntary return to the standardised or foundation approach is permitted only in extraordinary circumstances, such as divestiture of a large fraction of the bank's credit-related business in that asset class, and must be approved by the supervisor.

49. Given the data limitations associated with SL exposures, a bank may remain on the supervisory slotting criteria approach for one or more of the PF, OF, CF, IPRE or HVCRE sub-classes, and move to the foundation or advanced approach for the other sub-classes. However, a bank should not move to the advanced approach for the HVCRE sub-class without also doing so for material IPRE exposures at the same time.

50. Irrespective of the materiality, exposures to CCPs arising from OTC derivatives, exchange traded derivatives transactions and SFTs must be treated according to the dedicated treatment laid down in Section XI of the counterparty credit risk standards.

C. Rules for corporate and bank exposures

51. Section C presents the method of calculating the unexpected loss (UL) capital requirements for corporate and bank exposures. As discussed in Section C.1, a single risk-weight function is provided for determining the capital requirement for corporate and bank exposures. Supervisory risk weights are provided for each of the specialised lending sub-classes of corporates, and a separate risk-weight function is also provided for HVCRE. Section C.2 discusses the risk components. The method of calculating expected losses, and for determining the difference between that measure and provisions is described in Section G.

1. Risk-weighted assets for corporate and bank exposures

(i) Formula for derivation of risk-weighted assets for corporate and bank exposures

52. The derivation of risk-weighted assets is dependent on estimates of the PD, LGD, EAD and, in some cases, effective maturity (M), for a given exposure.

53. Throughout this section, PD and LGD are measured as decimals, and EAD is measured as currency (eg euros), except where explicitly noted otherwise. For exposures not in default, the formula for calculating risk-weighted assets is:[11, 12]

[11] In denotes the natural logarithm.

[12] N(x) denotes the cumulative distribution function for a standard normal random variable (ie the probability that a normal random variable with mean zero and variance of one is less than or equal to x). G(z) denotes the inverse cumulative distribution

Correlation (R) = $0.12 \cdot \frac{\left(1-e^{-50 \cdot PD}\right)}{\left(1-e^{-50}\right)} + 0.24 \cdot \left(1 - \frac{\left(1-e^{-50 \cdot PD}\right)}{\left(1-e^{-50}\right)}\right)$

Maturity adjustment (b) = $\left[0.11852 - 0.05478 \cdot \ln\left(PD\right)\right]^2$

Capital requirement[13,14](K) = $\left[LGD \cdot N\left[\frac{G\left(PD\right)}{\sqrt{\left(1-R\right)}} + \sqrt{\frac{R}{1-R}} \cdot G\left(0.999\right)\right] - PD \cdot LGD\right] \cdot \frac{\left(1+\left(M-2.5\right) \cdot b\right)}{\left(1-1.5 \cdot b\right)}$

Risk-weighted assets (RWA) = $K \cdot 12.5 \cdot EAD$

The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD (described in paragraph 235) and the bank's best estimate of expected loss (described in paragraph 238). The risk-weighted asset amount for the defaulted exposure is the product of K, 12.5, and the EAD.

A multiplier of 1.25 is applied to the correlation parameter of all exposures to financial institutions meeting the following criteria:

- Regulated financial institutions whose total assets are greater than or equal to US $100 billion. The most recent audited financial statement of the parent company and consolidated subsidiaries must be used in order to determine asset size. For the purpose of this paragraph, a regulated financial institution is defined as a parent and its subsidiaries where any substantial legal entity in the consolidated group is supervised by a regulator that imposes prudential requirements consistent with international norms. These include, but are not limited to, prudentially regulated Insurance Companies, Broker/Dealers, Banks, Thrifts and Futures Commission Merchants;
- Unregulated financial institutions, regardless of size. Unregulated financial institutions are, for the purposes of this paragraph, legal entities whose main business includes: the management of financial assets, lending, factoring, leasing, provision of credit enhancements, securitisation, investments, financial custody, central counterparty services, proprietary trading and other financial services activities identified by supervisors.
- Correlation (R_FI) = $1.25 \cdot \left[0.12 \cdot \frac{\left(1-e^{-50 \cdot PD}\right)}{\left(1-e^{-50}\right)} + 0.24 \cdot \left(1 - \frac{\left(1-e^{-50 \cdot PD}\right)}{\left(1-e^{-50}\right)}\right)\right]$

Illustrative risk weights are shown in Annex 5 of the Basel II framework (June 2006).

function for a standard normal random variable (ie the value of x such that N(x) = z). The normal cumulative distribution function and the inverse of the normal cumulative distribution function are, for example, available in Excel as the functions NORMSDIST and NORMSINV.

13 If this calculation results in a negative capital charge for any individual sovereign exposure, banks should apply a zero capital charge for that exposure.

14 The following terms are used to refer to specific parts of the capital requirements formula:

- Full maturity adjustment = $\frac{\left(1+\left(M-2.5\right) \cdot b\right)}{\left(1-1.5 \cdot b\right)}$
- Explicit maturity adjustment = $\left(1+\left(M-2.5\right) \cdot b\right)$
- M is the effective maturity, calculated according to paragraphs 107 to 114

(ii) Firm-size adjustment for small- and medium-sized entities (SME)

54. Under the IRB approach for corporate credits, banks will be permitted to separately distinguish exposures to SME borrowers (defined as corporate exposures where the reported sales for the consolidated group of which the firm is a part is less than €50 million) from those to large firms. A firm-size adjustment (ie 0.04 x (1 – (S – 5) / 45)) is made to the corporate risk weight formula for exposures to SME borrowers. S is expressed as total annual sales in millions of euros with values of S falling in the range of equal to or less than €50 million or greater than or equal to €5 million. Reported sales of less than €5 million will be treated as if they were equivalent to €5 million for the purposes of the firm-size adjustment for SME borrowers.

$$\text{Correlation (R)} = 0.12 \cdot \frac{\left(1-e^{-50 \cdot PD}\right)}{\left(1-e^{-50}\right)} + 0.24 \cdot \left(1 - \frac{\left(1-e^{-50 \cdot PD}\right)}{\left(1-e^{-50}\right)}\right) - 0.04 \cdot \left(1 - \frac{\left(S-5\right)}{45}\right)$$

55. Subject to national discretion, supervisors may allow banks, as a failsafe, to substitute total assets of the consolidated group for total sales in calculating the SME threshold and the firm-size adjustment. However, total assets should be used only when total sales are not a meaningful indicator of firm size.

(iii) Risk weights for specialised lending

Risk weights for PF, OF, CF and IPRE

56. Banks that do not meet the requirements for the estimation of PD under the corporate IRB approach will be required to map their internal grades to five supervisory categories, each of which is associated with a specific risk weight. The slotting criteria on which this mapping must be based are provided in Annex 6 of the Basel II framework (June 2006). The risk weights for unexpected losses associated with each supervisory category are:

Supervisory categories and UL risk weights for other SL exposures

Strong	Good	Satisfactory	Weak	Default
70%	90%	115%	250%	0%

57. Although banks are expected to map their internal ratings to the supervisory categories for specialised lending using the slotting criteria provided in Annex 6 of the Basel II framework (June 2006), each supervisory category broadly corresponds to a range of external credit assessments as outlined below.

Strong	Good	Satisfactory	Weak	Default
BBB- or better	BB+ or BB	BB- or B+	B to C-	Not applicable

58. At national discretion, supervisors may allow banks to assign preferential risk weights of 50% to “strong” exposures, and 70% to “good” exposures, provided they have a remaining maturity of less than 2.5 years or the supervisor determines that banks’ underwriting and other risk characteristics are substantially stronger than specified in the slotting criteria for the relevant supervisory risk category.

59. Banks that meet the requirements for the estimation of PD will be able to use the F-IRB approach for the corporate asset class to derive risk weights for SL sub-classes.

60. Banks that meet the requirements for the estimation of PD and LGD and EAD (where relevant) will be able to use the A-IRB approach for the corporate asset class to derive risk weights for SL sub-classes.

Risk weights for HVCRE

61. Banks that do not meet the requirements for estimation of PD, or whose supervisor has chosen not to implement the foundation or advanced approaches to HVCRE, must map their internal grades to five supervisory categories, each of which is associated with a specific risk weight. The slotting criteria on which this mapping must be based are the same as those for IPRE, as provided in Annex 6 of the Basel II framework (June 2006). The risk weights associated with each supervisory category are:

Supervisory categories and UL risk weights for high-volatility commercial real estate

Strong	Good	Satisfactory	Weak	Default
95%	120%	140%	250%	0%

62. As indicated in paragraph 57, each supervisory category broadly corresponds to a range of external credit assessments.

63. At national discretion, supervisors may allow banks to assign preferential risk weights of 70% to "strong" exposures, and 95% to "good" exposures, provided they have a remaining maturity of less than 2.5 years or the supervisor determines that banks' underwriting and other risk characteristics are substantially stronger than specified in the slotting criteria for the relevant supervisory risk category.

64. Banks that meet the requirements for the estimation of PD and whose supervisor has chosen to implement a foundation or advanced approach to HVCRE exposures will use the same formula for the derivation of risk weights that is used for other SL exposures, except that they will apply the following asset correlation formula:

$$\text{Correlation (R)} = 0.12 \cdot \frac{\left(1-e^{-50 \cdot PD}\right)}{\left(1-e^{-50}\right)} + 0.30 \cdot \left(1 - \frac{\left(1-e^{-50 \cdot PD}\right)}{\left(1-e^{-50}\right)}\right)$$

65. Banks that do not meet the requirements for estimation of LGD and EAD for HVCRE exposures must use the supervisory parameters for LGD and EAD for corporate exposures.

2. Risk components

66. This section, paragraphs 67 to 115, sets out the calculation of the risk components for corporate and bank exposures. In the case of an exposure that is guaranteed by a sovereign, the floors that apply to the risk components do not apply to that part of the exposure covered by the sovereign guarantee (ie any part of the exposure that is not covered by the guarantee is subject to the relevant floors).

(i) Probability of default (PD)

67. For corporate and bank exposures, the PD is the one-year PD associated with the internal borrower grade to which that exposure is assigned. The PD of borrowers assigned to a default grade(s), consistent with the reference definition of default, is 100%. The minimum requirements for the derivation of the PD estimates associated with each internal borrower grade are outlined in paragraphs 229 to 231.

68. The PD for each exposure that is used as input into the risk weight formula and the calculation of expected loss must not be less than 0.05%.

(ii) Loss given default (LGD)

69. A bank must provide an estimate of the LGD for each corporate and bank exposure. There are two approaches for deriving this estimate: a foundation approach and an advanced approach. As noted in paragraph 34, the advanced approach is not permitted for exposures to certain entities.

LGD under the foundation approach

Treatment of unsecured claims and non-recognised collateral

70. Under the foundation approach, senior claims on banks, securities firms and other financial institutions (including insurance companies and any financial institutions in the corporate asset class) that are not secured by recognised collateral will be assigned a 45% LGD. Senior claims on other corporates that are not secured by recognised collateral will be assigned a 40% LGD.

71. All subordinated claims on corporates and banks will be assigned a 75% LGD. A subordinated loan is a facility that is expressly subordinated to another facility. At national discretion, supervisors may choose to employ a wider definition of subordination. This might include economic subordination, such as cases where the facility is unsecured and the bulk of the borrower's assets are used to secure other exposures.

Collateral under the foundation approach

72. In addition to the eligible financial collateral recognised in the standardised approach, under the foundation IRB approach some other forms of collateral, known as eligible IRB collateral, are also recognised. These include receivables, specified commercial and residential real estate (CRE/RRE), and other physical collateral, where they meet the minimum requirements set out in paragraphs 283 to 299. For eligible financial collateral, the requirements are identical to the operational standards as set out in the credit risk mitigation section of the standardised approach.

Methodology for recognition of eligible collateral under the foundation approach

73. The simple approach to collateral presented in the standardised approach is not available to banks applying the IRB approach.

74. The LGD applicable to a collateralised transaction (LGD*) must be calculated as the exposure weighted average of the LGD applicable to the unsecured part of an exposure (LGD_U) and the LGD applicable to the collateralised part of an exposure (LGD_S). Specifically:

$$LGD^* = LGD_U \cdot \frac{E_U}{E \cdot (1+H_E)} + LGD_S \cdot \frac{E_S}{E \cdot (1+H_E)}$$

where:

- E is the current value of the exposure (ie cash lent or securities lent or posted). In the case of securities lent or posted the exposure value has to be increased by applying the appropriate haircuts (H_E) according to the comprehensive approach for financial collateral.
- E_S is the current value of the collateral received after the application of the haircut applicable for the type of collateral (H_c) and for any currency mismatches between the exposure and the collateral, as specified in paragraphs 75 to 76. E_S is capped at the value of $E \cdot (1+H_E)$.
- $E_U = E \cdot (1+H_E) - E_S$. The terms E_U and E_S are only used to calculate LGD*. Banks must continue to calculate EAD without taking into account the presence of any collateral, unless otherwise specified.
- LGD_U = the LGD applicable for an unsecured exposure, as set out in paragraph 70 to 71.
- LGD_S = the LGD applicable to exposures secured by the type of collateral used in the transaction, as specified in paragraph 75.

75. The following table specifies the LGD_S and haircuts applicable in the formula set out in paragraph 74:

Type of collateral	LGD_S	Haircut
Eligible financial collateral	0%	As determined by the haircuts that apply in the comprehensive formula of the standardised approach for credit risk (paragraph 163 for jurisdictions that allow the use of ratings for regulatory purposes and paragraph 164 for jurisdictions that do not). The haircuts have to be adjusted for different holding periods and non-daily remargining or revaluation according to paragraphs 169 to 172 of the standardised approach.
Eligible receivables	20%	40%
Eligible residential real estate / commercial real estate	20%	40%
Other eligible physical collateral	25%	40%
Ineligible collateral	N/A	100%

76. When eligible collateral is denominated in a different currency to that of the exposure, the haircut for currency risk is the same haircut that applies in the comprehensive approach (paragraph 165 of the standardised approach).

77. Banks that lend securities or post collateral must calculate capital requirements for both of the following: (i) the credit risk or market risk of the securities, if this remains with the bank; and (ii) the counterparty credit risk arising from the risk that the borrower of the securities may default. For repo-style transactions, banks may recognise a reduction in the counterparty credit risk requirement arising from the effect of a master netting agreement providing that it satisfies the criteria set out in paragraphs 175 and 176 of the standardised approach. The bank must calculate E*, which is the exposure to be used for the counterparty credit risk charge taking account of the risk mitigation of collateral received, using the formula set out in paragraph 178 of the standardised approach. In calculating RWA and EL amounts for the counterparty credit risk arising from the set of transactions covered by the master netting agreement, E* must be used as the EAD of the counterparty and the LGD of the counterparty must be determined using the LGD specified for unsecured exposures, as set out in paragraphs 70 and 71.

Use of models to calculate EAD for counterparty credit risk

78. As an alternative to the use of standard haircuts for the calculation of the counterparty credit risk charge for SFTs set out in paragraph 77, banks may be permitted to use a VaR models approach to reflect price volatility of the exposures and the financial collateral. This approach can take into account the correlation effects between security positions. This approach applies to single SFTs and SFTs covered by netting agreements on a counterparty-by-counterparty basis, both under the condition that the collateral is revalued on a daily basis. This holds for the underlying securities being different and unrelated to securitisations. The master netting agreement must satisfy the criteria set out in paragraph 175 and 176 of the standardised approach. The VaR models approach is available to banks that have received supervisory recognition for an internal market risk model according to paragraph 177 of "Minimum capital requirements for market risk". Banks which have not received market risk model recognition can separately apply for supervisory recognition to use their internal VaR models for the calculation of potential price volatility for SFTs, provided the model meets the requirements of paragraph 177. Although the market risk standards have changed from a 99% VaR to a 97.5% expected shortfall, the VaR models approach to SFTs retains the use of a 99% VaR to calculate the counterparty credit risk for SFTs. The VaR model needs to capture risk sufficient to pass the backtesting and profit and loss attribution tests of paragraph 183 of "Minimum capital requirements for market risk". The default risk charge of paragraph 186 is not required in the VaR model for SFTs.

79. The quantitative and qualitative criteria for recognition of internal market risk models for SFTs are in principle the same as in paragraphs 180 and 181 of "Minimum capital requirements for market risk". The minimum liquidity horizon or the holding period for SFTs is 5-business days for margined repo-style

transactions, rather than the 10-business days in paragraph 181 (k). For other transactions eligible for the VaR models approach, the 10-business day holding period will be retained. The minimum holding period should be adjusted upwards for market instruments where such a holding period would be inappropriate given the liquidity of the instrument concerned.

80. The calculation of the exposure E* for banks using their internal model to calculate their counterparty credit risk charge will be the following:

$$E^* = \max \{0, [(\Sigma E - \Sigma C) + \text{VaR output from internal model}]\}$$

In calculating capital requirements banks will use the previous business day's VaR number.

81. Subject to supervisory approval, instead of using the VaR approach, banks may also calculate an effective expected positive exposure for repo-style and other similar SFTs, in accordance with the Internal Model Method set out in the counterparty credit risk standards.

Carve out from the comprehensive approach

82. As in the standardised approach, for transactions where the conditions in paragraph 150 are met, and in addition, the counterparty is a core market participant as specified in paragraph 151, supervisors may choose not to apply the haircuts specified under the comprehensive approach, but instead to apply a zero H. A netting set that contains any transaction that does not meet the requirements in paragraph 150 of the standardised approach is not eligible for this treatment.

Methodology for the treatment of pools of collateral

83. In the case where a bank has obtained multiple types of collateral it may apply the formula set out in paragraph 74 sequentially for each individual type of collateral. In doing so, after each step of recognising one individual type of collateral, the remaining value of the unsecured exposure (E_U) will be reduced by the adjusted value of the collateral (E_S) recognised in that step. In line with paragraph 74, the total of E_S across all collateral types is capped at the value of $E \cdot (1 + H_E)$. This results in the following formula:

$$LGD^* = LGD_U \cdot \frac{E_U}{E \cdot (1 + H_E)} + \sum_i LGD_{Si} \cdot \frac{E_{Si}}{E \cdot (1 + H_E)}$$

where for each collateral type i:

- LGD_{Si} is the LGD applicable to that form of collateral (as specified in paragraph 75); and
- E_{Si} is the current value of the collateral received after the application of the haircut applicable for the type of collateral (Hc) (as specified in paragraph 75).

LGD under the advanced approach

84. Subject to certain additional minimum requirements specified below (and the conditions set out in paragraph 34), supervisors may permit banks to use their own internal estimates of LGD for corporate exposures. LGD must be measured as the loss given default as a percentage of the EAD. Banks eligible for the IRB approach that are unable to meet these additional minimum requirements must utilise the foundation LGD treatment described above.

85. The LGD for each exposure that is used as input into the risk weight formula and the calculation of expected loss must not be less than the parameter floors indicated in the table below:

LGD parameter floors

	LGD	
	Unsecured	Secured
Corporate	25%	Varying by collateral type: • 0% financial • 10% receivables • 10% commercial or residential real estate • 15% other physical

86. The LGD floors for secured exposures in the table above apply when the exposure is fully secured (ie the value of collateral after the application of haircuts exceeds the value of the exposure). The LGD floor for a partially secured exposure is calculated as a weighted average of the unsecured LGD floor for the unsecured portion and the secured LGD floor for the secured portion. That is, the following formula should be used to determine the LGD floor:

$$Floor = LGD_{U\,floor} \cdot \frac{E_U}{E \cdot (1 + H_E)} + LGD_{S\,floor} \cdot \frac{E_S}{E \cdot (1 + H_E)}$$

where:

- $LGD_{U\ floor}$ and $LGD_{S\ floor}$ are the floor values for fully unsecured and fully secured exposures respectively, as specified in the table in paragraph 85.
- The other terms are defined as set out in paragraph 74 and 75.

87. In cases where a bank has met the conditions to use their own internal estimates of LGD for a pool of unsecured exposures, and takes collateral against one of these exposures, it may not be able to model the effects of the collateral (ie it may not have enough data to model the effect of the collateral on recoveries). In such cases, the bank is permitted to apply the formula set out in paragraph 74 or 83, with the exception that the LGD_U term would be the bank's own internal estimate of the unsecured LGD. To adopt this treatment the collateral must be eligible under the F-IRB and the bank's estimate of LGD_U must not take account of any effects of collateral recoveries.

88. The minimum requirements for the derivation of LGD estimates are outlined in paragraphs 235 to 240.

Treatment of certain repo-style transactions

89. Banks that want to recognise the effects of master netting agreements on repo-style transactions for capital purposes must apply the methodology outlined in paragraph 77 for determining E* for use as the EAD in the calculation of counterparty credit risk. For banks using the advanced approach, own LGD estimates would be permitted for the unsecured equivalent amount (E*) used to calculate counterparty credit risk. In both cases banks, in addition to counterparty credit risk, must also calculate the capital requirements relating to any credit or market risk to which they remain exposed arising from the underlying securities in the master netting agreement.

Treatment of guarantees and credit derivatives

90. There are two approaches for recognition of CRM in the form of guarantees and credit derivatives in the IRB approach: a foundation approach for banks using supervisory values of LGD, and an advanced approach for those banks using their own internal estimates of LGD.

91. Under either approach, CRM in the form of guarantees and credit derivatives must not reflect the effect of double default (see paragraph 254). As such, to the extent that the CRM is recognised by the

bank, the adjusted risk weight will not be less than that of a comparable direct exposure to the protection provider. Consistent with the standardised approach, banks may choose not to recognise credit protection if doing so would result in a higher capital requirement.

Recognition under the foundation approach

92. For banks using the foundation approach for LGD, the approach to guarantees and credit derivatives closely follows the treatment under the standardised approach as specified in paragraphs 191 to 205 of the standardised approach. The range of eligible guarantors is the same as under the standardised approach except that companies that are internally rated may also be recognised under the foundation approach. To receive recognition, the requirements outlined in paragraphs 191 to 196 of the standardised approach must be met.

93. Eligible guarantees from eligible guarantors will be recognised as follows:

- For the covered portion of the exposure, a risk weight is derived by taking:
  - the risk-weight function appropriate to the type of guarantor, and
  - the PD appropriate to the guarantor's borrower grade.
- The bank may replace the LGD of the underlying transaction with the LGD applicable to the guarantee taking into account seniority and any collateralisation of a guaranteed commitment. For example, when a bank has a subordinated claim on the borrower but the guarantee represents a senior claim on the guarantor this may be reflected by using an LGD applicable for senior exposures (see paragraph 70) instead of an LGD applicable for subordinated exposures.
- In case the bank applies the standardised approach to direct exposures to the guarantor it may only recognise the guarantee by applying the standardised approach to the covered portion of the exposure.

94. The uncovered portion of the exposure is assigned the risk weight associated with the underlying obligor.

95. Where partial coverage exists, or where there is a currency mismatch between the underlying obligation and the credit protection, it is necessary to split the exposure into a covered and an uncovered amount. The treatment in the foundation approach follows that outlined in paragraphs 202 to 204 of the standardised approach, and depends upon whether the cover is proportional or tranched.

Recognition under the advanced approach

96. Banks using the advanced approach for estimating LGDs may reflect the risk-mitigating effect of guarantees and credit derivatives through either adjusting PD or LGD estimates. Whether adjustments are done through PD or LGD, they must be done in a consistent manner for a given guarantee or credit derivative type. In doing so, banks must not include the effect of double default in such adjustments. Thus, the adjusted risk weight must not be less than that of a comparable direct exposure to the protection provider. In case the bank applies the standardised approach to direct exposures to the guarantor it may only recognise the guarantee by applying the standardised approach to the covered portion of the exposure. In case the bank applies the foundation IRB approach to direct exposures to the guarantor it may only recognise the guarantee by determining the risk weight for the comparable direct exposure to the guarantor according to the foundation IRB approach.

97. A bank relying on own-estimates of LGD has the option to adopt the treatment outlined above for banks under the foundation IRB approach (paragraphs 92 to 95), or to make an adjustment to its LGD estimate of the exposure to reflect the presence of the guarantee or credit derivative. Under this option, there are no limits to the range of eligible guarantors although the set of minimum requirements provided in paragraphs 256 and 257 concerning the type of guarantee must be satisfied. For credit derivatives, the

requirements of paragraphs 262 and 263 must be satisfied.[15] For exposures for which a bank has permission to use its own estimates of LGD, the bank may recognise the risk mitigating effects of first-to-default credit derivatives, but may not recognise the risk mitigating effects of second-to-default or more generally nth-to-default credit derivatives.

(iii) Exposure at default (EAD)

98. The following sections apply to both on and off-balance sheet positions. All exposures are measured gross of specific provisions or partial write-offs. The EAD on drawn amounts should not be less than the sum of: (i) the amount by which a bank's regulatory capital would be reduced if the exposure were written-off fully; and (ii) any specific provisions and partial write-offs. When the difference between the instrument's EAD and the sum of (i) and (ii) is positive, this amount is termed a discount. The calculation of risk-weighted assets is independent of any discounts. Under the limited circumstances described in paragraph 147, discounts may be included in the measurement of total eligible provisions for purposes of the EL-provision calculation set out in Section G.

Exposure measurement for on-balance sheet items

99. On-balance sheet netting of loans and deposits will be recognised subject to the same conditions as under paragraph 190 of the standardised approach. Where currency or maturity mismatched on-balance sheet netting exists, the treatment follows the standardised approach, as set out in paragraphs 126 and 128 to 131.

Exposure measurement for off-balance sheet items (with the exception of derivatives)

100. For off-balance sheet items there are two approaches for the estimation of EAD: a foundation approach and an advanced approach. When only the drawn balances of revolving facilities have been securitised, banks must ensure that they continue to hold required capital against the undrawn balances associated with the securitised exposures.

101. In the foundation approach, EAD is calculated as the committed but undrawn amount multiplied by a CCF. In the advanced approach, EAD for undrawn commitments may be calculated as the committed but undrawn amount multiplied by a CCF or derived from direct estimates of total facility EAD.

EAD under the foundation approach

102. The types of instruments and the CCFs applied to them are the same as those in the standardised approach, as set out in paragraphs 78 to 89.

103. The amount to which the CCF is applied is the lower of the value of the unused committed credit line, and the value that reflects any possible constraining of the availability of the facility, such as the existence of a ceiling on the potential lending amount which is related to a borrower's reported cash flow. If the facility is constrained in this way, the bank must have sufficient line monitoring and management procedures to support this contention.

[15] When credit derivatives do not cover the restructuring of the underlying obligation, the partial recognition set out in paragraph 196 of the standardised approach applies.

104. Where a commitment is obtained on another off-balance sheet exposure, banks under the foundation approach are to apply the lower of the applicable CCFs.

EAD under the advanced approach

105. Banks which meet the minimum requirements for use of their own estimates of EAD (see paragraphs 241 to 250) will be allowed for exposures for which A-IRB is permitted (see paragraph 34) to use their own internal estimates of EAD for undrawn revolving commitments[16] to extend credit, purchase assets or issue credit substitutes provided the exposure is not subject to a CCF of 100% in the foundation approach (see paragraph 102). Standardised approach CCFs must be used for all other off-balance sheet items (for example, undrawn non-revolving commitments), and must be used where the minimum requirements for own estimates of EAD are not met. The EAD for each exposure that is used as input into the risk weight formula and the calculation of expected loss is subject to a floor that is the sum of: (i) the on balance sheet amount; and (ii) 50% of the off balance sheet exposure using the applicable CCF in the standardised approach.

Exposure measurement for transactions that expose banks to counterparty credit risk

106. Measures of exposure for SFTs and OTC derivatives that expose banks to counterparty credit risk under the IRB approach will be calculated as per the rules set forth in the counterparty credit risk standards.

(iv) Effective maturity (M)

107. For banks using the foundation approach for corporate exposures, effective maturity (M) will be 2.5 years except for repo-style transactions where the effective maturity will be 6 months (ie M=0.5). National supervisors may choose to require all banks in their jurisdiction (those using the foundation and advanced approaches) to measure M for each facility using the definition provided below.

108. Banks using any element of the advanced IRB approach are required to measure effective maturity for each facility as defined below. However, national supervisors may allow the effective maturity to be fixed at 2.5 years (the 'fixed maturity treatment') for facilities to certain smaller domestic corporate borrowers if the reported sales (ie turnover) as well as total assets for the consolidated group of which the firm is a part of are less than €500 million. The consolidated group has to be a domestic company based in the country where the fixed maturity treatment is applied. If adopted, national supervisors must apply the fixed maturity treatment to all IRB banks using the advanced approach in that country, rather than on a bank-by-bank basis.

109. Except as noted in paragraph 110, the effective maturity (M) is subject to a floor of one year and a cap of 5 years and is defined as follows:

- For an instrument subject to a determined cash flow schedule, effective maturity M is defined as:

  Effective maturity (M) = $\sum_t t \cdot CF_t \,/\, \sum_t CF_t$

  where CF_t denotes the cash flows (principal, interest payments and fees) contractually payable by the borrower in period t.

- If a bank is not in a position to calculate the effective maturity of the contracted payments as noted above, it is allowed to use a more conservative measure of M such as that it equals the maximum remaining time (in years) that the borrower is permitted to take to fully discharge its

[16] A revolving loan facility is one that lets a borrower obtain a loan where the borrower has the flexibility to decide how often to withdraw from the loan and at what time intervals. A revolving facility allows the borrower to drawdown, repay and re-draw loans advanced to it. Facilities that allow prepayments and subsequent redraws of those prepayments are considered as revolving.

contractual obligation (principal, interest, and fees) under the terms of loan agreement. Normally, this will correspond to the nominal maturity of the instrument.

- For derivatives subject to a master netting agreement, the effective maturity is defined as the weighted average maturity of the transactions within the netting agreement. Further, the notional amount of each transaction should be used for weighting the maturity.
- For revolving exposures, effective maturity must be determined using the maximum contractual termination date of the facility. Banks must not use the repayment date of the current drawing.

110. The one-year floor does not apply to certain short-term exposures, comprising fully or nearly-fully collateralised[17] capital market-driven transactions (ie OTC derivatives transactions and margin lending) and repo-style transactions (ie repos/reverse repos and securities lending/borrowing) with an original maturity of less than one year, where the documentation contains daily remargining clauses. For all eligible transactions the documentation must require daily revaluation, and must include provisions that must allow for the prompt liquidation or setoff of the collateral in the event of default or failure to re-margin. The maturity of such transactions must be calculated as the greater of one-day, and the effective maturity (M, consistent with the definition above), except for transactions subject to a master netting agreement, where the floor is determined by the minimum holding period for the transaction type, as required by paragraph 113.

111. The one-year floor also does not apply to the following exposures:

(i) Short-term self-liquidating trade transactions. Import and export letters of credit and similar transactions should be accounted for at their actual remaining maturity.

(ii) Issued as well as confirmed letters of credit that are short term (ie have a maturity below one year) and self-liquidating.

112. In addition to the transactions considered in paragraph 110 above, other short-term exposures with an original maturity of less than one year that are not part of a bank's ongoing financing of an obligor may be eligible for exemption from the one-year floor. After a careful review of the particular circumstances in their jurisdictions, national supervisors should define the types of short-term exposures that might be considered eligible for this treatment. The results of these reviews might, for example, include transactions such as:

- Some capital market-driven transactions and repo-style transactions that might not fall within the scope of paragraph 110;
- Some trade finance transactions that are not exempted by paragraph 111.
- Some exposures arising from settling securities purchases and sales. This could also include overdrafts arising from failed securities settlements provided that such overdrafts do not continue more than a short, fixed number of business days;
- Some exposures arising from cash settlements by wire transfer, including overdrafts arising from failed transfers provided that such overdrafts do not continue more than a short, fixed number of business days;
- Some exposures to banks arising from foreign exchange settlements; and
- Some short-term loans and deposits.

113. For transactions falling within the scope of paragraph 110 subject to a master netting agreement, the effective maturity is defined as the weighted average maturity of the transactions. A floor equal to the minimum holding period for the transaction type set out in paragraph 170 of the standardised approach

[17] The intention is to include both parties of a transaction meeting these conditions where neither of the parties is systematically under-collateralised.

will apply to the average. Where more than one transaction type is contained in the master netting agreement a floor equal to the highest holding period will apply to the average. Further, the notional amount of each transaction should be used for weighting maturity.

114. Where there is no explicit definition, the effective maturity (M) assigned to all exposures is set at 2.5 years unless otherwise specified in paragraph 107.

Treatment of maturity mismatches

115. The treatment of maturity mismatches under IRB is identical to that in the standardised approach (see paragraphs 126 to 130).

D. Rules for retail exposures

116. Section D presents in detail the method of calculating the UL capital requirements for retail exposures. Section D.1 provides the risk weight functions. Section D.2 presents the risk components to serve as inputs to the risk-weight functions. The method of calculating expected losses, and for determining the difference between that measure and provisions is described in Section G.

1. Risk-weighted assets for retail exposures

117. There are three separate risk-weight functions for retail exposures, as defined in paragraphs 118 to 120. Risk weights for retail exposures are based on separate assessments of PD and LGD as inputs to the risk-weight functions. None of the three retail risk-weight functions contain the full maturity adjustment component that is present in the risk-weight function for exposures to banks and corporates. Throughout this section, PD and LGD are measured as decimals, and EAD is measured as currency (eg euros).

(i) Retail residential mortgage exposures

118. For exposures defined in paragraph 21 that are not in default and are secured or partly secured[18] by residential mortgages, risk weights will be assigned based on the following formula:

Correlation (R) = 0.15

$$\text{Capital requirement (K)} = \left[LGD \cdot N\left[\frac{G(PD)}{\sqrt{(1-R)}} + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right] - PD \cdot LGD \right]$$

Risk-weighted assets = $K \cdot 12.5 \cdot EAD$

The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD (described in paragraph 235) and the bank's best estimate of expected loss (described in paragraph 238). The risk-weighted asset amount for the defaulted exposure is the product of K, 12.5 and the EAD.

(ii) Qualifying revolving retail exposures

119. For qualifying revolving retail exposures as defined in paragraphs 24 and 25 that are not in default, risk weights are defined based on the following formula:

[18] This means that risk weights for residential mortgages also apply to the unsecured portion of such residential mortgages.

Correlation (R) = 0.04

$$\text{Capital requirement (K)} = \left[LGD \cdot N\left[\frac{G(PD)}{\sqrt{(1-R)}} + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right] - PD \cdot LGD \right]$$

Risk-weighted assets = $K \cdot 12.5 \cdot EAD$

The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD (described in paragraph 235) and the bank's best estimate of expected loss (described in paragraph 238). The risk-weighted asset amount for the defaulted exposure is the product of K, 12.5, and the EAD.

(iii) Other retail exposures

120. For all other retail exposures that are not in default, risk weights are assigned based on the following function, which allows correlation to vary with PD:

$$\text{Correlation (R)} = 0.03 \cdot \frac{\left(1-e^{-35 \cdot PD}\right)}{\left(1-e^{-35}\right)} + 0.16 \cdot \left(1 - \frac{\left(1-e^{-35 \cdot PD}\right)}{\left(1-e^{-35}\right)} \right)$$

$$\text{Capital requirement (K)} = \left[LGD \cdot N\left[\frac{G(PD)}{\sqrt{(1-R)}} + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right] - PD \cdot LGD \right]$$

Risk-weighted assets = $K \cdot 12.5 \cdot EAD$

The capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD (described in paragraph 235) and the bank's best estimate of expected loss (described in paragraph 238). The risk-weighted asset amount for the defaulted exposure is the product of K, 12.5, and the EAD.

Illustrative risk weights are shown in Annex 5 of the Basel II framework (June 2006).

2. Risk components

(i) Probability of default (PD) and loss given default (LGD)

121. For each identified pool of retail exposures, banks are expected to provide an estimate of the PD and LGD associated with the pool, subject to the minimum requirements as set out in Section H. Additionally, the PD for retail exposures is the greater of: (i) the one-year PD associated with the internal borrower grade to which the pool of retail exposures is assigned; and (ii) 0.1% for QRRE revolvers (see paragraph 25 for the definition of QRRE revolvers) and 0.05% for all other exposures. The LGD for each exposure that is used as input into the risk weight formula and the calculation of expected loss must not be less than the parameter floors indicated in the table below:

LGD parameter floors

	LGD	
	Unsecured	Secured
Retail classes:		
Mortgages	N/A	5%
QRRE (transactors and revolvers)	50%	N/A
Other retail	30%	Varying by collateral type: • 0% financial • 10% receivables • 10% commercial or residential real estate • 15% other physical

The LGD floors for partially secured exposures in the "other retail" category should be calculated according to the formula set out in paragraph 86. The LGD floor for residential mortgages is fixed at 5%, irrespective of the level of collateral provided by the property.

(ii) Recognition of guarantees and credit derivatives

122. Banks may reflect the risk-reducing effects of guarantees and credit derivatives, either in support of an individual obligation or a pool of exposures, through an adjustment of either the PD or LGD estimate, subject to the minimum requirements in paragraphs 252 to 263. Whether adjustments are done through PD or LGD, they must be done in a consistent manner for a given guarantee or credit derivative type. In case the bank applies the standardised approach to direct exposures to the guarantor it must assign the standardised approach risk weight to the covered portion of the exposure.

123. Consistent with the requirements outlined above for corporate and bank exposures, banks must not include the effect of double default in such adjustments. The adjusted risk weight must not be less than that of a comparable direct exposure to the protection provider. Consistent with the standardised approach, banks may choose not to recognise credit protection if doing so would result in a higher capital requirement.

(iii) Exposure at default (EAD)

124. Both on and off-balance sheet retail exposures are measured gross of specific provisions or partial write-offs. The EAD on drawn amounts should not be less than the sum of: (i) the amount by which a bank's regulatory capital would be reduced if the exposure were written-off fully; and (ii) any specific provisions and partial write-offs. When the difference between the instrument's EAD and the sum of (i) and (ii) is positive, this amount is termed a discount. The calculation of risk-weighted assets is independent of any discounts. Under the limited circumstances described in paragraph 147, discounts may be included in the measurement of total eligible provisions for purposes of the EL-provision calculation set out in Section G.

125. On-balance sheet netting of loans and deposits of a bank to or from a retail customer will be permitted subject to the same conditions outlined in paragraph 190 of the standardised approach. Banks must use their own estimates of EAD for undrawn revolving commitments to extend credit, purchase assets or issue credit substitutes provided the exposure is not subject to a CCF of 100% in the standardised approach (see paragraph 79 of the standardised approach) and the minimum requirements in paragraphs 241 to 251 are satisfied. Foundation approach CCFs must be used for all other off-balance sheet items (for example, undrawn non-revolving commitments), and must be used where the minimum requirements for own estimates of EAD are not met.

126. For retail exposures with uncertain future drawdown such as credit cards, banks must take into account their history and/or expectation of additional drawings prior to default in their overall calibration

of loss estimates. In particular, where a bank does not reflect conversion factors for undrawn lines in its EAD estimates, it must reflect in its LGD estimates the likelihood of additional drawings prior to default. Conversely, if the bank does not incorporate the possibility of additional drawings in its LGD estimates, it must do so in its EAD estimates.

127. When only the drawn balances of revolving retail facilities have been securitised, banks must ensure that they continue to hold required capital against the undrawn balances associated with the securitised exposures using the IRB approach to credit risk for commitments.

128. To the extent that foreign exchange and interest rate commitments exist within a bank's retail portfolio for IRB purposes, banks are not permitted to provide their internal assessments of credit equivalent amounts. Instead, the rules for the standardised approach continue to apply.

F. Rules for purchased receivables

129. Section F presents the method of calculating the UL capital requirements for purchased receivables. For such assets, there are IRB capital charges for both default risk and dilution risk. Section F.1 discusses the calculation of risk-weighted assets for default risk. The calculation of risk-weighted assets for dilution risk is provided in Section F.2. The method of calculating expected losses, and for determining the difference between that measure and provisions, is described in Section G.

1. Risk-weighted assets for default risk

130. For receivables belonging unambiguously to one asset class, the IRB risk weight for default risk is based on the risk-weight function applicable to that particular exposure type, as long as the bank can meet the qualification standards for this particular risk-weight function. For example, if banks cannot comply with the standards for qualifying revolving retail exposures (defined in paragraph 24), they should use the risk-weight function for other retail exposures. For hybrid pools containing mixtures of exposure types, if the purchasing bank cannot separate the exposures by type, the risk-weight function producing the highest capital requirements for the exposure types in the receivable pool applies.

(i) Purchased retail receivables

131. For purchased retail receivables, a bank must meet the risk quantification standards for retail exposures but can utilise external and internal reference data to estimate the PDs and LGDs. The estimates for PD and LGD (or EL) must be calculated for the receivables on a stand-alone basis; that is, without regard to any assumption of recourse or guarantees from the seller or other parties.

(ii) Purchased corporate receivables

132. For purchased corporate receivables the purchasing bank is expected to apply the existing IRB risk quantification standards for the bottom-up approach. However, for eligible purchased corporate receivables, and subject to supervisory permission, a bank may employ the following top-down procedure for calculating IRB risk weights for default risk:

- The purchasing bank will estimate the pool's one-year EL for default risk, expressed in percentage of the exposure amount (ie the total EAD amount to the bank by all obligors in the receivables pool). The estimated EL must be calculated for the receivables on a stand-alone basis; that is, without regard to any assumption of recourse or guarantees from the seller or other parties. The treatment of recourse or guarantees covering default risk (and/or dilution risk) is discussed separately below.

- Given the EL estimate for the pool's default losses, the risk weight for default risk is determined by the risk-weight function for corporate exposures.[19] As described below, the precise calculation of risk weights for default risk depends on the bank's ability to decompose EL into its PD and LGD components in a reliable manner. Banks can utilise external and internal data to estimate PDs and LGDs. However, the advanced approach will not be available for banks that use the foundation approach for corporate exposures.

Foundation IRB treatment

133. If the purchasing bank is unable to decompose EL into its PD and LGD components in a reliable manner, the risk weight is determined from the corporate risk-weight function using the following specifications: if the bank can demonstrate that the exposures are exclusively senior claims to corporate borrowers, an LGD of 40% can be used. PD will be calculated by dividing the EL using this LGD. EAD will be calculated as the outstanding amount minus the capital charge for dilution prior to credit risk mitigation ($K_{Dilution}$). Otherwise, PD is the bank's estimate of EL; LGD will be 100%; and EAD is the amount outstanding minus $K_{Dilution}$. EAD for a revolving purchase facility is the sum of the current amount of receivables purchased plus 40% of any undrawn purchase commitments minus $K_{Dilution}$. If the purchasing bank is able to estimate PD in a reliable manner, the risk weight is determined from the corporate risk-weight functions according to the specifications for LGD, M and the treatment of guarantees under the foundation approach as given in paragraphs 70 to 83, 89 to 95, and 107.

Advanced IRB treatment

134. If the purchasing bank can estimate either the pool's default-weighted average loss rates given default (as defined in paragraph 235) or average PD in a reliable manner, the bank may estimate the other parameter based on an estimate of the expected long-run loss rate. The bank may: (i) use an appropriate PD estimate to infer the long-run default-weighted average loss rate given default; or (ii) use a long-run default-weighted average loss rate given default to infer the appropriate PD. In either case, it is important to recognise that the LGD used for the IRB capital calculation for purchased receivables cannot be less than the long-run default-weighted average loss rate given default and must be consistent with the concepts defined in paragraph 235. The risk weight for the purchased receivables will be determined using the bank's estimated PD and LGD as inputs to the corporate risk-weight function. Similar to the foundation IRB treatment, EAD will be the amount outstanding minus $K_{Dilution}$. EAD for a revolving purchase facility will be the sum of the current amount of receivables purchased plus 40% of any undrawn purchase commitments minus $K_{Dilution}$ (thus, banks using the advanced IRB approach will not be permitted to use their internal EAD estimates for undrawn purchase commitments).

135. For drawn amounts, M will equal the pool's exposure-weighted average effective maturity (as defined in paragraphs 109 to 114). This same value of M will also be used for undrawn amounts under a committed purchase facility provided the facility contains effective covenants, early amortisation triggers, or other features that protect the purchasing bank against a significant deterioration in the quality of the future receivables it is required to purchase over the facility's term. Absent such effective protections, the

[19] The firm-size adjustment for SME, as defined in paragraph 54, will be the weighted average by individual exposure of the pool of purchased corporate receivables. If the bank does not have the information to calculate the average size of the pool, the firm-size adjustment will not apply.

M for undrawn amounts will be calculated as the sum of: (a) the longest-dated potential receivable under the purchase agreement; and (b) the remaining maturity of the purchase facility.

2. Risk-weighted assets for dilution risk

136. Dilution refers to the possibility that the receivable amount is reduced through cash or non-cash credits to the receivable's obligor.[20] For both corporate and retail receivables, unless the bank can demonstrate to its supervisor that the dilution risk for the purchasing bank is immaterial, the treatment of dilution risk must be the following: at the level of either the pool as a whole (top-down approach) or the individual receivables making up the pool (bottom-up approach), the purchasing bank will estimate the one-year EL for dilution risk, also expressed in percentage of the receivables amount. Banks can utilise external and internal data to estimate EL. As with the treatments of default risk, this estimate must be computed on a stand-alone basis; that is, under the assumption of no recourse or other support from the seller or third-party guarantors. For the purpose of calculating risk weights for dilution risk, the corporate risk-weight function must be used with the following settings: the PD must be set equal to the estimated EL, and the LGD must be set at 100%. An appropriate maturity treatment applies when determining the capital requirement for dilution risk. If a bank can demonstrate that the dilution risk is appropriately monitored and managed to be resolved within one year, the supervisor may allow the bank to apply a one-year maturity.

137. This treatment will be applied regardless of whether the underlying receivables are corporate or retail exposures, and regardless of whether the risk weights for default risk are computed using the standard IRB treatments or, for corporate receivables, the top-down treatment described above.

3. Treatment of purchase price discounts for receivables

138. In many cases, the purchase price of receivables will reflect a discount (not to be confused with the discount concept defined in paragraphs 98 and 124) that provides first loss protection for default losses, dilution losses or both. To the extent that a portion of such a purchase price discount may be refunded to the seller based on the performance of the receivables, the purchaser may recognise this refundable amount as first-loss protection and hence treat this exposure under the securitisation framework, while the seller providing such a refundable purchase price discount must treat the refundable amount as a first-loss position under the securitisation framework. Non-refundable purchase price discounts for receivables do not affect either the EL-provision calculation in Section G or the calculation of risk-weighted assets.

139. When collateral or partial guarantees obtained on receivables provide first loss protection (collectively referred to as mitigants in this paragraph), and these mitigants cover default losses, dilution losses, or both, they may also be treated as first loss protection under the securitisation framework (see paragraph 51 of the securitisation framework). When the same mitigant covers both default and dilution

20 Examples include offsets or allowances arising from returns of goods sold, disputes regarding product quality, possible debts of the borrower to a receivables obligor, and any payment or promotional discounts offered by the borrower (eg a credit for cash payments within 30 days).

risk, banks using the Securitisation Internal Ratings-Based Approach (SEC-IRBA) that are able to calculate an exposure-weighted LGD must do so as defined in paragraph 60 of the securitisation framework.

4. Recognition of credit risk mitigants

140. Credit risk mitigants will be recognised generally using the same type of framework as set forth in paragraphs 90 to 97.[21] In particular, a guarantee provided by the seller or a third party will be treated using the existing IRB rules for guarantees, regardless of whether the guarantee covers default risk, dilution risk, or both.

- If the guarantee covers both the pool's default risk and dilution risk, the bank will substitute the risk weight for an exposure to the guarantor in place of the pool's total risk weight for default and dilution risk.
- If the guarantee covers only default risk or dilution risk, but not both, the bank will substitute the risk weight for an exposure to the guarantor in place of the pool's risk weight for the corresponding risk component (default or dilution). The capital requirement for the other component will then be added.
- If a guarantee covers only a portion of the default and/or dilution risk, the uncovered portion of the default and/or dilution risk will be treated as per the existing CRM rules for proportional or tranched coverage (ie the risk weights of the uncovered risk components will be added to the risk weights of the covered risk components).

G. Treatment of expected losses and recognition of provisions

141. Section G discusses the method by which the difference between provisions (eg specific provisions, portfolio-specific general provisions such as country risk provisions or general provisions) and expected losses may be included in or must be deducted from regulatory capital, as outlined in the definition of capital section of the Basel III framework (June 2011).

1. Calculation of expected losses

142. A bank must sum the EL amount (defined as EL multiplied by EAD) associated with its exposures to which the IRB approach is applied (excluding the EL amount associated with securitisation exposures) to obtain a total EL amount. The treatment of EL for securitisation exposures is described in paragraph 37 of the securitisation framework.

(i) Expected loss for exposures other than exposures subject to the supervisory slotting criteria

143. Banks must calculate EL as PD x LGD for corporate, bank, and retail exposures not in default. For corporate, bank, and retail exposures that are in default, banks must use their best estimate of expected loss as defined in paragraph 238 for exposures subject to the advanced approach and for exposures subject to the foundation approach banks must use the supervisory LGD. For exposures subject to the supervisory slotting criteria EL is calculated as described in paragraphs 144 to 146. Securitisation exposures do not contribute to the EL amount, as set out in paragraph 37 of the securitisation framework.

[21] At national supervisory discretion, banks may recognise guarantors that are internally rated and associated with a PD equivalent to less than A- under the foundation IRB approach for purposes of determining capital requirements for dilution risk.

(ii) Expected loss for specialised lending (SL) exposures subject to the supervisory slotting criteria

144. For SL exposures subject to the supervisory slotting criteria, the EL amount is determined by multiplying 8% by the risk-weighted assets produced from the appropriate risk weights, as specified below, multiplied by EAD.

Supervisory categories and EL risk weights for non-HVCRE SL exposures

145. The risk weights for SL, other than HVCRE, are as follows:

Strong	Good	Satisfactory	Weak	Default
5%	10%	35%	100%	625%

Where, at national discretion, supervisors allow banks to assign preferential risk weights to non-HVCRE SL exposures falling into the "strong" and "good" supervisory categories as outlined in paragraph 58, the corresponding EL risk weight is 0% for "strong" exposures, and 5% for "good" exposures.

Supervisory categories and EL risk weights for HVCRE

146. The risk weights for HVCRE are as follows:

Strong	Good	Satisfactory	Weak	Default
5%	5%	35%	100%	625%

Even where, at national discretion, supervisors allow banks to assign preferential risk weights to HVCRE exposures falling into the "strong" and "good" supervisory categories as outlined in paragraph 63, the corresponding EL risk weight will remain at 5% for both "strong" and "good" exposures.

2. Calculation of provisions

(i) Exposures subject to the IRB approach

147. Total eligible provisions are defined as the sum of all provisions (eg specific provisions, partial write-offs, portfolio-specific general provisions such as country risk provisions or general provisions) that are attributed to exposures treated under the IRB approach. In addition, total eligible provisions may include any discounts on defaulted assets. Specific provisions set aside against securitisation exposures must not be included in total eligible provisions.

(ii) Portion of exposures subject to the standardised approach for credit risk

148. Banks using the standardised approach for a portion of their credit risk exposures (see paragraphs 44 to 48), must determine the portion of general provisions attributed to the standardised or IRB treatment of provisions according to the methods outlined in paragraphs 149 and 150.

149. Banks should generally attribute total general provisions on a pro rata basis according to the proportion of credit risk-weighted assets subject to the standardised and IRB approaches. However, when one approach to determining credit risk-weighted assets (ie standardised or IRB approach) is used exclusively within an entity, general provisions booked within the entity using the standardised approach may be attributed to the standardised treatment. Similarly, general provisions booked within entities using the IRB approach may be attributed to the total eligible provisions as defined in paragraph 147.

150. At national supervisory discretion, banks using both the standardised and IRB approaches may rely on their internal methods for allocating general provisions for recognition in capital under either the standardised or IRB approach, subject to the following conditions. Where the internal allocation method

is made available, the national supervisor will establish the standards surrounding their use. Banks will need to obtain prior approval from their supervisors to use an internal allocation method for this purpose.

3. Treatment of EL and provisions

151. As specified in paragraphs 61 and 73 of the Basel III framework (June 2011), banks using the IRB approach must compare the total amount of total eligible provisions (as defined in paragraph 147) with the total EL amount as calculated within the IRB approach (as defined in paragraph 142). In addition, paragraph 60 of the Basel III framework (June 2011) outlines the treatment for that portion of a bank that is subject to the standardised approach for credit risk when the bank uses both the standardised and IRB approaches.

152. Where the calculated EL amount is lower than the total eligible provisions of the bank, its supervisors must consider whether the EL fully reflects the conditions in the market in which it operates before allowing the difference to be included in Tier 2 capital. If specific provisions exceed the EL amount on defaulted assets this assessment also needs to be made before using the difference to offset the EL amount on non-defaulted assets.

153. The treatment of EL and provisions related to securitisation exposures is outlined in paragraph 37 of the securitisation framework.

H. Minimum requirements for IRB approach

154. Section H presents the minimum requirements for entry and on-going use of the IRB approach. The minimum requirements are set out in 12 separate sections concerning: (a) composition of minimum requirements; (b) compliance with minimum requirements; (c) rating system design; (d) risk rating system operations; (e) corporate governance and oversight; (f) use of internal ratings; (g) risk quantification; (h) validation of internal estimates; (i) supervisory LGD and EAD estimates; (j) requirements for recognition of leasing; (k) calculation of capital charges for equity exposures; and (l) disclosure requirements. It may be helpful to note that the minimum requirements cut across asset classes. Therefore, more than one asset class may be discussed within the context of a given minimum requirement.

1. Composition of minimum requirements

155. To be eligible for the IRB approach a bank must demonstrate to its supervisor that it meets certain minimum requirements at the outset and on an ongoing basis. Many of these requirements are in the form of objectives that a qualifying bank's risk rating systems must fulfil. The focus is on banks' abilities to rank order and quantify risk in a consistent, reliable and valid fashion.

156. The overarching principle behind these requirements is that rating and risk estimation systems and processes provide for a meaningful assessment of borrower and transaction characteristics; a meaningful differentiation of risk; and reasonably accurate and consistent quantitative estimates of risk. Furthermore, the systems and processes must be consistent with internal use of these estimates. The Committee recognises that differences in markets, rating methodologies, banking products, and practices require banks and supervisors to customise their operational procedures. It is not the Committee's intention to dictate the form or operational detail of banks' risk management policies and practices. Each supervisor will develop detailed review procedures to ensure that banks' systems and controls are adequate to serve as the basis for the IRB approach.

157. The minimum requirements set out in this document apply to all asset classes unless noted otherwise. The standards related to the process of assigning exposures to borrower or facility *grades* (and

the related oversight, validation, etc) apply equally to the process of assigning retail exposures to pools of homogenous exposures, unless noted otherwise.

158. The minimum requirements set out in this document apply to both foundation and advanced approaches unless noted otherwise. Generally, all IRB banks must produce their own estimates of PD[22] and must adhere to the overall requirements for rating system design, operations, controls, and corporate governance, as well as the requisite requirements for estimation and validation of PD measures. Banks wishing to use their own estimates of LGD and EAD must also meet the incremental minimum requirements for these risk factors included in paragraphs 235 to 263.

2. Compliance with minimum requirements

159. To be eligible for an IRB approach, a bank must demonstrate to its supervisor that it meets the IRB requirements in this document, at the outset and on an ongoing basis. Banks' overall credit risk management practices must also be consistent with the evolving sound practice guidelines issued by the Committee and national supervisors.

160. There may be circumstances when a bank is not in complete compliance with all the minimum requirements. Where this is the case, the bank must produce a plan for a timely return to compliance, and seek approval from its supervisor, or the bank must demonstrate that the effect of such non-compliance is immaterial in terms of the risk posed to the institution. Failure to produce an acceptable plan or satisfactorily implement the plan or to demonstrate immateriality will lead supervisors to reconsider the bank's eligibility for the IRB approach. Furthermore, for the duration of any non-compliance, supervisors will consider the need for the bank to hold additional capital under Pillar 2 or take other appropriate supervisory action.

3. Rating system design

161. The term "rating system" comprises all of the methods, processes, controls, and data collection and IT systems that support the assessment of credit risk, the assignment of internal risk ratings, and the quantification of default and loss estimates.

162. Within each asset class, a bank may utilise multiple rating methodologies/systems. For example, a bank may have customised rating systems for specific industries or market segments (eg middle market, and large corporate). If a bank chooses to use multiple systems, the rationale for assigning a borrower to a rating system must be documented and applied in a manner that best reflects the level of risk of the borrower. Banks must not allocate borrowers across rating systems inappropriately to minimise regulatory capital requirements (ie cherry-picking by choice of rating system). Banks must demonstrate that each system used for IRB purposes is in compliance with the minimum requirements at the outset and on an ongoing basis.

(i) Rating dimensions

Standards for corporate and bank exposures

163. A qualifying IRB rating system must have two separate and distinct dimensions: (i) the risk of borrower default; and (ii) transaction-specific factors.

164. The first dimension must be oriented to the risk of borrower default. Separate exposures to the same borrower must be assigned to the same borrower grade, irrespective of any differences in the nature of each specific transaction. There are two exceptions to this. Firstly, in the case of country transfer risk,

[22] Banks are not required to produce their own estimates of PD for exposures subject to the supervisory slotting approach.

where a bank may assign different borrower grades depending on whether the facility is denominated in local or foreign currency. Secondly, when the treatment of associated guarantees to a facility may be reflected in an adjusted borrower grade. In either case, separate exposures may result in multiple grades for the same borrower. A bank must articulate in its credit policy the relationship between borrower grades in terms of the level of risk each grade implies. Perceived and measured risk must increase as credit quality declines from one grade to the next. The policy must articulate the risk of each grade in terms of both a description of the probability of default risk typical for borrowers assigned the grade and the criteria used to distinguish that level of credit risk.

165. The second dimension must reflect transaction-specific factors, such as collateral, seniority, product type, etc. For exposures subject to the foundation IRB approach, this requirement can be fulfilled by the existence of a facility dimension, which reflects both borrower and transaction-specific factors. For example, a rating dimension that reflects EL by incorporating both borrower strength (PD) and loss severity (LGD) considerations would qualify. Likewise a rating system that exclusively reflects LGD would qualify. Where a rating dimension reflects EL and does not separately quantify LGD, the supervisory estimates of LGD must be used.

166. For banks using the advanced approach, facility ratings must reflect exclusively LGD. These ratings can reflect any and all factors that can influence LGD including, but not limited to, the type of collateral, product, industry, and purpose. Borrower characteristics may be included as LGD rating criteria only to the extent they are predictive of LGD. Banks may alter the factors that influence facility grades across segments of the portfolio as long as they can satisfy their supervisor that it improves the relevance and precision of their estimates.

167. Banks using the supervisory slotting criteria are exempt from this two-dimensional requirement for these exposures. Given the interdependence between borrower/transaction characteristics in exposures subject to the supervisory slotting approaches, banks may satisfy the requirements under this heading through a single rating dimension that reflects EL by incorporating both borrower strength (PD) and loss severity (LGD) considerations. This exemption does not apply to banks using the general corporate foundation or advanced approach for the SL sub-class.

Standards for retail exposures

168. Rating systems for retail exposures must be oriented to both borrower and transaction risk, and must capture all relevant borrower and transaction characteristics. Banks must assign each exposure that falls within the definition of retail for IRB purposes into a particular pool. Banks must demonstrate that this process provides for a meaningful differentiation of risk, provides for a grouping of sufficiently homogenous exposures, and allows for accurate and consistent estimation of loss characteristics at pool level.

169. For each pool, banks must estimate PD, LGD, and EAD. Multiple pools may share identical PD, LGD and EAD estimates. At a minimum, banks should consider the following risk drivers when assigning exposures to a pool:

- Borrower risk characteristics (eg borrower type, demographics such as age/occupation);
- Transaction risk characteristics, including product and/or collateral types (eg loan to value measures, seasoning,[23] guarantees; and seniority (first vs. second lien)). Banks must explicitly address cross-collateral provisions where present.

[23] For each pool where the banks estimate PD and LGD, banks should analyse the representativeness of the age of the facilities (in terms of time since origination for PD and time since the date of default for LGD) in the data used to derive the estimates of the bank's actual facilities. In some jurisdictions default rates peak several years after origination or recovery rates show a low point several years after default, banks should adjust the estimates with an adequate margin of conservatism to account for the lack of representativeness as well as anticipated implications of rapid exposure growth.

- Delinquency of exposure: Banks are expected to separately identify exposures that are delinquent and those that are not.

(ii) Rating structure

Standards for corporate and bank exposures

170. A bank must have a meaningful distribution of exposures across grades with no excessive concentrations, on both its borrower-rating and its facility-rating scales.

171. To meet this objective, a bank must have a minimum of seven borrower grades for non-defaulted borrowers and one for those that have defaulted. Banks with lending activities focused on a particular market segment may satisfy this requirement with the minimum number of grades.

172. A borrower grade is defined as an assessment of borrower risk on the basis of a specified and distinct set of rating criteria, from which estimates of PD are derived. The grade definition must include both a description of the degree of default risk typical for borrowers assigned the grade and the criteria used to distinguish that level of credit risk. Furthermore, "+" or "-" modifiers to alpha or numeric grades will only qualify as distinct grades if the bank has developed complete rating descriptions and criteria for their assignment, and separately quantifies PDs for these modified grades.

173. Banks with loan portfolios concentrated in a particular market segment and range of default risk must have enough grades within that range to avoid undue concentrations of borrowers in particular grades. Significant concentrations within a single grade or grades must be supported by convincing empirical evidence that the grade or grades cover reasonably narrow PD bands and that the default risk posed by all borrowers in a grade fall within that band.

174. There is no specific minimum number of facility grades for banks using the advanced approach for estimating LGD. A bank must have a sufficient number of facility grades to avoid grouping facilities with widely varying LGDs into a single grade. The criteria used to define facility grades must be grounded in empirical evidence.

175. Banks using the supervisory slotting criteria must have at least four grades for non-defaulted borrowers, and one for defaulted borrowers. The requirements for SL exposures that qualify for the corporate foundation and advanced approaches are the same as those for general corporate exposures.

Standards for retail exposures

176. For each pool identified, the bank must be able to provide quantitative measures of loss characteristics (PD, LGD, and EAD) for that pool. The level of differentiation for IRB purposes must ensure that the number of exposures in a given pool is sufficient so as to allow for meaningful quantification and validation of the loss characteristics at the pool level. There must be a meaningful distribution of borrowers and exposures across pools. A single pool must not include an undue concentration of the bank's total retail exposure.

(iii) Rating criteria

177. A bank must have specific rating definitions, processes and criteria for assigning exposures to grades within a rating system. The rating definitions and criteria must be both plausible and intuitive and must result in a meaningful differentiation of risk.

- The grade descriptions and criteria must be sufficiently detailed to allow those charged with assigning ratings to consistently assign the same grade to borrowers or facilities posing similar risk. This consistency should exist across lines of business, departments and geographic locations. If rating criteria and procedures differ for different types of borrowers or facilities, the bank must monitor for possible inconsistency, and must alter rating criteria to improve consistency when appropriate.

- Written rating definitions must be clear and detailed enough to allow third parties to understand the assignment of ratings, such as internal audit or an equally independent function and supervisors, to replicate rating assignments and evaluate the appropriateness of the grade/pool assignments.
- The criteria must also be consistent with the bank's internal lending standards and its policies for handling troubled borrowers and facilities.

178. To ensure that banks are consistently taking into account available information, they must use all relevant and material information in assigning ratings to borrowers and facilities. Information must be current. The less information a bank has, the more conservative must be its assignments of exposures to borrower and facility grades or pools. An external rating can be the primary factor determining an internal rating assignment; however, the bank must ensure that it considers other relevant information.

Exposures subject to the supervisory slotting approach

179. Banks using the supervisory slotting criteria must assign exposures to their internal rating grades based on their own criteria, systems and processes, subject to compliance with the requisite minimum requirements. Banks must then map these internal rating grades into the five supervisory rating categories. Tables 1 to 4 in Annex 6 of the Basel II framework (June 2006) provide, for each sub-class of SL exposures, the general assessment factors and characteristics exhibited by the exposures that fall under each of the supervisory categories. Each lending activity has a unique table describing the assessment factors and characteristics.

180. The Committee recognises that the criteria that banks use to assign exposures to internal grades will not perfectly align with criteria that define the supervisory categories; however, banks must demonstrate that their mapping process has resulted in an alignment of grades which is consistent with the preponderance of the characteristics in the respective supervisory category. Banks should take special care to ensure that any overrides of their internal criteria do not render the mapping process ineffective.

(iv) Rating assignment horizon

181. Although the time horizon used in PD estimation is one year (as described in paragraph 215), banks are expected to use a longer time horizon in assigning ratings.

182. A borrower rating must represent the bank's assessment of the borrower's ability and willingness to contractually perform despite adverse economic conditions or the occurrence of unexpected events. The range of economic conditions that are considered when making assessments must be consistent with current conditions and those that are likely to occur over a business cycle within the respective industry/geographic region. Rating systems should be designed in such a way that idiosyncratic or industry-specific changes are a driver of migrations from one category to another, and business cycle effects may also be a driver.

183. PD estimates for borrowers that are highly leveraged or for borrowers whose assets are predominantly traded assets must reflect the performance of the underlying assets based on periods of stressed volatilities.

184. Given the difficulties in forecasting future events and the influence they will have on a particular borrower's financial condition, a bank must take a conservative view of projected information. Furthermore, where limited data are available, a bank must adopt a conservative bias to its analysis.

(v) Use of models

185. The requirements in this section apply to statistical models and other mechanical methods used to assign borrower or facility ratings or in estimation of PDs, LGDs, or EADs. Credit scoring models and other mechanical rating procedures generally use only a subset of available information. Although mechanical rating procedures may sometimes avoid some of the idiosyncratic errors made by rating systems in which human judgement plays a large role, mechanical use of limited information also is a source of rating errors. Credit scoring models and other mechanical procedures are permissible as the primary or partial basis of rating assignments, and may play a role in the estimation of loss characteristics. Sufficient human judgement and human oversight is necessary to ensure that all relevant and material information, including that which is outside the scope of the model, is also taken into consideration, and that the model is used appropriately.

- The burden is on the bank to satisfy its supervisor that a model or procedure has good predictive power and that regulatory capital requirements will not be distorted as a result of its use. The variables that are input to the model must form a reasonable set of predictors. The model must be accurate on average across the range of borrowers or facilities to which the bank is exposed and there must be no known material biases.
- The bank must have in place a process for vetting data inputs into a statistical default or loss prediction model which includes an assessment of the accuracy, completeness and appropriateness of the data specific to the assignment of an approved rating.
- The bank must demonstrate that the data used to build the model are representative of the population of the bank's actual borrowers or facilities.
- When combining model results with human judgement, the judgement must take into account all relevant and material information not considered by the model. The bank must have written guidance describing how human judgement and model results are to be combined.
- The bank must have procedures for human review of model-based rating assignments. Such procedures should focus on finding and limiting errors associated with known model weaknesses and must also include credible ongoing efforts to improve the model's performance.
- The bank must have a regular cycle of model validation that includes monitoring of model performance and stability; review of model relationships; and testing of model outputs against outcomes.

(vi) Documentation of rating system design

186. Banks must document in writing their rating systems' design and operational details. The documentation must evidence banks' compliance with the minimum standards, and must address topics such as portfolio differentiation, rating criteria, responsibilities of parties that rate borrowers and facilities, definition of what constitutes a rating exception, parties that have authority to approve exceptions, frequency of rating reviews, and management oversight of the rating process. A bank must document the rationale for its choice of internal rating criteria and must be able to provide analyses demonstrating that rating criteria and procedures are likely to result in ratings that meaningfully differentiate risk. Rating criteria and procedures must be periodically reviewed to determine whether they remain fully applicable to the current portfolio and to external conditions. In addition, a bank must document a history of major changes in the risk rating process, and such documentation must support identification of changes made to the risk rating process subsequent to the last supervisory review. The organisation of rating assignment, including the internal control structure, must also be documented.

187. Banks must document the specific definitions of default and loss used internally and demonstrate consistency with the reference definitions set out in paragraphs 220 to 228.

188. If the bank employs statistical models in the rating process, the bank must document their methodologies. This material must:

- Provide a detailed outline of the theory, assumptions and/or mathematical and empirical basis of the assignment of estimates to grades, individual obligors, exposures, or pools, and the data source(s) used to estimate the model;
- Establish a rigorous statistical process (including out-of-time and out-of-sample performance tests) for validating the model; and
- Indicate any circumstances under which the model does not work effectively.

189. Use of a model obtained from a third-party vendor that claims proprietary technology is not a justification for exemption from documentation or any other of the requirements for internal rating systems. The burden is on the model's vendor and the bank to satisfy supervisors.

4. Risk rating system operations

(i) Coverage of ratings

190. For corporate, and bank exposures, each borrower and all recognised guarantors must be assigned a rating and each exposure must be associated with a facility rating as part of the loan approval process. Similarly, for retail, each exposure must be assigned to a pool as part of the loan approval process.

191. Each separate legal entity to which the bank is exposed must be separately rated. A bank must have policies acceptable to its supervisor regarding the treatment of individual entities in a connected group including circumstances under which the same rating may or may not be assigned to some or all related entities. Those policies must include a process for the identification of specific wrong way risk for each legal entity to which the bank is exposed. Transactions with counterparties where specific wrong way risk has been identified need to be treated differently when calculating the EAD for such exposures (see paragraph 58 of the counterparty credit risk standards).

(ii) Integrity of rating process

Standards for corporate and bank exposures

192. Rating assignments and periodic rating reviews must be completed or approved by a party that does not directly stand to benefit from the extension of credit. Independence of the rating assignment process can be achieved through a range of practices that will be carefully reviewed by supervisors. These operational processes must be documented in the bank's procedures and incorporated into bank policies. Credit policies and underwriting procedures must reinforce and foster the independence of the rating process.

193. Borrowers and facilities must have their ratings refreshed at least on an annual basis. Certain credits, especially higher risk borrowers or problem exposures, must be subject to more frequent review. In addition, banks must initiate a new rating if material information on the borrower or facility comes to light.

194. The bank must have an effective process to obtain and update relevant and material information on the borrower's financial condition, and on facility characteristics that affect LGDs and EADs (such as the condition of collateral). Upon receipt, the bank needs to have a procedure to update the borrower's rating in a timely fashion.

Standards for retail exposures

195. A bank must review the loss characteristics and delinquency status of each identified risk pool on at least an annual basis. It must also review the status of individual borrowers within each pool as a means of ensuring that exposures continue to be assigned to the correct pool. This requirement may be satisfied by review of a representative sample of exposures in the pool.

(iii) Overrides

196. For rating assignments based on expert judgement, banks must clearly articulate the situations in which bank officers may override the outputs of the rating process, including how and to what extent such overrides can be used and by whom. For model-based ratings, the bank must have guidelines and processes for monitoring cases where human judgement has overridden the model's rating, variables were excluded or inputs were altered. These guidelines must include identifying personnel that are responsible for approving these overrides. Banks must identify overrides and separately track their performance.

(iv) Data maintenance

197. A bank must collect and store data on key borrower and facility characteristics to provide effective support to its internal credit risk measurement and management process, to enable the bank to meet the other requirements in this document, and to serve as a basis for supervisory reporting. These data should be sufficiently detailed to allow retrospective re-allocation of obligors and facilities to grades, for example if increasing sophistication of the internal rating system suggests that finer segregation of portfolios can be achieved. Furthermore, banks must collect and retain data on aspects of their internal ratings as required under Pillar 3 of this Framework.

For corporate and bank exposures

198. Banks must maintain rating histories on borrowers and recognised guarantors, including the rating since the borrower/guarantor was assigned an internal grade, the dates the ratings were assigned, the methodology and key data used to derive the rating and the person/model responsible. The identity of borrowers and facilities that default, and the timing and circumstances of such defaults, must be retained. Banks must also retain data on the PDs and realised default rates associated with rating grades and ratings migration in order to track the predictive power of the borrower rating system.

199. Banks using the advanced IRB approach must also collect and store a complete history of data on the LGD and EAD estimates associated with each facility and the key data used to derive the estimate and the person/model responsible. Banks must also collect data on the estimated and realised LGDs and EADs associated with each defaulted facility. Banks that reflect the credit risk mitigating effects of guarantees/credit derivatives through LGD must retain data on the LGD of the facility before and after evaluation of the effects of the guarantee/credit derivative. Information about the components of loss or recovery for each defaulted exposure must be retained, such as amounts recovered, source of recovery (eg collateral, liquidation proceeds and guarantees), time period required for recovery, and administrative costs.

200. Banks under the foundation approach which utilise supervisory estimates are encouraged to retain the relevant data (ie data on loss and recovery experience for corporate exposures under the foundation approach, data on realised losses for banks using the supervisory slotting criteria).

For retail exposures

201. Banks must retain data used in the process of allocating exposures to pools, including data on borrower and transaction risk characteristics used either directly or through use of a model, as well as data on delinquency. Banks must also retain data on the estimated PDs, LGDs and EADs, associated with pools

of exposures. For defaulted exposures, banks must retain the data on the pools to which the exposure was assigned over the year prior to default and the realised outcomes on LGD and EAD.

(v) Stress tests used in assessment of capital adequacy

202. An IRB bank must have in place sound stress testing processes for use in the assessment of capital adequacy. Stress testing must involve identifying possible events or future changes in economic conditions that could have unfavourable effects on a bank's credit exposures and assessment of the bank's ability to withstand such changes. Examples of scenarios that could be used are (i) economic or industry downturns; (ii) market-risk events; and (iii) liquidity conditions.

203. In addition to the more general tests described above, the bank must perform a credit risk stress test to assess the effect of certain specific conditions on its IRB regulatory capital requirements. The test to be employed would be one chosen by the bank, subject to supervisory review. The test to be employed must be meaningful and reasonably conservative. Individual banks may develop different approaches to undertaking this stress test requirement, depending on their circumstances. For this purpose, the objective is not to require banks to consider worst-case scenarios. The bank's stress test in this context should, however, consider at least the effect of mild recession scenarios. In this case, one example might be to use two consecutive quarters of zero growth to assess the effect on the bank's PDs, LGDs and EADs, taking account – on a conservative basis – of the bank's international diversification.

204. Whatever method is used, the bank must include a consideration of the following sources of information. First, a bank's own data should allow estimation of the ratings migration of at least some of its exposures. Second, banks should consider information about the impact of smaller deterioration in the credit environment on a bank's ratings, giving some information on the likely effect of bigger, stress circumstances. Third, banks should evaluate evidence of ratings migration in external ratings. This would include the bank broadly matching its buckets to rating categories.

205. National supervisors may wish to issue guidance to their banks on how the tests to be used for this purpose should be designed, bearing in mind conditions in their jurisdiction. The results of the stress test may indicate no difference in the capital calculated under the IRB rules described in this section of this Framework if the bank already uses such an approach for its internal rating purposes. Where a bank operates in several markets, it does not need to test for such conditions in all of those markets, but a bank should stress portfolios containing the vast majority of its total exposures.

5. Corporate governance and oversight

(i) Corporate governance

206. All material aspects of the rating and estimation processes must be approved by the bank's board of directors or a designated committee thereof and senior management.[24] These parties must possess a general understanding of the bank's risk rating system and detailed comprehension of its associated management reports. Senior management must provide notice to the board of directors or a designated committee thereof of material changes or exceptions from established policies that will materially impact the operations of the bank's rating system.

[24] This standard refers to a management structure composed of a board of directors and senior management. The Committee is aware that there are significant differences in legislative and regulatory frameworks across countries as regards the functions of the board of directors and senior management. In some countries, the board has the main, if not exclusive, function of supervising the executive body (senior management, general management) so as to ensure that the latter fulfils its tasks. For this reason, in some cases, it is known as a supervisory board. This means that the board has no executive functions. In other countries, by contrast, the board has a broader competence in that it lays down the general framework for the management of the bank. Owing to these differences, the notions of the board of directors and senior management are used in this paper not to identify legal constructs but rather to label two decision-making functions within a bank.

207. Senior management also must have a good understanding of the rating system's design and operation, and must approve material differences between established procedure and actual practice. Management must also ensure, on an ongoing basis, that the rating system is operating properly. Management and staff in the credit control function must meet regularly to discuss the performance of the rating process, areas needing improvement, and the status of efforts to improve previously identified deficiencies.

208. Internal ratings must be an essential part of the reporting to these parties. Reporting must include risk profile by grade, migration across grades, estimation of the relevant parameters per grade, and comparison of realised default rates (and LGDs and EADs for banks on advanced approaches) against expectations. Reporting frequencies may vary with the significance and type of information and the level of the recipient.

(ii) Credit risk control

209. Banks must have independent credit risk control units that are responsible for the design or selection, implementation and performance of their internal rating systems. The unit(s) must be functionally independent from the personnel and management functions responsible for originating exposures. Areas of responsibility must include:

- Testing and monitoring internal grades;
- Production and analysis of summary reports from the bank's rating system, to include historical default data sorted by rating at the time of default and one year prior to default, grade migration analyses, and monitoring of trends in key rating criteria;
- Implementing procedures to verify that rating definitions are consistently applied across departments and geographic areas;
- Reviewing and documenting any changes to the rating process, including the reasons for the changes; and
- Reviewing the rating criteria to evaluate if they remain predictive of risk. Changes to the rating process, criteria or individual rating parameters must be documented and retained for supervisors to review.

210. A credit risk control unit must actively participate in the development, selection, implementation and validation of rating models. It must assume oversight and supervision responsibilities for any models used in the rating process, and ultimate responsibility for the ongoing review and alterations to rating models.

(iii) Internal and external audit

211. Internal audit or an equally independent function must review at least annually the bank's rating system and its operations, including the operations of the credit function and the estimation of PDs, LGDs and EADs. Areas of review include adherence to all applicable minimum requirements. Internal audit must document its findings.

6. Use of internal ratings

212. Internal ratings and default and loss estimates must play an essential role in the credit approval, risk management, internal capital allocations, and corporate governance functions of banks using the IRB approach. Ratings systems and estimates designed and implemented exclusively for the purpose of qualifying for the IRB approach and used only to provide IRB inputs are not acceptable. It is recognised that banks will not necessarily be using exactly the same estimates for both IRB and all internal purposes.

For example, pricing models are likely to use PDs and LGDs relevant to the life of the asset. Where there are such differences, a bank must document them and demonstrate their reasonableness to the supervisor.

213. A bank must have a credible track record in the use of internal ratings information. Thus, the bank must demonstrate that it has been using a rating system that was broadly in line with the minimum requirements articulated in this document for at least the three years prior to qualification. A bank using the advanced IRB approach must demonstrate that it has been estimating and employing LGDs and EADs in a manner that is broadly consistent with the minimum requirements for use of own estimates of LGDs and EADs for at least the three years prior to qualification. Improvements to a bank's rating system will not render a bank non-compliant with the three-year requirement.

7. Risk quantification

(i) Overall requirements for estimation

Structure and intent

214. This section addresses the broad standards for own-estimates of PD, LGD, and EAD. Generally, all banks using the IRB approaches must estimate a PD[25] for each internal borrower grade for corporate and bank exposures or for each pool in the case of retail exposures.

215. PD estimates must be a long-run average of one-year default rates for borrowers in the grade, with the exception of retail exposures as set out in paragraph 233 and 234. Requirements specific to PD estimation are provided in paragraphs 229 to 234. Banks on the advanced approach must estimate an appropriate LGD (as defined in paragraphs 235 to 240) for each of its facilities (or retail pools). For exposures subject to the advanced approach, banks must also estimate an appropriate long-run default-weighted average EAD for each of its facilities as defined in paragraphs 241 and 242. Requirements specific to EAD estimation appear in paragraphs 241 to 251. For corporate and bank exposures, banks that do not meet the requirements for own-estimates of EAD or LGD, above, must use the supervisory estimates of these parameters. Standards for use of such estimates are set out in paragraphs 280 to 297.

216. Internal estimates of PD, LGD, and EAD must incorporate all relevant, material and available data, information and methods. A bank may utilise internal data and data from external sources (including pooled data). Where internal or external data is used, the bank must demonstrate that its estimates are representative of long run experience.

217. Estimates must be grounded in historical experience and empirical evidence, and not based purely on subjective or judgmental considerations. Any changes in lending practice or the process for pursuing recoveries over the observation period must be taken into account. A bank's estimates must promptly reflect the implications of technical advances and new data and other information, as it becomes available. Banks must review their estimates on a yearly basis or more frequently.

218. The population of exposures represented in the data used for estimation, and lending standards in use when the data were generated, and other relevant characteristics should be closely matched to or at least comparable with those of the bank's exposures and standards. The bank must also demonstrate that economic or market conditions that underlie the data are relevant to current and foreseeable conditions. For estimates of LGD and EAD, banks must take into account paragraphs 235 to 251. The number of exposures in the sample and the data period used for quantification must be sufficient to provide the bank with confidence in the accuracy and robustness of its estimates. The estimation technique must perform well in out-of-sample tests.

25 Banks are not required to produce their own estimates of PD for exposures subject to the supervisory slotting approach.

219. In general, estimates of PDs, LGDs, and EADs are likely to involve unpredictable errors. In order to avoid over-optimism, a bank must add to its estimates a margin of conservatism that is related to the likely range of errors. Where methods and data are less satisfactory and the likely range of errors is larger, the margin of conservatism must be larger. Supervisors may allow some flexibility in application of the required standards for data that are collected prior to the date of implementation of this Framework. However, in such cases banks must demonstrate to their supervisors that appropriate adjustments have been made to achieve broad equivalence to the data without such flexibility. Data collected beyond the date of implementation must conform to the minimum standards unless otherwise stated.

(ii) Definition of default

220. A default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place.

- The bank considers that the obligor is unlikely to pay its credit obligations to the banking group in full, without recourse by the bank to actions such as realising security (if held).
- The obligor is past due more than 90 days on any material credit obligation to the banking group.[26] Overdrafts will be considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than current outstandings.

221. The elements to be taken as indications of unlikeliness to pay include:

- The bank puts the credit obligation on non-accrued status.
- The bank makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure.
- The bank sells the credit obligation at a material credit-related economic loss.
- The bank consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or (where relevant) fees.
- The bank has filed for the obligor's bankruptcy or a similar order in respect of the obligor's credit obligation to the banking group.
- The obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of the credit obligation to the banking group.

222. National supervisors will provide appropriate guidance as to how these elements must be implemented and monitored.

223. For retail exposures, the definition of default can be applied at the level of a particular facility, rather than at the level of the obligor. As such, default by a borrower on one obligation does not require a bank to treat all other obligations to the banking group as defaulted.

224. A bank must record actual defaults on IRB exposure classes using this reference definition. A bank must also use the reference definition for its estimation of PDs, and (where relevant) LGDs and EADs. In arriving at these estimations, a bank may use external data available to it that is not itself consistent with that definition, subject to the requirements set out in paragraph 230. However, in such cases, banks must demonstrate to their supervisors that appropriate adjustments to the data have been made to achieve broad equivalence with the reference definition. This same condition would apply to any internal data used up to implementation of this Framework. Internal data (including that pooled by banks) used in such

[26] In the case of retail and PSE obligations, for the 90 days figure, a supervisor may substitute a figure up to 180 days for different products, as it considers appropriate to local conditions.

estimates beyond the date of implementation of this Framework must be consistent with the reference definition.

225. If the bank considers that a previously defaulted exposure's status is such that no trigger of the reference definition any longer applies, the bank must rate the borrower and estimate LGD as they would for a non-defaulted facility. Should the reference definition subsequently be triggered, a second default would be deemed to have occurred.

(iii) Re-ageing

226. The bank must have clearly articulated and documented policies in respect of the counting of days past due, in particular in respect of the re-ageing of the facilities and the granting of extensions, deferrals, renewals and rewrites to existing accounts. At a minimum, the re-ageing policy must include: (a) approval authorities and reporting requirements; (b) minimum age of a facility before it is eligible for re-ageing; (c) delinquency levels of facilities that are eligible for re-ageing; (d) maximum number of re-ageings per facility; and (e) a reassessment of the borrower's capacity to repay. These policies must be applied consistently over time, and must support the 'use test' (ie if a bank treats a re-aged exposure in a similar fashion to other delinquent exposures more than the past-due cut off point, this exposure must be recorded as in default for IRB purposes).

(iv) Treatment of overdrafts

227. Authorised overdrafts must be subject to a credit limit set by the bank and brought to the knowledge of the client. Any break of this limit must be monitored; if the account were not brought under the limit after 90 to 180 days (subject to the applicable past-due trigger), it would be considered as defaulted. Non-authorised overdrafts will be associated with a zero limit for IRB purposes. Thus, days past due commence once any credit is granted to an unauthorised customer; if such credit were not repaid within 90 to 180 days, the exposure would be considered in default. Banks must have in place rigorous internal policies for assessing the creditworthiness of customers who are offered overdraft accounts.

(v) Definition of loss for all asset classes

228. The definition of loss used in estimating LGD is economic loss. When measuring economic loss, all relevant factors should be taken into account. This must include material discount effects and material direct and indirect costs associated with collecting on the exposure. Banks must not simply measure the loss recorded in accounting records, although they must be able to compare accounting and economic losses. The bank's own workout and collection expertise significantly influences their recovery rates and must be reflected in their LGD estimates, but adjustments to estimates for such expertise must be conservative until the bank has sufficient internal empirical evidence of the impact of its expertise.

(vi) Requirements specific to PD estimation

Corporate and bank exposures

229. Banks must use information and techniques that take appropriate account of the long-run experience when estimating the average PD for each rating grade. For example, banks may use one or more of the three specific techniques set out below: internal default experience, mapping to external data, and statistical default models.

230. Banks may have a primary technique and use others as a point of comparison and potential adjustment. Supervisors will not be satisfied by mechanical application of a technique without supporting analysis. Banks must recognise the importance of judgmental considerations in combining results of techniques and in making adjustments for limitations of techniques and information.

- A bank may use data on internal default experience for the estimation of PD. A bank must demonstrate in its analysis that the estimates are reflective of underwriting standards and of any differences in the rating system that generated the data and the current rating system. Where only limited data are available, or where underwriting standards or rating systems have changed, the bank must add a greater margin of conservatism in its estimate of PD. The use of pooled data across institutions may also be recognised. A bank must demonstrate that the internal rating systems and criteria of other banks in the pool are comparable with its own.
- Banks may associate or map their internal grades to the scale used by an external credit assessment institution or similar institution and then attribute the default rate observed for the external institution's grades to the bank's grades. Mappings must be based on a comparison of internal rating criteria to the criteria used by the external institution and on a comparison of the internal and external ratings of any common borrowers. Biases or inconsistencies in the mapping approach or underlying data must be avoided. The external institution's criteria underlying the data used for quantification must be oriented to the risk of the borrower and not reflect transaction characteristics. The bank's analysis must include a comparison of the default definitions used, subject to the requirements in paragraph 220 to 225. The bank must document the basis for the mapping.
- A bank is allowed to use a simple average of default-probability estimates for individual borrowers in a given grade, where such estimates are drawn from statistical default prediction models. The bank's use of default probability models for this purpose must meet the standards specified in paragraph 185.

For all methods above, banks must estimate a PD for each rating grade based on the observed historical average one-year default rate that is a simple average based on number of obligors (count weighted). Weighting approaches, such as EAD weighting, are not permitted.

231. Irrespective of whether a bank is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used must be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data are relevant and material, this longer period must be used. The data should include a representative mix of good and bad years.

Retail exposures

232. Given the bank-specific basis of assigning exposures to pools, banks must regard internal data as the primary source of information for estimating loss characteristics. Banks are permitted to use external data or statistical models for quantification provided a strong link can be demonstrated between: (a) the bank's process of assigning exposures to a pool and the process used by the external data source; and (b) between the bank's internal risk profile and the composition of the external data. In all cases banks must use all relevant and material data sources as points of comparison.

233. One method for deriving long-run average estimates of PD and default-weighted average loss rates given default (as defined in paragraph 235) for retail would be based on an estimate of the expected long-run loss rate. A bank may (i) use an appropriate PD estimate to infer the long-run default-weighted average loss rate given default, or (ii) use a long-run default-weighted average loss rate given default to infer the appropriate PD. In either case, it is important to recognise that the LGD used for the IRB capital calculation cannot be less than the long-run default-weighted average loss rate given default and must be consistent with the concepts defined in paragraph 235.

234. Irrespective of whether banks are using external, internal, pooled data sources, or a combination of the three, for their estimation of loss characteristics, the length of the underlying historical observation period used must be at least five years. If the available observation spans a longer period for any source, and these data are relevant, this longer period must be used. The data should include a representative mix

of good and bad years of the economic cycle relevant for the portfolio. The PD should be based on the observed historical average one-year default rate.

(vii) Requirements specific to own-LGD estimates

Standards for all asset classes

235. A bank must estimate an LGD for each facility that aims to reflect economic downturn conditions where necessary to capture the relevant risks. This LGD cannot be less than the long-run default-weighted average loss rate given default calculated based on the average economic loss of all observed defaults within the data source for that type of facility. In addition, a bank must take into account the potential for the LGD of the facility to be higher than the default-weighted average during a period when credit losses are substantially higher than average. For certain types of exposures, loss severities may not exhibit such cyclical variability and LGD estimates may not differ materially from the long-run default-weighted average. However, for other exposures, this cyclical variability in loss severities may be important and banks will need to incorporate it into their LGD estimates. For this purpose, banks may make reference to the averages of loss severities observed during periods of high credit losses, forecasts based on appropriately conservative assumptions, or other similar methods. Appropriate estimates of LGD during periods of high credit losses might be formed using either internal and/or external data. Supervisors will continue to monitor and encourage the development of appropriate approaches to this issue.

236. In its analysis, the bank must consider the extent of any dependence between the risk of the borrower and that of the collateral or collateral provider. Cases where there is a significant degree of dependence must be addressed in a conservative manner. Any currency mismatch between the underlying obligation and the collateral must also be considered and treated conservatively in the bank's assessment of LGD.

237. LGD estimates must be grounded in historical recovery rates and, when applicable, must not solely be based on the collateral's estimated market value. This requirement recognises the potential inability of banks to gain both control of their collateral and liquidate it expeditiously. To the extent that LGD estimates take into account the existence of collateral, banks must establish internal requirements for collateral management, operational procedures, legal certainty and risk management process that are generally consistent with those required for the foundation IRB approach.

238. Recognising the principle that realised losses can at times systematically exceed expected levels, the LGD assigned to a defaulted asset should reflect the possibility that the bank would have to recognise additional, unexpected losses during the recovery period. For each defaulted asset, the bank must also construct its best estimate of the expected loss on that asset based on current economic circumstances and facility status. The amount, if any, by which the LGD on a defaulted asset exceeds the bank's best estimate of expected loss on the asset represents the capital requirement for that asset, and should be set by the bank on a risk-sensitive basis in accordance with paragraphs 53 and 118 to 120. Instances where the best estimate of expected loss on a defaulted asset is less than the sum of specific provisions and partial charge-offs on that asset will attract supervisory scrutiny and must be justified by the bank.

Additional standards for corporate exposures

239. Estimates of LGD must be based on a minimum data observation period that should ideally cover at least one complete economic cycle but must in any case be no shorter than a period of seven years for at least one source. If the available observation period spans a longer period for any source, and the data are relevant, this longer period must be used.

Additional standards for retail exposures

240. The minimum data observation period for LGD estimates for retail exposures is five years. The less data a bank has, the more conservative it must be in its estimation.

(viii) Requirements specific to own-EAD estimates

Standards for all asset classes

241. EAD for an on-balance sheet or off-balance sheet item is defined as the expected gross exposure of the facility upon default of the obligor. For on-balance sheet items, banks must estimate EAD at no less than the current drawn amount, subject to recognising the effects of on-balance sheet netting as specified in the foundation approach. The minimum requirements for the recognition of netting are the same as those under the foundation approach. The additional minimum requirements for internal estimation of EAD under the advanced approach, therefore, focus on the estimation of EAD for off-balance sheet items (excluding transactions that expose banks to counterparty credit risk as set out in the counterparty credit risk standards). Banks using the advanced approach must have established procedures in place for the estimation of EAD for off-balance sheet items. These must specify the estimates of EAD to be used for each facility type. Banks' estimates of EAD should reflect the possibility of additional drawings by the borrower up to and after the time a default event is triggered. Where estimates of EAD differ by facility type, the delineation of these facilities must be clear and unambiguous.

242. Under the advanced approach, banks must assign an estimate of EAD for each eligible facility. It must be an estimate of the long-run default-weighted average EAD for similar facilities and borrowers over a sufficiently long period of time, but with a margin of conservatism appropriate to the likely range of errors in the estimate. If a positive correlation can reasonably be expected between the default frequency and the magnitude of EAD, the EAD estimate must incorporate a larger margin of conservatism. Moreover, for exposures for which EAD estimates are volatile over the economic cycle, the bank must use EAD estimates that are appropriate for an economic downturn, if these are more conservative than the long-run average. For banks that have been able to develop their own EAD models, this could be achieved by considering the cyclical nature, if any, of the drivers of such models. Other banks may have sufficient internal data to examine the impact of previous recession(s). However, some banks may only have the option of making conservative use of external data. Moreover, where a bank bases its estimates on alternative measures of central tendency (such as the median or a higher percentile estimate) or only on 'downturn' data, it should explicitly confirm that the basic downturn requirement of the framework is met, ie the bank's estimates do not fall below a (conservative) estimate of the long-run default-weighted average EAD for similar facilities.

243. The criteria by which estimates of EAD are derived must be plausible and intuitive, and represent what the bank believes to be the material drivers of EAD. The choices must be supported by credible internal analysis by the bank. The bank must be able to provide a breakdown of its EAD experience by the factors it sees as the drivers of EAD. A bank must use all relevant and material information in its derivation of EAD estimates. Across facility types, a bank must review its estimates of EAD when material new information comes to light and at least on an annual basis.

244. Due consideration must be paid by the bank to its specific policies and strategies adopted in respect of account monitoring and payment processing. The bank must also consider its ability and willingness to prevent further drawings in circumstances short of payment default, such as covenant violations or other technical default events. Banks must also have adequate systems and procedures in place to monitor facility amounts, current outstandings against committed lines and changes in outstandings per borrower and per grade. The bank must be able to monitor outstanding balances on a daily basis.

245. Banks' EAD estimates must be developed using a 12-month fixed-horizon approach; ie for each observation in the reference data set, default outcomes must be linked to relevant obligor and facility characteristics twelve months prior to default.

246. As set out in paragraph 218, banks' EAD estimates should be based on reference data that reflect the obligor, facility and bank management practice characteristics of the exposures to which the estimates

are applied. Consistent with this principle, EAD estimates applied to particular exposures should not be based on data that comingle the effects of disparate characteristics or data from exposures that exhibit different characteristics (eg same broad product grouping but different customers that are managed differently by the bank). The estimates should be based on appropriately homogenous segments. Alternatively, the estimates should be based on an estimation approach that effectively disentangles the impact of the different characteristics exhibited within the relevant dataset. Practices that generally do not comply with this principle include use of estimates based or partly based on:

- SME/midmarket data being applied to large corporate obligors.
- Data from commitments with 'small' unused limit availability being applied to facilities with 'large' unused limit availability.
- Data from obligors already identified as problematic at reference date being applied to current obligors with no known issues (eg customers at reference date who were already delinquent, watchlisted by the bank, subject to recent bank-initiated limit reductions, blocked from further drawdowns or subject to other types of collections activity).
- Data that has been affected by changes in obligors' mix of borrowing and other credit-related products over the observation period unless that data has been effectively mitigated for such changes, eg by adjusting the data to remove the effects of the changes in the product mix. Supervisors should expect banks to demonstrate a detailed understanding of the impact of changes in customer product mix on EAD reference data sets (and associated EAD estimates) and that the impact is immaterial or has been effectively mitigated within each bank's estimation process. Banks' analyses in this regard should be actively challenged by supervisors. Effective mitigation would not include: setting floors to CCF/EAD observations; use of obligor-level estimates that do not fully cover the relevant product transformation options or inappropriately combine products with very different characteristics (eg revolving and non-revolving products); adjusting only 'material' observations affected by product transformation; generally excluding observations affected by product profile transformation (thereby potentially distorting the representativeness of the remaining data).

247. A well-known feature of the commonly used undrawn limit factor (ULF) approach[27] to estimating CCFs is the region of instability associated with facilities close to being fully drawn at reference date. Banks should ensure that their EAD estimates are effectively quarantined from the potential effects of this region of instability.

- An acceptable approach could include using an estimation method other than the ULF approach that avoids the instability issue by not using potentially small undrawn limits that could approach zero in the denominator or, as appropriate, switching to a method other than the ULF as the region of instability is approached, eg a limit factor, balance factor or additional utilisation factor approach.[28] Note that, consistent with paragraph 246, including limit utilisation as a driver in EAD models could quarantine much of the relevant portfolio from this issue but, in the absence of

[27] A specific type of CCF, where predicted additional drawings in the lead-up to default are expressed as a percentage of the undrawn limit that remains available to the obligor under the terms and conditions of a facility, ie EAD=B0=Bt+ULF[Lt –Bt], where B0 = facility balance at date of default; Bt = current balance (for predicted EAD) or balance at reference date (for observed EAD); Lt = current limit (for predicted EAD) or limit at reference date (for realised/observed EAD).

[28] A limit factor (LF) is a specific type of CCF, where the predicted balance at default is expressed as a percentage of the total limit that is available to the obligor under the terms and conditions of a credit facility, ie EAD=B0= LF[Lt], where B0 = facility balance at date of default; Bt = current balance (for predicted EAD) or balance at reference date (for observed EAD); Lt = current limit (for predicted EAD) or limit at reference date (for realised/observed EAD). A balance factor (BF) is a specific type of CCF, where the predicted balance at default is expressed as a percentage of the current balance that has been drawn down under a credit facility, ie EAD=B0=BF[Bt]. An additional utilisation factor (AUF) is a specific type of CCF, where predicted additional drawings in the lead-up to default are expressed as a percentage of the total limit that is available to the obligor under the terms and conditions of a credit facility, ie EAD = B0 = Bt + AUF[Lt].

other actions, leaves open how to develop appropriate EAD estimates to be applied to exposures within the region of instability.

- Common but ineffective approaches to mitigating this issue include capping and flooring reference data (eg observed CCFs at 100 per cent and zero respectively) or omitting observations that are judged to be affected.

248. EAD reference data must not be capped to the principal amount outstanding or facility limits. Accrued interest, other due payments and limit excesses should be included in EAD reference data.

249. For transactions that expose banks to counterparty credit risk, estimates of EAD must fulfil the requirements set forth in the counterparty credit risk standards.

Additional standards for corporate exposures

250. Estimates of EAD must be based on a time period that must ideally cover a complete economic cycle but must in any case be no shorter than a period of seven years. If the available observation period spans a longer period for any source, and the data are relevant, this longer period must be used. EAD estimates must be calculated using a default-weighted average and not a time-weighted average.

Additional standards for retail exposures

251. The minimum data observation period for EAD estimates for retail exposures is five years. The less data a bank has, the more conservative it must be in its estimation. A bank need not give equal importance to historic data if it can demonstrate to its supervisor that more recent data are a better predictor of drawdowns.

(ix) Minimum requirements for assessing effect of guarantees and credit derivatives

Standards for corporate exposures where own estimates of LGD are used and standards for retail exposures

Guarantees

252. When a bank uses its own estimates of LGD, it may reflect the risk-mitigating effect of guarantees through an adjustment to PD or LGD estimates. The option to adjust LGDs is available only to those banks that have been approved to use their own internal estimates of LGD. For retail exposures, where guarantees exist, either in support of an individual obligation or a pool of exposures, a bank may reflect the risk-reducing effect either through its estimates of PD or LGD, provided this is done consistently. In adopting one or the other technique, a bank must adopt a consistent approach, both across types of guarantees and over time.

253. In all cases, both the borrower and all recognised guarantors must be assigned a borrower rating at the outset and on an ongoing basis. A bank must follow all minimum requirements for assigning borrower ratings set out in this document, including the regular monitoring of the guarantor's condition and ability and willingness to honour its obligations. Consistent with the requirements in paragraphs 198 and 199, a bank must retain all relevant information on the borrower absent the guarantee and the guarantor. In the case of retail guarantees, these requirements also apply to the assignment of an exposure to a pool, and the estimation of PD.

254. In no case can the bank assign the guaranteed exposure an adjusted PD or LGD such that the adjusted risk weight would be lower than that of a comparable, direct exposure to the guarantor. Neither criteria nor rating processes are permitted to consider possible favourable effects of imperfect expected correlation between default events for the borrower and guarantor for purposes of regulatory minimum capital requirements. As such, the adjusted risk weight must not reflect the risk mitigation of "double default."

255. In case the bank applies the standardised approach to direct exposures to the guarantor, the guarantee may only be recognised by treating the covered portion of the exposure as a direct exposure to the guarantor under the standardised approach. Similarly, in case the bank applies the F-IRB approach to direct exposures to the guarantor, the guarantee may only be recognised by applying the F-IRB approach to the covered portion of the exposure. Alternatively, banks may choose to not recognise the effect of guarantees on their exposures.

Eligible guarantors and guarantees

256. There are no restrictions on the types of eligible guarantors. The bank must, however, have clearly specified criteria for the types of guarantors it will recognise for regulatory capital purposes.

257. The guarantee must be evidenced in writing, non-cancellable on the part of the guarantor, in force until the debt is satisfied in full (to the extent of the amount and tenor of the guarantee) and legally enforceable against the guarantor in a jurisdiction where the guarantor has assets to attach and enforce a judgement. The guarantee must also be unconditional; there should be no clause in the protection contract outside the direct control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due. However, as an exception for the purposes of own estimates of EAD under the A-IRB, guarantees that only cover loss remaining after the bank has first pursued the original obligor for payment and has completed the workout process may be recognised.

258. In case of guarantees where the bank applies the standardised approach to the covered portion of the exposure, the scope of guarantors and the minimum requirements as under the standardised approach apply.

Adjustment criteria

259. A bank must have clearly specified criteria for adjusting borrower grades or LGD estimates (or in the case of retail and eligible purchased receivables, the process of allocating exposures to pools) to reflect the impact of guarantees for regulatory capital purposes. These criteria must be as detailed as the criteria for assigning exposures to grades consistent with paragraphs 177 and 178, and must follow all minimum requirements for assigning borrower or facility ratings set out in this document.

260. The criteria must be plausible and intuitive, and must address the guarantor's ability and willingness to perform under the guarantee. The criteria must also address the likely timing of any payments and the degree to which the guarantor's ability to perform under the guarantee is correlated with the borrower's ability to repay. The bank's criteria must also consider the extent to which residual risk to the borrower remains, for example a currency mismatch between the guarantee and the underlying exposure.

261. In adjusting borrower grades or LGD estimates (or in the case of retail and eligible purchased receivables, the process of allocating exposures to pools), banks must take all relevant available information into account.

Credit derivatives

262. The minimum requirements for guarantees are relevant also for single-name credit derivatives. Additional considerations arise in respect of asset mismatches. The criteria used for assigning adjusted borrower grades or LGD estimates (or pools) for exposures hedged with credit derivatives must require that the asset on which the protection is based (the reference asset) cannot be different from the underlying asset, unless the conditions outlined in the foundation approach are met.

263. In addition, the criteria must address the payout structure of the credit derivative and conservatively assess the impact this has on the level and timing of recoveries. The bank must also consider the extent to which other forms of residual risk remain.

For banks using foundation LGD estimates

264. The minimum requirements outlined in paragraphs 252 to 263 apply to banks using the foundation LGD estimates with the following exceptions:

(i) The bank is not able to use an 'LGD-adjustment' option; and

(ii) The range of eligible guarantees and guarantors is limited to those outlined in paragraph 92.

(x) Requirements specific to estimating PD and LGD (or EL) for qualifying purchased receivables

265. The following minimum requirements for risk quantification must be satisfied for any purchased receivables (corporate or retail) making use of the top-down treatment of default risk and/or the IRB treatments of dilution risk.

266. The purchasing bank will be required to group the receivables into sufficiently homogeneous pools so that accurate and consistent estimates of PD and LGD (or EL) for default losses and EL estimates of dilution losses can be determined. In general, the risk bucketing process will reflect the seller's underwriting practices and the heterogeneity of its customers. In addition, methods and data for estimating PD, LGD, and EL must comply with the existing risk quantification standards for retail exposures. In particular, quantification should reflect all information available to the purchasing bank regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing bank, or by external sources. The purchasing bank must determine whether the data provided by the seller are consistent with expectations agreed upon by both parties concerning, for example, the type, volume and on-going quality of receivables purchased. Where this is not the case, the purchasing bank is expected to obtain and rely upon more relevant data.

Minimum operational requirements

267. A bank purchasing receivables has to justify confidence that current and future advances can be repaid from the liquidation of (or collections against) the receivables pool. To qualify for the top-down treatment of default risk, the receivable pool and overall lending relationship should be closely monitored and controlled. Specifically, a bank will have to demonstrate the following:

Legal certainty

268. The structure of the facility must ensure that under all foreseeable circumstances the bank has effective ownership and control of the cash remittances from the receivables, including incidences of seller or servicer distress and bankruptcy. When the obligor makes payments directly to a seller or servicer, the bank must verify regularly that payments are forwarded completely and within the contractually agreed terms. As well, ownership over the receivables and cash receipts should be protected against bankruptcy 'stays' or legal challenges that could materially delay the lender's ability to liquidate/assign the receivables or retain control over cash receipts.

Effectiveness of monitoring systems

269. The bank must be able to monitor both the quality of the receivables and the financial condition of the seller and servicer. In particular:

- The bank must (a) assess the correlation among the quality of the receivables and the financial condition of both the seller and servicer, and (b) have in place internal policies and procedures that provide adequate safeguards to protect against such contingencies, including the assignment of an internal risk rating for each seller and servicer.
- The bank must have clear and effective policies and procedures for determining seller and servicer eligibility. The bank or its agent must conduct periodic reviews of sellers and servicers in

order to verify the accuracy of reports from the seller/servicer, detect fraud or operational weaknesses, and verify the quality of the seller's credit policies and servicer's collection policies and procedures. The findings of these reviews must be well documented.

- The bank must have the ability to assess the characteristics of the receivables pool, including: (a) over-advances; (b) history of the seller's arrears, bad debts, and bad debt allowances; (c) payment terms; and (d) potential contra accounts.
- The bank must have effective policies and procedures for monitoring on an aggregate basis single-obligor concentrations both within and across receivables pools.
- The bank must receive timely and sufficiently detailed reports of receivables ageings and dilutions to (a) ensure compliance with the bank's eligibility criteria and advancing policies governing purchased receivables, and (b) provide an effective means with which to monitor and confirm the seller's terms of sale (eg invoice date ageing) and dilution.

Effectiveness of work-out systems

270. An effective programme requires systems and procedures not only for detecting deterioration in the seller's financial condition and deterioration in the quality of the receivables at an early stage, but also for addressing emerging problems pro-actively. In particular,

- The bank should have clear and effective policies, procedures, and information systems to monitor compliance with (a) all contractual terms of the facility (including covenants, advancing formulas, concentration limits, early amortisation triggers, etc) as well as (b) the bank's internal policies governing advance rates and receivables eligibility. The bank's systems should track covenant violations and waivers as well as exceptions to established policies and procedures.
- To limit inappropriate draws, the bank should have effective policies and procedures for detecting, approving, monitoring, and correcting over-advances.
- The bank should have effective policies and procedures for dealing with financially weakened sellers or servicers and/or deterioration in the quality of receivable pools. These include, but are not necessarily limited to, early termination triggers in revolving facilities and other covenant protections, a structured and disciplined approach to dealing with covenant violations, and clear and effective policies and procedures for initiating legal actions and dealing with problem receivables.

Effectiveness of systems for controlling collateral, credit availability, and cash

271. The bank must have clear and effective policies and procedures governing the control of receivables, credit, and cash. In particular,

- Written internal policies must specify all material elements of the receivables purchase programme, including the advancing rates, eligible collateral, necessary documentation, concentration limits, and how cash receipts are to be handled. These elements should take appropriate account of all relevant and material factors, including the seller's/servicer's financial condition, risk concentrations, and trends in the quality of the receivables and the seller's customer base.
- Internal systems must ensure that funds are advanced only against specified supporting collateral and documentation (such as servicer attestations, invoices, shipping documents, etc).

Compliance with the bank's internal policies and procedures

272. Given the reliance on monitoring and control systems to limit credit risk, the bank should have an effective internal process for assessing compliance with all critical policies and procedures, including

- regular internal and/or external audits of all critical phases of the bank's receivables purchase programme.
- verification of the separation of duties (i) between the assessment of the seller/servicer and the assessment of the obligor and (ii) between the assessment of the seller/servicer and the field audit of the seller/servicer.

273. A bank's effective internal process for assessing compliance with all critical policies and procedures should also include evaluations of back office operations, with particular focus on qualifications, experience, staffing levels, and supporting systems.

8. Validation of internal estimates

274. Banks must have a robust system in place to validate the accuracy and consistency of rating systems, processes, and the estimation of all relevant risk components. A bank must demonstrate to its supervisor that the internal validation process enables it to assess the performance of internal rating and risk estimation systems consistently and meaningfully.

275. Banks must regularly compare realised default rates with estimated PDs for each grade and be able to demonstrate that the realised default rates are within the expected range for that grade. Banks using the advanced IRB approach must complete such analysis for their estimates of LGDs and EADs. Such comparisons must make use of historical data that are over as long a period as possible. The methods and data used in such comparisons by the bank must be clearly documented by the bank. This analysis and documentation must be updated at least annually.

276. Banks must also use other quantitative validation tools and comparisons with relevant external data sources. The analysis must be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. Banks' internal assessments of the performance of their own rating systems must be based on long data histories, covering a range of economic conditions, and ideally one or more complete business cycles.

277. Banks must demonstrate that quantitative testing methods and other validation methods do not vary systematically with the economic cycle. Changes in methods and data (both data sources and periods covered) must be clearly and thoroughly documented.

278. Banks must have well-articulated internal standards for situations where deviations in realised PDs, LGDs and EADs from expectations become significant enough to call the validity of the estimates into question. These standards must take account of business cycles and similar systematic variability in default experiences. Where realised values continue to be higher than expected values, banks must revise estimates upward to reflect their default and loss experience.

279. Where banks rely on supervisory, rather than internal, estimates of risk parameters, they are encouraged to compare realised LGDs and EADs to those set by the supervisors. The information on realised LGDs and EADs should form part of the bank's assessment of economic capital.

9. Supervisory LGD and EAD estimates

280. Banks under the foundation IRB approach, which do not meet the requirements for own-estimates of LGD and EAD, above, must meet the minimum requirements described in the standardised approach to receive recognition for eligible financial collateral (as set out in the credit risk mitigation section (Section D) of the standardised approach). They must meet the following additional minimum requirements in order to receive recognition for additional collateral types.

(i) Definition of eligibility of CRE and RRE as collateral

281. Eligible CRE and RRE collateral for corporate and bank exposures are defined as:

- Collateral where the risk of the borrower is not materially dependent upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility is not materially dependent on any cash flow generated by the underlying CRE/RRE serving as collateral;[29] and
- Additionally, the value of the collateral pledged must not be materially dependent on the performance of the borrower. This requirement is not intended to preclude situations where purely macro-economic factors affect both the value of the collateral and the performance of the borrower.

282. In light of the generic description above and the definition of corporate exposures, income producing real estate that falls under the SL asset class is specifically excluded from recognition as collateral for corporate exposures.[30]

(ii) Operational requirements for eligible CRE/RRE

283. Subject to meeting the definition above, CRE and RRE will be eligible for recognition as collateral for corporate claims only if all of the following operational requirements are met.

- *Legal enforceability*: any claim on collateral taken must be legally enforceable in all relevant jurisdictions, and any claim on collateral must be properly filed on a timely basis. Collateral interests must reflect a perfected lien (ie all legal requirements for establishing the claim have been fulfilled). Furthermore, the collateral agreement and the legal process underpinning it must be such that they provide for the bank to realise the value of the collateral within a reasonable timeframe.
- *Objective market value of collateral*: the collateral must be valued at or less than the current fair value under which the property could be sold under private contract between a willing seller and an arm's-length buyer on the date of valuation.

[29] The Committee recognises that in some countries where multifamily housing makes up an important part of the housing market and where public policy is supportive of that sector, including specially established public sector companies as major providers, the risk characteristics of lending secured by mortgage on such residential real estate can be similar to those of traditional corporate exposures. The national supervisor may under such circumstances recognise mortgage on multifamily residential real estate as eligible collateral for corporate exposures.

[30] In exceptional circumstances for well-developed and long-established markets, mortgages on office and/or multi-purpose commercial premises and/or multi-tenanted commercial premises may have the potential to receive recognition as collateral in the corporate portfolio. This exceptional treatment will be subject to very strict conditions. In particular, two tests must be fulfilled, namely that (i) losses stemming from commercial real estate lending up to the lower of 50% of the market value or 60% of loan-to value (LTV) based on mortgage-lending-value (MLV) must not exceed 0.3% of the outstanding loans in any given year; and that (ii) overall losses stemming from commercial real estate lending must not exceed 0.5% of the outstanding loans in any given year. This is, if either of these tests is not satisfied in a given year, the eligibility to use this treatment will cease and the original eligibility criteria would need to be satisfied again before it could be applied in the future. Countries applying such a treatment must publicly disclose that these are met.

- *Frequent revaluation*: the bank is expected to monitor the value of the collateral on a frequent basis and at a minimum once every year. More frequent monitoring is suggested where the market is subject to significant changes in conditions. Statistical methods of evaluation (eg reference to house price indices, sampling) may be used to update estimates or to identify collateral that may have declined in value and that may need re-appraisal. A qualified professional must evaluate the property when information indicates that the value of the collateral may have declined materially relative to general market prices or when a credit event, such as default, occurs.
- *Junior liens*: In some member countries, eligible collateral will be restricted to situations where the lender has a first charge over the property.[31] Junior liens may be taken into account where there is no doubt that the claim for collateral is legally enforceable and constitutes an efficient credit risk mitigant. Where junior liens are recognised the bank must first take the haircut value of the collateral, then reduce it by the sum of all loans with liens that rank higher than the junior lien, the remaining value is the collateral that supports the loan with the junior lien. In cases where liens are held by third parties that rank pari passu with the lien of the bank, only the proportion of the collateral (after the application of haircuts and reductions due to the value of loans with liens that rank higher than the lien of the bank) that is attributable to the bank may be recognised.

284. Additional collateral management requirements are as follows:

- The types of CRE and RRE collateral accepted by the bank and lending policies (advance rates) when this type of collateral is taken must be clearly documented.
- The bank must take steps to ensure that the property taken as collateral is adequately insured against damage or deterioration.
- The bank must monitor on an ongoing basis the extent of any permissible prior claims (eg tax) on the property.
- The bank must appropriately monitor the risk of environmental liability arising in respect of the collateral, such as the presence of toxic material on a property.

(iii) Requirements for recognition of financial receivables

Definition of eligible receivables

285. Eligible financial receivables are claims with an original maturity of less than or equal to one year where repayment will occur through the commercial or financial flows related to the underlying assets of the borrower. This includes both self-liquidating debt arising from the sale of goods or services linked to a commercial transaction and general amounts owed by buyers, suppliers, renters, national and local governmental authorities, or other non-affiliated parties not related to the sale of goods or services linked to a commercial transaction. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives.

Operational requirements

Legal certainty

286. The legal mechanism by which collateral is given must be robust and ensure that the lender has clear rights over the proceeds from the collateral.

[31] In some of these jurisdictions, first liens are subject to the prior right of preferential creditors, such as outstanding tax claims and employees' wages.

287. Banks must take all steps necessary to fulfil local requirements in respect of the enforceability of security interest, eg by registering a security interest with a registrar. There should be a framework that allows the potential lender to have a perfected first priority claim over the collateral.

288. All documentation used in collateralised transactions must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review to verify this and have a well-founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.

289. The collateral arrangements must be properly documented, with a clear and robust procedure for the timely collection of collateral proceeds. Banks' procedures should ensure that any legal conditions required for declaring the default of the customer and timely collection of collateral are observed. In the event of the obligor's financial distress or default, the bank should have legal authority to sell or assign the receivables to other parties without consent of the receivables' obligors.

Risk management

290. The bank must have a sound process for determining the credit risk in the receivables. Such a process should include, among other things, analyses of the borrower's business and industry (eg effects of the business cycle) and the types of customers with whom the borrower does business. Where the bank relies on the borrower to ascertain the credit risk of the customers, the bank must review the borrower's credit policy to ascertain its soundness and credibility.

291. The margin between the amount of the exposure and the value of the receivables must reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual borrower, and potential concentration risk within the bank's total exposures.

292. The bank must maintain a continuous monitoring process that is appropriate for the specific exposures (either immediate or contingent) attributable to the collateral to be utilised as a risk mitigant. This process may include, as appropriate and relevant, ageing reports, control of trade documents, borrowing base certificates, frequent audits of collateral, confirmation of accounts, control of the proceeds of accounts paid, analyses of dilution (credits given by the borrower to the issuers) and regular financial analysis of both the borrower and the issuers of the receivables, especially in the case when a small number of large-sized receivables are taken as collateral. Observance of the bank's overall concentration limits should be monitored. Additionally, compliance with loan covenants, environmental restrictions, and other legal requirements should be reviewed on a regular basis.

293. The receivables pledged by a borrower should be diversified and not be unduly correlated with the borrower. Where the correlation is high, eg where some issuers of the receivables are reliant on the borrower for their viability or the borrower and the issuers belong to a common industry, the attendant risks should be taken into account in the setting of margins for the collateral pool as a whole. Receivables from affiliates of the borrower (including subsidiaries and employees) will not be recognised as risk mitigants.

294. The bank should have a documented process for collecting receivable payments in distressed situations. The requisite facilities for collection should be in place, even when the bank normally looks to the borrower for collections.

Requirements for recognition of other physical collateral

295. Supervisors may allow for recognition of the credit risk mitigating effect of certain other physical collateral when the following conditions are met:

- The bank demonstrates to the satisfaction of the supervisor that there are liquid markets for disposal of collateral in an expeditious and economically efficient manner. Banks must carry out a reassessment of this condition both periodically and when information indicates material changes in the market.

- The bank demonstrates to the satisfaction of the supervisor that there are well established, publicly available market prices for the collateral. Banks must also demonstrate that the amount they receive when collateral is realised does not deviate significantly from these market prices.

296. In order for a given bank to receive recognition for additional physical collateral, it must meet all the standards in paragraphs 283 and 284, subject to the following modifications.

- First Claim: With the sole exception of permissible prior claims specified in footnote 31, only first liens on, or charges over, collateral are permissible. As such, the bank must have priority over all other lenders to the realised proceeds of the collateral.
- The loan agreement must include detailed descriptions of the collateral and the right to examine and revalue the collateral whenever this is deemed necessary by the lending bank.
- The types of physical collateral accepted by the bank and policies and practices in respect of the appropriate amount of each type of collateral relative to the exposure amount must be clearly documented in internal credit policies and procedures and available for examination and/or audit review.
- Bank credit policies with regard to the transaction structure must address appropriate collateral requirements relative to the exposure amount, the ability to liquidate the collateral readily, the ability to establish objectively a price or market value, the frequency with which the value can readily be obtained (including a professional appraisal or valuation), and the volatility of the value of the collateral. The periodic revaluation process must pay particular attention to "fashion-sensitive" collateral to ensure that valuations are appropriately adjusted downward of fashion, or model-year, obsolescence as well as physical obsolescence or deterioration.
- In cases of inventories (eg raw materials, work-in-process, finished goods, dealers' inventories of autos) and equipment, the periodic revaluation process must include physical inspection of the collateral.

297. General Security Agreements, and other forms of floating charge, can provide the lending bank with a registered claim over a company's assets. In cases where the registered claim includes both assets that are not eligible as collateral under the F-IRB and assets that are eligible as collateral under the F-IRB, the bank may recognise the latter. Recognition is conditional on the claims meeting the operational requirements set out paragraphs 280 to 296.

10. Requirements for recognition of leasing

298. Leases other than those that expose the bank to residual value risk (see paragraph 299) will be accorded the same treatment as exposures collateralised by the same type of collateral. The minimum requirements for the collateral type must be met (CRE/RRE or other collateral). In addition, the bank must also meet the following standards:

- Robust risk management on the part of the lessor with respect to the location of the asset, the use to which it is put, its age, and planned obsolescence;
- A robust legal framework establishing the lessor's legal ownership of the asset and its ability to exercise its rights as owner in a timely fashion; and
- The difference between the rate of depreciation of the physical asset and the rate of amortisation of the lease payments must not be so large as to overstate the CRM attributed to the leased assets.

299. Leases that expose the bank to residual value risk will be treated in the following manner. Residual value risk is the bank's exposure to potential loss due to the fair value of the equipment declining below its residual estimate at lease inception.

- The discounted lease payment stream will receive a risk weight appropriate for the lessee's financial strength (PD) and supervisory or own-estimate of LGD, whichever is appropriate.
- The residual value will be risk-weighted at 100%.

11. Disclosure requirements

300. In order to be eligible for the IRB approach, banks must meet the disclosure requirements set out in Pillar 3. These are minimum requirements for use of IRB: failure to meet these will render banks ineligible to use the relevant IRB approach.

Minimum capital requirements for CVA risk

A. General provisions

1. In the context of this document, CVA stands for credit valuation adjustment specified at a counterparty level. CVA reflects the adjustment of default risk-free prices of derivatives and securities financing transactions (SFTs) as defined in paragraphs 4 and 5 of Annex 4 of the Basel II framework[1] due to a potential default of the counterparty. Regulatory CVA may differ from CVA used for accounting purposes as follows: (i) regulatory CVA excludes the effect of the bank's own default; (ii) several constraints reflecting best practice in accounting CVA are imposed on calculations of regulatory CVA, so some banks may find that regulatory CVA deviates from their accounting CVA. Unless explicitly specified otherwise, the term "CVA" in this document means "regulatory CVA".

2. CVA risk is defined as the risk of losses arising from changing CVA values in response to changes in counterparty credit spreads and market risk factors that drive prices of derivative transactions and SFTs.

3. The capital requirement for CVA risk must be calculated by all banks involved in covered transactions. Covered transactions include all derivatives except those transacted directly with a qualified central counterparty. Furthermore, covered transactions also include SFTs that are fair-valued by a bank for accounting purposes.

4. The CVA risk capital requirement is calculated for a bank's "CVA portfolio" on a standalone basis. The CVA portfolio includes CVA for a bank's entire portfolio of covered transactions and eligible CVA hedges.

5. Two approaches are available for calculating CVA capital: the standardised approach (SA-CVA) and the basic approach (BA-CVA). Banks must use the BA-CVA unless they receive approval from their relevant supervisory authority to use the SA-CVA.[2]

6. Banks that have received approval of their supervisory authority to use the SA-CVA may carve out from the SA-CVA calculations any number of netting sets. CVA capital for all carved out netting sets must be calculated via the BA-CVA.

7. A materiality threshold is established. Any bank whose aggregate notional amount of non-centrally cleared derivatives is less than or equal to 100 billion euro is deemed as being below the materiality threshold. Any bank below the materiality threshold may choose to set its CVA capital equal to 100% of the bank's capital requirement for counterparty credit risk (CCR). CVA hedges are not recognised under this treatment. If chosen, this treatment must be applied to the bank's entire portfolio instead of the BA-CVA or the SA-CVA. A bank's relevant supervisory authority, however, can remove this option if it determines that CVA risk resulting from the bank's derivative positions materially contributes to the bank's overall risk.

8. Eligibility criteria for CVA hedges are specified in paragraphs 15 to 17 for the BA-CVA and in paragraphs 36 to 38 for the SA-CVA.

9. CVA hedging instruments can be external (ie with an external counterparty) or internal (ie with one of the bank's trading desks).

[1] See Basel Committee on Banking Supervision, *Basel II: International Convergence of Capital Measurement and Capital Standards – Comprehensive Version*, June 2006, www.bis.org/publ/bcbs128.htm.

[2] Note that this is in contrast to the revised market risk framework, where banks do not need supervisory approval to use the standardised approach.

- All external CVA hedges (whether eligible or not) that are covered transactions must be included in the CVA calculation for the counterparty to the hedge.
- All eligible external CVA hedges must be excluded from a bank's market risk capital charge calculations in the trading book.
- Non-eligible external CVA hedges are treated as trading book instruments and are capitalised via the revised market risk standard.[3]
- An internal CVA hedge involves two perfectly offsetting positions: one of the CVA desk and the opposite position of the trading desk.
  - If an internal CVA hedge is ineligible, both positions belong to the trading book where they cancel each other, so there is no impact on either CVA portfolio or the trading book.
  - If an internal CVA hedge is eligible, the CVA desk's position is part of the CVA portfolio where it is capitalised via the revised CVA framework, while the trading desk's position is part of the trading book where it is capitalised via the revised market risk standard.
- If an internal CVA hedge involves an instrument that is subject to curvature risk, default risk charge or the residual risk add-on under the standardised approach of the revised market risk standard, it can be eligible only if the trading desk that is the CVA desk's "counterparty" executes a transaction with an external counterparty that exactly offsets the trading desk's position with the CVA desk.

10. Banks that use the BA-CVA or the SA-CVA for calculating CVA capital requirements may cap the maturity adjustment factor at 1 for all netting sets contributing to CVA capital when they calculate CCR capital under the Internal Ratings Based (IRB) approach.

B. Basic Approach for CVA

1. General provisions

11. The BA-CVA calculations may be performed either via the reduced version or the full version. The full version recognises counterparty spread hedges and is intended for banks that hedge CVA risk. The reduced version is obtained from the full version via elimination of hedging recognition. The reduced version is designed to simplify BA-CVA implementation for less sophisticated banks that do not hedge CVA. The reduced BA-CVA is also part of the full BA-CVA capital calculations as a conservative means to restrict hedging efficiency, so all banks using the BA-CVA must make these calculations. Any bank under the BA-CVA approach can choose whether to implement the full version or the reduced version.

2. Reduced version of the BA-CVA (hedges are not recognised)

12. The capital requirement for CVA risk under the reduced version of the BA-CVA ($K_{reduced}$) is calculated as follows, where the summations are taken over all counterparties that are within scope of the CVA charge:

$$K_{reduced} = \sqrt{\left(\rho \cdot \sum_c SCVA_c\right)^2 + \left(1-\rho^2\right) \cdot \sum_c SCVA_c^2}$$

[3] Basel Committee on Banking Supervision, *Minimum capital requirements for market risk*, January 2016, www.bis.org/bcbs/publ/d352.pdf.

where:

- $SCVA_c$ is the CVA capital requirement that counterparty *c* would receive if considered on a stand-alone basis (referred to as "stand-alone CVA capital" below). See paragraph 13 for its calculation.

- ρ= 50%. It is the supervisory correlation parameter. Its square, ρ^2=25%, represents the correlation between credit spreads of any two counterparties.[4] In the formula above, the effect of ρ is to recognise the fact that the CVA risk to which a bank is exposed is less that the sum of the CVA risk for each counterparty, given that the credit spreads of counterparties are typically not perfectly correlated.

  The first term under the square root in the formula above aggregates the systematic components of CVA risk, and the second term under the square root aggregates the idiosyncratic components of CVA risk.

13. The stand-alone CVA capital for counterparty *c* that is used in the formula in paragraph 12 ($SCVA_c$) is calculated as follows (where the summation is across all netting sets with the counterparty):

$$SCVA_c = \frac{1}{\alpha} \cdot RW_c \cdot \sum_{NS} M_{NS} \cdot EAD_{NS} \cdot DF_{NS}$$

where:

- RW_c is the risk weight for counterparty *c* that reflects the volatility of its credit spread. These risk weights are based on a combination of sector and credit quality of the counterparty as prescribed in paragraph 14.

- M_{NS} is the effective maturity for the netting set *NS*. For banks that have supervisory approval to use IMM (internal models method) , M_{NS} is calculated as per paragraphs 38 and 39 of Annex 4 of the Basel II framework, with the exception that the five year cap in paragraph 38 is not applied. For banks that do not have supervisory approval to use IMM, M_{NS} is calculated according to paragraphs 320 to 323 of the Basel II framework, with the exception that the five year cap in paragraph 320 is not applied.

- EAD_{NS} is the exposure at default (EAD) of the netting set *NS*, calculated in the same way as the bank calculates it for minimum capital requirements for CCR.

- DF_{NS} is a supervisory discount factor. It is 1 for banks using the (IMM to calculate EAD, and is $\frac{1-e^{-0.05 \cdot M_{NS}}}{0.05 \cdot M_{NS}}$ for banks not using IMM.[5]

- α = 1.4.[6]

14. The supervisory risk weights (RW_C) are given in the tables below. Credit quality is specified as either investment grade (IG), high yield (HY), or not rated (NR). Where there are no external ratings or where external ratings are not recognised within a jurisdiction, banks may, subject to supervisory approval,

4 One of the basic assumptions underlying the BA-CVA is that systematic credit spread risk is driven by a single factor. Under this assumption, ρ can be interpreted as the correlation between the credit spread of a counterparty and the single credit spread systematic factor.

5 DF is the supervisory discount factor averaged over time between today and the netting set's effective maturity date. The interest rate used for discounting is set at 5%, hence 0.05 in the formula. The product of EAD and effective maturity in the BA-CVA formula is a proxy for the area under the discounted expected exposure (EE) profile of the netting set. The IMM definition of effective maturity already includes this discount factor, hence DF is set to 1 for IMM banks. Outside IMM, netting set effective maturity is defined as an average of actual trade maturities. This definition lacks discounting, so the supervisory discount factor is added to compensate for this.

6 α is the multiplier used to convert Effective Expected Positive Exposure (EEPE) to EAD in both SA-CCR and IMM. Its role in the calculation, therefore, is to convert the EAD of the netting set (EAD_{NS}) back to EEPE.

map the internal rating to an external rating and assign a risk weight corresponding to either IG or HY. Otherwise, the risk weights corresponding to NR is to be applied.

Sector of counterparty	Credit quality of counterparty	
	IG	HY and NR
Sovereigns including central banks, multilateral development banks	0.5%	3.0%
Local government, government-backed non-financials, education and public administration	1.0%	4.0%
Financials including government-backed financials	5.0%	12.0%
Basic materials, energy, industrials, agriculture, manufacturing, mining and quarrying	3.0%	7.0%
Consumer goods and services, transportation and storage, administrative and support service activities	3.0%	8.5%
Technology, telecommunications	2.0%	5.5%
Health care, utilities, professional and technical activities	1.5%	5.0%
Other sector	5.0%	12.0%

3. Full version of the BA-CVA (hedges are recognised)

(a) Eligible hedges

15. Only transactions used for the purpose of mitigating the counterparty credit spread component of CVA risk, and managed as such, can be eligible hedges.

16. Only single-name CDS, single-name contingent CDS and index CDS can be eligible CVA hedges.

17. Eligible single-name credit instruments must: (i) reference the counterparty directly; (ii) reference an entity legally related to the counterparty; or (iii) reference an entity that belongs to the same sector and region as the counterparty.

(b) Calculations

18. Banks that intend to use the full version of BA-CVA must calculate $K_{reduced}$ as well. Under the full version, capital requirement for CVA risk K_{full} is calculated as follows:

$$K_{full} = \beta \cdot K_{reduced} + (1-\beta) \cdot K_{hedged}$$

where β=0.25 and is the supervisory parameter that is used to provide a floor that limits the extent to which hedging can reduce the capital that is required to cover CVA risk.

19. The part of capital requirements that recognises eligible hedges (K_{hedged}) is calculated using the following formula, where the summations are taken over all counterparties c that are within scope of the CVA charge:

$$K_{hedged} = \sqrt{\left(\rho \cdot \sum_c (SCVA_c - SNH_c) - IH\right)^2 + (1-\rho^2)\sum_c (SCVA_c - SNH_c)^2 + \sum_c HMA_c}$$

where:

- Both the stand-alone CVA capital ($SCVA_C$) and the correlation parameter (ρ) are defined in exactly the same way as for the reduced form calculation BA-CVA.

- SNH_C is a parameter that gives recognition to the reduction in CVA risk of the counterparty c arising from the bank's use of single-name hedges of credit spread risk. See paragraph 21 for its calculation.
- IH is a parameter that gives recognition to the reduction in CVA risk across all counterparties arising from the bank's use of index hedges. See paragraph 22 for its calculation.
- HMA_C is a hedging misalignment parameter, which is designed to limit the extent to which indirect hedges can reduce capital requirements given that they will not fully offset movements in a counterparty's credit spread. That is, with indirect hedges present K_{hedged} cannot reach zero. See paragraph 23 for its calculation.

20. Regarding the main three terms in the formula for K_{hedged} in paragraph 19:

- The first term $\left(\rho \cdot \sum_c (SCVA_c - SNH_c) - IH\right)^2$ aggregates the systematic components of CVA risk arising from the bank's counterparties, the single-name hedges and the index hedges.
- The second term $\left(1-\rho^2\right)\sum_c (SCVA_c - SNH_c)^2$ aggregates the idiosyncratic components of CVA risk arising from the bank's counterparties and the single-name hedges.
- The third term $\sum_c HMA_c$ aggregates the components of indirect hedges that are not aligned with counterparties' credit spreads.

21. The quantity SNH_c is calculated as follows (where the summation is across all single name hedges h that the bank has taken out to hedge the CVA risk of counterparty c):

$$SNH_c = \sum_{h \in c} r_{hc} \cdot RW_h \cdot M_h^{SN} \cdot B_h^{SN} \cdot DF_h^{SN}$$

where:

- r_{hc} is the supervisory prescribed correlation between the credit spread of counterparty c and the credit spread of a single-name hedge h of counterparty c. It is set using the table under paragraph 24. It is set at 100% if the hedge directly references the counterparty, and set at lower values if it does not.
- M_h^{SN} is the remaining maturity of single-name hedge h.
- B_h^{SN} is the notional of single-name hedge h. For single-name contingent CDS, the notional is determined by the current market value of the reference portfolio or instrument.
- DF_h^{SN} is the supervisory discount factor calculated as $\dfrac{1-e^{-0.05 \cdot M_h^{SN}}}{0.05 \cdot M_h^{SN}}$
- RW_h is the supervisory risk weight of single-name hedge h that reflects the volatility of the credit spread of the reference name of the hedging instrument. These risk weights are based on a combination of sector and credit quality of the reference name of the hedging instrument as prescribed in paragraph 14.

22. The quantity IH is calculated as follows (where the summation is across all index hedges i that the bank has taken out to hedge CVA risk):

$$IH = \sum_i RW_i \cdot M_i^{ind} \cdot B_i^{ind} \cdot DF_i^{ind}$$

where

- M_i^{ind} is the remaining maturity of index hedge *i*.
- B_i^{ind} is the notional of the index hedge *i*.
- DF_i^{ind} is the supervisory discount factor calculated as $\dfrac{1-e^{-0.05 \cdot M_i^{ind}}}{0.05 \cdot M_i^{ind}}$
- RW_i is the supervisory risk weight of the index hedge *i*. RW_i is taken from the table in paragraph 14 based on the sector and credit quality of the index constituents and adjusted as follows:
  - For indices where all index constituents belong to the same sector and are of the same credit quality, the relevant value in the table in paragraph 14 is multiplied by 0.7 to account for diversification of idiosyncratic risk within the index.
  - For indices spanning multiple sectors or with a mixture of investment grade constituents and other constituents, the name-weighted average of the risk weights from the table in paragraph 14 should be calculated and then multiplied by 0.7.

23. The quantity HMA_C is calculated as follows:

$$HMA_c = \sum_{h \in c} \left(1 - r_{hc}^2\right) \cdot \left(RW_h \cdot M_h^{SN} \cdot B_h^{SN} \cdot DF_h^{SN}\right)^2$$

where the summation is across all single name hedges *h* that have been taken out to hedge the CVA risk of counterparty *c*, and where r_{hc}, M_h^{SN}, B_h^{SN}, DF_h^{SN} and RW_h have the same definitions as set out in paragraph 21.

24. The supervisory prescribed correlations r_{hc} between the credit spread of counterparty *c* and the credit spread of its single-name hedge *h* are set as follows:

Single-name hedge *h* of counterparty *c*	Value of r_{hc}
references counterparty *c* directly	100%
has legal relation with counterparty *c*	80%
shares sector and region with counterparty *c*	50%

C. Standardised approach for CVA

1. General provisions

25. The standardised approach for CVA (SA-CVA) is an adaptation of the standardised approach for market risk (SA-TB) under the revised market risk standard. The primary differences of the SA-CVA from the SA-TB are: (i) the SA-CVA features a reduced granularity of market risk factors; (ii) the SA-CVA does not include default risk and curvature risk; (iii) the SA-CVA uses a more conservative risk aggregation; (iv) the SA-CVA uses the conservativeness multiplier m_{CVA}.

26. The SA-CVA must be calculated and reported to supervisors at the same monthly frequency as the SA-TB. In addition, banks using the SA-CVA must calculate, and have the ability to produce to their supervisors, SA-CVA calculations on demand.

27. The SA-CVA uses as inputs the sensitivities of regulatory CVA to counterparty credit spreads and market risk factors driving covered transactions' values. Sensitivities must be computed by banks in accordance with the sensitivity validation standards described for the SA-TB in the revised market risk standard.

28. The minimum criteria for the SA-CVA eligibility include the following:

- A bank must be able to model exposure and calculate, on at least a monthly basis, CVA and CVA sensitivities to the market risk factors specified in Section C.6 of this framework.
- A bank must have a CVA desk (or a similar dedicated function) responsible for risk management and hedging of CVA.

2. Regulatory CVA calculations

29. Regulatory CVA is the base for the calculation of the CVA risk capital requirement under the SA-CVA. Calculations of regulatory CVA must be performed for each counterparty with which a bank has at least one covered position.

30. Regulatory CVA at a counterparty level must be calculated according to the following principles, with the bank's adherence to the principles to be demonstrated by the bank to its relevant supervisor:

- Regulatory CVA must be calculated as the expectation of future losses resulting from default of the counterparty under the assumption that the bank itself is default risk-free.
- The calculation must be based on at least the following inputs: (i) term structure of market-implied probability of default (PD); (ii) market-consensus expected loss given default (ELGD); (3) simulated paths of discounted future exposure.
- The term structure of market-implied PD must be estimated from credit spreads observed in the markets. For counterparties whose credit is not actively traded (ie illiquid counterparties), the market-implied PD must be estimated from proxy credit spreads estimated for these counterparties according to the following requirements:
  - A bank must estimate the credit spread curves of illiquid counterparties from credit spreads observed in the markets of the counterparty's liquid peers via an algorithm that discriminates on at least three variables: a measure of credit quality (eg rating), industry, and region.
  - In certain cases, mapping an illiquid counterparty to a single liquid reference name can be allowed. A typical example would be mapping a municipality to its home country (ie setting the municipality credit spread equal to the sovereign credit spread plus a premium). A bank must justify to its supervisor every case of mapping to single names.
  - When no credit spreads of any of the counterparty's peers is available due to the counterparty's specific type (eg project finance, funds), a bank is allowed to use a more fundamental analysis of credit risk to proxy the spread of an illiquid counterparty. However, where historical PDs are used as part of this assessment, the resulting spread cannot be based on historical PD only – it must relate to credit markets.
- The market-consensus ELGD value used for regulatory CVA calculation must be the same as the one used to calculate the risk-neutral PD from credit spreads unless the bank can demonstrate that the seniority of the derivative exposure differs from the seniority of senior unsecured bonds. Collateral provided by the counterparty does not change the seniority of the derivative exposure.
- The paths of discounted future exposure are produced via pricing of all derivative transactions with the counterparty on simulated paths of relevant market risk factors and discounting the prices to today using risk-free interest rates along the path.
- All market risk factors material for the transactions with a counterparty must be simulated as stochastic processes for an appropriate number of paths defined on an appropriate set of future time points extending to the maturity of the longest transaction.

- For transactions with a significant level of dependence between exposure and the counterparty's credit quality, this dependence should be taken into account.
- For margined counterparties, collateral is permitted to be recognised as a risk mitigant under the following conditions:
  - Collateral management requirements outlined in paragraph 51(i)–(ii) of Annex 4 of the Basel II framework are satisfied.
  - All documentation used in collateralised transactions must be binding on all parties and legally enforceable in all relevant jurisdictions. Banks must have conducted sufficient legal review to verify this and have a well-founded legal basis to reach this conclusion, and undertake such further review as necessary to ensure continuing enforceability.
- For margined counterparties, the exposure simulation must capture the effects of margining collateral that is recognised as a risk mitigant along each exposure path. All the relevant contractual features such as the nature of the margin agreement (unilateral vs bilateral), the frequency of margin calls, the type of collateral, thresholds, independent amounts, initial margins and minimum transfer amounts must be appropriately captured by the exposure model. To determine collateral available to a bank at a given exposure measurement time point, the exposure model must assume that the counterparty will not post or return any collateral within a certain time period immediately prior to that time point. The assumed value of this time period, known as the margin period of risk (MPoR), cannot be less than a supervisory floor. The supervisory floor is equal to 9 + N business days, where N is the re-margining period specified in the margin agreement (in particular, for margin agreements with daily or intra-daily exchange of margin, the minimum MPoR is 10 business days).

31. The paths of discounted exposure are obtained via exposure models used by a bank for calculating front office/accounting CVA, adjusted (if needed) to meet the requirements imposed for regulatory CVA calculation. Model calibration process (with the exception of the MPoR), market and transaction data used for regulatory CVA calculation must be the same as the ones used for accounting CVA calculation.

32. The generation of market risk factor paths underlying the exposure models must satisfy the following requirements, with the bank's adherence to these requirements to be demonstrated by the bank to its relevant supervisor:

- Drifts of risk factors must be consistent with a risk-neutral probability measure. Historical calibration of drifts is not allowed.
- The volatilities and correlations of market risk factors must be calibrated to market data whenever sufficient data exists in a given market. Otherwise, historical calibration is permissible.
- The distribution of modelled risk factors must account for the possible non-normality of the distribution of exposures, including the existence of leptokurtosis ("fat tails"), where appropriate.

33. Netting recognition is the same as in the accounting CVA calculations. In particular, netting uncertainty can be modelled.

34. The requirements for illiquid positions, which are accounted for at fair value in the revised market risk framework extend to accounting-based CVA calculations. In particular, all components of accounting-based exposure models must be independently validated.

35. The following requirements apply, with the bank's adherence to these requirements to be demonstrated by the bank to its relevant supervisor:

- Exposure models used for calculating regulatory CVA must be part of a CVA risk management framework that includes the identification, measurement, management, approval and internal reporting of CVA market risk. A bank must have a credible track record in using these exposure models for calculating CVA and CVA sensitivities to market risk factors.

- Senior management should be actively involved in the risk control process and must regard CVA risk control as an essential aspect of the business to which significant resources need to be devoted.
- Banks must have a process in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the exposure system used for accounting CVA calculations.
- Banks must have an independent control unit that is responsible for the effective initial and ongoing validation of the exposure models. This unit must be independent from business credit and trading units (including the CVA desk), must be adequately staffed and must report directly to senior management of the firm.
- Banks must document the process for initial and ongoing validation of their exposure models to a level of detail that would enable a third party to understand how the model operates, its limitations, and its key assumptions; and recreate the analysis. This documentation must set out the minimum frequency with which ongoing validation will be conducted as well as other circumstances (such as a sudden change in market behaviour). In addition, the documentation must describe how the validation is conducted with respect to data flows and portfolios, what analyses are used and how representative counterparty portfolios are constructed.
- The pricing models used to calculate exposure for a given path of market risk factors must be tested against appropriate independent benchmarks for a wide range of market states as part of the initial and ongoing model validation process. Pricing models for options must account for the non-linearity of option value with respect to market risk factors.
- An independent review of the overall CVA risk management process should be carried out regularly in the bank's own internal auditing process. This review should include both the activities of the CVA desk and of the independent risk control unit.
- Banks must define criteria on which to assess the exposure models and their inputs and have a written policy in place to describe the process by which unacceptable performance will be determined and remedied.
- An exposure model must capture transaction-specific information in order to aggregate exposures at the level of the netting set. Banks must verify that transactions are assigned to the appropriate netting set within the model.
- The exposure models must reflect transaction terms and specifications in a timely, complete, and conservative fashion. The terms and specifications must reside in a secure database that is subject to formal and periodic audit. The transmission of transaction terms and specifications data to the exposure model must also be subject to internal audit, and formal reconciliation processes must be in place between the internal model and source data systems to verify on an ongoing basis that transaction terms and specifications are being reflected in the exposure system correctly or at least conservatively.
- The current and historical market data must be acquired independently of the lines of business and be compliant with accounting. They must be fed into the exposure model in a timely and complete fashion, and maintained in a secure database subject to formal and periodic audit. Banks must also have a well-developed data integrity process to handle the data of erroneous and/or anomalous observations. To the extent that the exposure model relies on proxy market data, internal policies must identify suitable proxies and the bank must demonstrate empirically on an ongoing basis that the proxy provides a conservative representation of the underlying risk under adverse market conditions.

3. Eligible hedges

36. Only whole transactions[7] that are used for the purpose of mitigating CVA risk, and managed as such, can be eligible hedges.

37. Hedges of both the counterparty credit spread and exposure components of CVA risk can be eligible.

38. Instruments that cannot be included in the Internal Model Approach for market risk under the revised market risk standard (eg tranched credit derivatives) cannot be eligible CVA hedges.

4. Multiplier

39. To compensate for a higher level of model risk in calculation of CVA sensitivities in comparison to sensitivities of market value of trading book instruments, the equivalent measure used in the revised market risk standard is scaled up via a multiplier m_{CVA}.

40. Multiplier m_{CVA} has a default value of 1.25. However, the default value of the multiplier can be increased by the bank's supervisory authority if it determines that the bank's CVA model risk warrants it (eg the dependence between the bank's exposure to a counterparty and the counterparty's credit quality is not taken into account in its CVA calculations).

5. Calculations

41. The SA-CVA capital requirement is calculated as the sum of the capital requirements for delta and vega risks calculated for the entire CVA portfolio (including eligible hedges).

42. The capital requirement for delta risk is calculated as the simple sum of delta capital requirements calculated independently for the following six risk types: (i) interest rate (IR); (ii) foreign exchange (FX); (iii) counterparty credit spreads; (iv) reference credit spreads (ie credit spreads that drive exposure); (v) equity; (vi) commodity.

43. If an instrument is deemed as an eligible hedge for credit spread delta risk, it must be assigned in its entirety (see footnote 7) either to the counterparty credit spread or to the reference credit spread risk type. Instruments cannot be split between the two risk types.

44. The capital requirement for vega risk is calculated as the simple sum of vega capital requirements calculated independently for the following five risk types: (i) interest rates (IR); (ii) foreign exchange (FX); (iii) reference credit spreads; (iv) equity; (v) commodity. There is no vega capital requirement for counterparty credit spread risk.

45. Delta and vega capital requirements are calculated via the same procedure described below in paragraphs 46 to 52.

46. For a given risk type, calculate the sensitivity of the aggregate CVA, s_k^{CVA}, and the sensitivity of the market value of all eligible hedging instruments in the CVA portfolio, s_k^{Hdg}, to each risk factor k in the risk type. The sensitivities are defined as the ratio of the change of the quantity in question (aggregate CVA or market value of all CVA hedges) caused by a small change of the risk factor current value to the size of the change. More specific definitions are provided for each asset class in Section C.6. These definitions include specific values of risk factor shifts. However, a bank may use smaller values of risk factor shifts if doing so is consistent with internal risk management calculations.

[7] Transactions cannot be split into several effective transactions.

47. When CVA sensitivities for vega risk are calculated, the volatility shift must apply to both types of volatilities that appear in exposure models: (i) volatilities used for generating risk factor paths; and (ii) volatilities used for pricing options. CVA sensitivities for vega risk are always material and must be calculated regardless of whether or not the portfolio includes options.

48. If a hedging instrument is an index, its sensitivities to all risk factors upon which the value of the index depends must be calculated. The index sensitivity to risk factor *k* must be calculated via applying the shift of risk factor *k* to all index constituents that depend on this risk factor and recalculating the index. For example, to calculate delta sensitivity of S&P500 to large financial companies, banks must apply the relevant shift to equity prices of all large financial companies that are constituents of S&P500 and re-compute the index.

49. Obtain the weighted sensitivities WS_k^{CVA} and WS_k^{Hdg} for each risk factor *k* by multiplying the net sensitivities s_k^{CVA} and s_k^{Hdg}, respectively, by the corresponding risk weight RW_k (the risk weights applicable to each risk type are specified in Section C.6).

$$WS_k^{CVA} = RW_k \cdot s_k^{CVA} \qquad\qquad WS_k^{Hdg} = RW_k \cdot s_k^{Hdg}$$

50. The net weighted sensitivity of the CVA portfolio s_k to risk factor *k* is obtained via:

$$WS_k = WS_k^{CVA} + WS_k^{Hdg}$$

51. Weighted sensitivities must be aggregated into a capital charge K_b within each bucket *b* (the buckets and correlation parameters ρ_{kl} applicable to each risk type are specified in Section C.6).

$$K_b = \sqrt{\left[\sum_{k \in b} WS_k^2 + \sum_{k \in b} \sum_{l \in b; l \neq k} \rho_{kl} \cdot WS_k \cdot WS_l\right] + R \cdot \sum_{k \in b}\left[(WS_k^{Hdg})^2\right]}$$

where *R* is the hedging disallowance parameter, set at 0.01, that prevents the possibility of perfect hedging of CVA risk.

52. Bucket-level capital charges must then be aggregated across buckets within each risk type (the correlation parameters γ_{bc} applicable to each risk type are specified in Section C.6.

$$K = m_{CVA} \cdot \sqrt{\sum_b K_b^2 + \sum_b \sum_{c \neq b} \gamma_{bc} \cdot K_b \cdot K_c}$$

Note that this equation differs from the corresponding equation in the revised market risk standard by the absence of a residual value and of quantities S_b and the presence of multiplier m_{CVA}.

6. Buckets, risk factors, sensitivities, risk weights and correlations[8]

(a) Interest rates

53. For interest rate delta and vega risks, buckets are individual currencies.

54. For interest rate delta and vega risks, cross-bucket correlation is $\gamma_{bc} = 0.5$ for all currency pairs.

55. Interest rate delta risk factors for a bank's domestic currency and for the following currencies: USD, EUR, GBP, AUD, CAD, SEK or JPY:

8 The risk weights and correlations match the ones in the SA-TB, except for interest rate cross-tenor correlations that are obtained via the formula underlying interest rate correlations in the SA-CCR (see pages 14-17 of "Foundations of the standardised approach for measuring counterparty credit risk exposures", www.bis.org/publ/bcbs_wp26.pdf). The numbers in the tables are subject to change if calibration of the SA-TB changes.

- Interest rate delta risk factors are the absolute changes of the inflation rate and of the risk-free yields for the following five tenors: 1 year, 2 years, 5 years, 10 years and 30 years.
- Sensitivities to the abovementioned yields are measured by changing the risk-free yield in a given currency by 1 basis point (0.0001 in absolute terms) and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.0001. Sensitivity to the inflation rate is obtained by changing the inflation rate by 1 basis point and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.0001.
- Risk weights RW_k are given by:

Risk factor	1 year	2 years	5 years	10 years	30 years	Inflation
Risk weight	1.59%	1.33%	1.06%	1.06%	1.06%	1.59%

- Correlations ρ_{kl} between pairs of risk factors are:

	1 year	**2 years**	**5 years**	**10 years**	**30 years**	**Inflation**
1 year	100%	91%	72%	55%	31%	40%
2 years		100%	87%	72%	45%	40%
5 years			100%	91%	68%	40%
10 years				100%	83%	40%
30 years					100%	40%
Inflation						100%

56. Interest rate delta risk factors for any currency not specified in paragraph 55:

- Interest rate risk factors are the absolute change of the inflation rate and the parallel shift of the entire risk-free yield curve for a given currency.
- Sensitivity to the yield curve is measured by shifting all risk-free yield curves in a given currency by 1 basis point (0.0001 in absolute terms) and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.0001. Sensitivity to the inflation rate is obtained by changing the inflation rate by 1 basis point and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.0001.
- Risk weights for both risk-free yield curve and inflation rate are set at $RW_k = 2.25\%$.
- Correlations between risk-free yield curve and inflation rate are set at $\rho_{kl} = 40\%$.

57. Interest rate vega risk factors for any currency:

- Interest rate vega risk factors are a simultaneous relative change of all volatilities for the inflation rate and a simultaneous relative change of all interest rate volatilities for a given currency.
- Sensitivity to the interest rate (or inflation rate) volatilities is measured by simultaneously shifting all interest rate- (or inflation rate-) volatilities by 1% relative to their current values and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.01.
- Risk weights for both interest rate and inflation volatilities are set to $RW_k = RW_\sigma \cdot \sqrt{6}$, where RW_σ is set at 55%.
- Correlations between interest rate volatilities and inflation volatilities are set at $\rho_{kl} = 40\%$.

(b) Foreign exchange (FX)

58. For FX delta and vega risks, buckets are individual currencies except for a bank's domestic currency.

59. For FX delta and vega risks, cross-bucket correlation is $\gamma_{bc} = 0.6$ for all currency pairs.

60. FX delta risk factors for any foreign currency:

- The single FX delta risk factor is the relative change of the FX spot rate between a given foreign currency and a bank's domestic currency (ie only foreign-domestic exchange rates are risk factors).
- Sensitivities to the FX spot rate are measured by shifting a given foreign-domestic exchange rate by 1% relative to its current value and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.01. All foreign-foreign rates involving the currency of the shifted foreign-domestic rate are shifted accordingly via the representation of the foreign-foreign rate as the ratio of two foreign-domestic rates (for example, if EUR is the domestic currency and USDEUR is shifted, the shifted value of USDGBP is obtained as the ratio of the shifted value of USDEUR to the unshifted value of GBPEUR).
- Risk weights for all foreign-domestic exchange rates are set at $RW_k = 21\%$.

61. FX vega risk factors for any foreign currency:

- The single FX vega risk factor is a simultaneous relative change of all volatilities for a given foreign-domestic exchange rate.
- Sensitivities to the FX volatilities are measured by simultaneously shifting all volatilities for a given foreign-domestic exchange rate by 1% relative to their current values and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.01. Volatilities of all foreign-foreign exchange rates involving the shifted currency are shifted according to the representation of the foreign-foreign exchange rate volatility via two foreign-domestic exchange rate volatilities and the relevant implied correlation (the latter is assumed to be fixed).
- Risk weights for FX volatilities are set to $RW_k = RW_\sigma \cdot \sqrt{4}$, where RW_σ is set at 55%.

(c) Counterparty credit spread

62. For counterparty credit spread, vega risk is not calculated. Buckets for delta risk are:

Bucket number	Sector
1	a) Sovereigns including central banks, multilateral development banks
	b) Local government, government-backed non-financials, education and public administration
2	Financials including government-backed financials
3	Basic materials, energy, industrials, agriculture, manufacturing, mining and quarrying
4	Consumer goods and services, transportation and storage, administrative and support service activities
5	Technology, telecommunications
6	Health care, utilities, professional and technical activities
7	Other sector

63. For counterparty credit spread delta risk, cross-bucket correlations γ_{bc} are given by

Bucket	1	2	3	4	5	6
1	100%	10%	20%	25%	20%	15%
2		100%	5%	15%	20%	5%
3			100%	20%	25%	5%
4				100%	25%	5%
5					100%	5%
6						100%

- For cross-bucket correlations γ_{bc} applying across bucket 7 and another bucket, γ_{bc} = 0%.

64. Counterparty credit spread delta risk factors for a given bucket:

- Counterparty credit spread delta risk factors are absolute shifts of credit spreads of individual entities (counterparties and reference names for counterparty credit spread hedges) at the following tenors: 0.5 years, 1 year, 3 years, 5 years and 10 years.
- For a given entity and tenor point, the sensitivities are measured by shifting the relevant credit spread by 1 basis point (0.0001 in absolute terms) and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.0001.
- Risk weights RW_k are the same for all tenors and depend on the entity's bucket according to:

Bucket	1 a)	1 b)	2	3	4	5	6	7
IG names	0.5%	1.0%	5.0%	3.0%	3.0%	2.0%	1.5%	5.0%
HY and NR names	3.0%	4.0%	12.0%	7.0%	8.5%	5.5%	5.0%	12.0%

where IG, HY and NR are the shorthand notations for "investment grade", "high yield" and "not rated". This credit quality designation is the same as in the BA-CVA (see paragraph 14).

- Correlations ρ_{kl} between different tenors for the same entity are set to 90%.

For unrelated entities of the same credit quality (IG and IG or HY/NR and HY/NR):

- Correlations ρ_{kl} between the same tenors are set to 50%.
- Correlations ρ_{kl} between different tenors are set to 45%.

For unrelated entities of different credit quality (IG and HY/NR):

- Correlations ρ_{kl} between the same tenors are set to 40%.
- Correlations ρ_{kl} between different tenors are set to 36%.

For entities that are legally related:

- Correlations ρ_{kl} between the same tenors are set to 90%.
- Correlations ρ_{kl} between different tenors are set to 81%.

(d) Reference credit spread

65. For reference credit spreads, both delta and vega risks are calculated. Buckets for delta and vega risks are as follows (with the IG, HY and NR credit quality designations the same as in paragraph 14 of the BA-CVA):

Bucket number	Credit quality	Sector
1	Investment grade (IG)	Sovereigns including central banks, multilateral development banks
2		Local government, government-backed non-financials, education and public administration
3		Financials including government-backed financials
4		Basic materials, energy, industrials, agriculture, manufacturing, mining and quarrying
5		Consumer goods and services, transportation and storage, administrative and support service activities
6		Technology, telecommunications
7		Health care, utilities, professional and technical activities
8	High yield (HY) & non-rated (NR)	Sovereigns including central banks, multilateral development banks
9		Local government, government-backed non-financials, education and public administration
10		Financials including government-backed financials
11		Basic materials, energy, industrials, agriculture, manufacturing, mining and quarrying
12		Consumer goods and services, transportation and storage, administrative and support service activities
13		Technology, telecommunications
14		Health care, utilities, professional and technical activities
15	(Not applicable)	Other sector

66. For reference credit spread delta and vega risks, cross-bucket correlations γ_{bc} within the same credit quality category (ie either IG or HY&NR) are given by

Bucket	1/8	2/9	3/10	4/11	5/12	6/13	7/14
1/8	100%	75%	10%	20%	25%	20%	15%
2/9		100%	5%	15%	20%	15%	10%
3/10			100%	5%	15%	20%	5%
4/11				100%	20%	25%	5%
5/12					100%	25%	5%
6/13						100%	5%
7/14							100%

- For cross-bucket correlations γ_{bc} applying across IG and HY&NR categories, these correlations are divided by 2.
- For cross-bucket correlations γ_{bc} applying across bucket 15 and another bucket, γ_{bc} is set to 0%.

67. Reference credit spread delta risk factors for a given bucket:

- The single reference credit spread delta risk factor is a simultaneous absolute shift of credit spreads of all tenors for all reference names in the bucket.
- Sensitivity to reference credit spreads is measured by shifting the credit spreads of all reference names in the bucket by 1 basis point (0.0001 in absolute terms) and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.0001.

- Risk weights RW_k depend on the reference name's bucket according to:

IG bucket	1	2	3	4	5	6	7
Risk weight	0.5%	1.0%	5.0%	3.0%	3.0%	2.0%	1.5%

HY/NR bucket	8	9	10	11	12	13	14	15
Risk weight	3.0%	4.0%	12.0%	7.0%	8.5%	5.5%	5.0%	12.0%

68. Reference credit spread vega risk factors for a given bucket:

- The single reference credit spread vega risk factor is a simultaneous relative shift of the volatilities of credit spreads of all tenors for all reference names in the bucket.
- Sensitivity to volatility of reference credit spread is measured by shifting the volatilities of credit spreads of all reference names in the bucket by 1% relative to their current values and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.01.
- Risk weights for reference credit spread volatilities are set to $RW_k = RW_\sigma \cdot \sqrt{12}$, where RW_σ is set at 55%.

(e) Equity

69. For equity delta and vega risks, buckets are defined as:

Bucket number	Size	Region	Sector
1	Large	Emerging market economies	Consumer goods and services, transportation and storage, administrative and support service activities, healthcare, utilities
2			Telecommunications, industrials
3			Basic materials, energy, agriculture, manufacturing, mining and quarrying
4			Financials including government-backed financials, real estate activities, technology
5		Advanced economies	Consumer goods and services, transportation and storage, administrative and support service activities, healthcare, utilities
6			Telecommunications, industrials
7			Basic materials, energy, agriculture, manufacturing, mining and quarrying
8			Financials including government-backed financials, real estate activities, technology
9	Small	Emerging market economies	All sectors described under bucket numbers 1, 2, 3, and 4
10		Advanced economies	All sectors described under bucket numbers 5, 6, 7, and 8
11	(Not applicable)		Other sector

The terminology used in the equity bucket definition should be understood as follows:

- Market capitalisation ("market cap") is defined as the sum of the market capitalisations of the same legal entity or group of legal entities across all stock markets globally.
- "Large market cap" is defined as a market capitalisation equal to or greater than USD 2 billion and "small market cap" is defined as a market capitalisation of less than USD 2 billion.

- The advanced economies are Canada, the United States, Mexico, the euro area, the non-euro area western European countries (the United Kingdom, Norway, Sweden, Denmark and Switzerland), Japan, Oceania (Australia and New Zealand), Singapore and Hong Kong SAR.
- To assign a risk exposure to a sector, banks must rely on a classification that is commonly used in the market for grouping issuers by industry sector. The bank must assign each issuer to one of the sector buckets in the table above and it must assign all issuers from the same industry to the same sector. Risk positions from any issuer that a bank cannot assign to a sector in this fashion must be assigned to the "other sector" (ie bucket 11). For multinational multi-sector equity issuers, the allocation to a particular bucket must be done according to the most material region and sector in which the issuer operates.

70. For equity delta and vega risks, cross-bucket correlation γ_{bc} = 15% for all cross-bucket pairs that fall within bucket numbers 1 to 10. γ_{bc} = 0% for all cross-bucket pairs that include bucket 11.

71. Equity delta risk factors for a given bucket:

- The single equity delta risk factor is a simultaneous relative shift of equity spot prices for all reference names in the bucket.
- The sensitivities to equity delta risk factors are measured by shifting the equity spot prices for all reference names in the bucket by 1% relative to their current values and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.01.
- Risk weights RW_k depend on the reference name's bucket according to the following table:

Bucket number	Risk weight
1	55%
2	60%
3	45%
4	55%
5	30%
6	35%
7	40%
8	50%
9	70%
10	50%
11	70%

72. Equity vega risk factors for a given bucket:

- The single equity vega risk factor is a simultaneous relative shift of the volatilities for all reference names in the bucket.
- The sensitivities to equity vega risk factors are measured by shifting the volatilities for all reference names in the bucket by 1% relative to their current values and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.01.
- Risk weights for equity volatilities are set to $RW_k = RW_\sigma \cdot \sqrt{2}$ for large capitalisation buckets and to $RW_k = RW_\sigma \cdot \sqrt{6}$ for small capitalisation buckets, where RW_σ is set at 55%.

(f) Commodity

73. For commodity delta and vega risks, buckets are defined as:

Bucket	Commodity group	Examples
1	Energy – Solid combustibles	coal, charcoal, wood pellets, nuclear fuel (such as uranium)
2	Energy – Liquid combustibles	crude oil (such as Light-sweet, heavy, WTI and Brent); biofuels (such as bioethanol and biodiesel); petrochemicals (such as propane, ethane, gasoline, methanol and butane); refined fuels (such as jet fuel, kerosene, gasoil, fuel oil, naptha, heating oil and diesel)
3	Energy – Electricity and carbon trading	electricity (such as spot, day-ahead, peak and off-peak); carbon emissions trading (such as certified emissions reductions, in-delivery month EUA, RGGI CO2 allowance and renewable energy certificates)
4	Freight	dry-bulk route (such as capesize, panamex, handysize and supramax); liquid-bulk/gas shipping route (such as suezmax, aframax and very large crude carriers)
5	Metals – non-precious	base metal (such as aluminium, copper, lead, nickel, tin and zinc); steel raw materials (such as steel billet, steel wire, steel coil, steel scrap and steel rebar, iron ore, tungsten, vanadium, titanium and tantalum); minor metals (such as cobalt, manganese, molybdenum)
6	Gaseous combustibles	natural gas; liquefied natural gas
7	Precious metals (including gold)	gold; silver; platinum; palladium
8	Grains & oilseed	corn; wheat; soybean (such as soybean seed, soybean oil and soybean meal); oats; palm oil; canola; barley; rapeseed (such as rapeseed seed, rapeseed oil, and rapeseed meal); red bean, sorghum; coconut oil; olive oil; peanut oil; sunflower oil; rice
9	Livestock & dairy	cattle (such live and feeder); hog; poultry; lamb; fish; shrimp; dairy (such as milk, whey, eggs, butter and cheese)
10	Softs and other agriculturals	cocoa; coffee (such as arabica and robusta); tea; citrus and orange juice; potatoes; sugar; cotton; wool; lumber and pulp; rubber
11	Other commodity	industrial minerals (such as potash, fertiliser and phosphate rocks), rare earths; terephthalic acid; flat glass

74. For commodity delta and vega risks, cross-bucket correlation γ_{bc} = 20% for all cross-bucket pairs that fall within bucket numbers 1 to 10. γ_{bc} = 0% for all cross-bucket pairs that include bucket 11.

75. Commodity delta risk factors for a given bucket:

- The single commodity delta risk factor is a simultaneous relative shift of commodity spot prices for all commodities in the bucket.
- The sensitivities to commodity delta risk factors are measured by shifting the spot prices of all commodities in the bucket by 1% relative to their current values and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.01.
- Risk weights RW_k depend on the reference name's bucket according to the following table:

Bucket	1	2	3	4	5	6	7	8	9	10	11
RW	30%	35%	60%	80%	40%	45%	20%	35%	25%	35%	50%

76. Commodity vega risk factors for a given bucket:

- The single commodity vega risk factor is a simultaneous relative shift of the volatilities for all commodities in the bucket.
- The sensitivities to commodity vega risk factors are measured by shifting the volatilities for all commodities in the bucket by 1% relative to their current values and dividing the resulting change in the aggregate CVA (or the value of CVA hedges) by 0.01.
- Risk weights for commodity volatilities are set to $RW_k = RW_\sigma \cdot \sqrt{12}$, where RW_σ is set at 55%.

Minimum capital requirements for operational risk

1. Introduction

1. Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk,[1] but excludes strategic and reputational risk.

2. The standardised approach for measuring minimum operational risk capital requirements replaces all existing approaches in the Basel II framework.[2] That is, this standard replaces paragraphs 644 to 683 of the Basel II framework.

3. Consistent with Part I (Scope of Application) of the Basel II Framework, the standardised approach applies to internationally active banks on a consolidated basis. Supervisors retain the discretion to apply the standardised approach framework to non-internationally active banks.

2. The standardised approach

4. The standardised approach methodology is based on the following components: (i) the Business Indicator (BI) which is a financial-statement-based proxy for operational risk; (ii) the Business Indicator Component (BIC), which is calculated by multiplying the BI by a set of regulatory determined marginal coefficients (α_i); and (iii) the Internal Loss Multiplier (ILM), which is a scaling factor that is based on a bank's average historical losses and the BIC.

The Business Indicator

5. The Business Indicator (BI) comprises three components: the interest, leases and dividend component (ILDC); the services component (SC), and the financial component (FC).

6. The BI is defined as:

$$BI = ILDC + SC + FC$$

In the formula below, a bar above a term indicates that it is calculated as the average over three years: t, t-1 and t-2, and:[3]

$$ILDC = Min\left[\overline{Abs\left(Interest\ Income - Interest\ Expense\right)};\ 2.25\%\cdot\overline{Interest\ Earning\ Assets}\right] + \overline{Dividend\ Income}$$

$$SC = Max\left[\overline{Other\ Operating\ Income}\ ;\ \overline{Other\ Operating\ Expense}\right] + Max\left[\overline{Fee\ Income}; \overline{Fee\ Expense}\right]$$

$$FC = \overline{Abs\left(Net\ P\ \&\ L\ Trading\ Book\right)} + \overline{Abs\left(Net\ P\ \&\ L\ Banking\ Book\right)}$$

1 Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

2 Basel Committee on Banking Supervision, *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version*, June 2006, www.bis.org/pub/bcbs128.htm.

3 The absolute value of net items (eg, interest income – interest expense) should be calculated first year by year. Only after this year by year calculation should the average of the three years be calculated.

7. The definitions for each of the components of the BI are provided in the annex of this section.

The Business Indicator Component

8. To calculate the BIC, the BI is multiplied by the marginal coefficients (α_i). The marginal coefficients increase with the size of the BI as shown in Table 1. For banks in the first bucket (ie with a BI less than or equal to €1bn) the BIC is equal to BI x 12%. The marginal increase in the BIC resulting from a one unit increase in the BI is 12% in bucket 1, 15% in bucket 2 and 18% in bucket 3. For example, given a BI = €35bn, the BIC = (1 x 12%) + (30-1) x 15% + (35-30) x 18% = €5.37bn.

BI ranges and marginal coefficients — Table 1

Bucket	BI range (in €bn)	BI marginal coefficients (α_i)
1	≤1	12%
2	1 < BI ≤30	15%
3	> 30	18%

The Internal Loss Multiplier

9. A bank's internal operational risk loss experience affects the calculation of operational risk capital through the Internal Loss Multiplier (ILM). The ILM is defined as:

$$ILM = Ln\left(\exp(1) - 1 + \left(\frac{LC}{BIC}\right)^{0.8}\right)$$

where the Loss Component (LC) is equal to 15 times average annual operational risk losses incurred over the previous 10 years. The ILM is equal to one where the loss and business indicator components are equal. Where the LC is greater than the BIC, the ILM is greater than one. That is, a bank with losses that are high relative to its BIC is required to hold higher capital due to the incorporation of internal losses into the calculation methodology. Conversely, where the LC is lower than the BIC, the ILM is less than one. That is, a bank with losses that are low relative to its BIC is required to hold lower capital due to the incorporation of internal losses into the calculation methodology.

10. The calculation of average losses in the Loss Component must be based on 10 years of high-quality annual loss data. The qualitative requirements for loss data collection are outlined in paragraphs 19 to 31. As part of the transition to the standardised approach, banks that do not have 10 years of high-quality loss data may use a minimum of five years of data to calculate the Loss Component.[4] Banks that do not have five years of high-quality loss data must calculate the capital requirement based solely on the BI Component. Supervisors may however require a bank to calculate capital requirements using fewer than five years of losses if the ILM is greater than 1 and supervisors believe the losses are representative of the bank's operational risk exposure.

The standardised approach operational risk capital requirement

11. The operational risk capital requirement is determined by the product of the BIC and the ILM. For banks in bucket 1 (ie with BI ≤ €1 billion), internal loss data does not affect the capital calculation. That is, the ILM is equal to 1, so that operational risk capital is equal to the BIC (=12% · BI).

[4] This treatment is not expected to apply to banks that currently use the advanced measurement approaches for determining operational risk capital requirements.

12. At national discretion, supervisors may allow the inclusion of internal loss data into the framework for banks in bucket 1, subject to meeting the loss data collection requirements specified in paragraphs 19 to 31. In addition, at national discretion, supervisors may set the value of ILM equal to 1 for all banks in their jurisdiction. In case this discretion is exercised, banks would still be subject to the full set of disclosure requirements summarised in paragraph 32.

13. Minimum operational risk capital (ORC) is calculated by multiplying the BIC and the ILM:[5]

$$ORC = BIC \cdot ILM$$

3. Application of the standardised approach within a group

14. At the consolidated level, the standardised approach calculations use fully consolidated BI figures, which net all the intragroup income and expenses. The calculations at a sub-consolidated level use BI figures for the banks consolidated at that particular sub-level. The calculations at the subsidiary level use the BI figures from the subsidiary.

15. Similar to bank holding companies, when BI figures for sub-consolidated or subsidiary banks reach bucket 2, these banks are required to use loss experience in the standardised approach calculations. A sub-consolidated bank or a subsidiary bank uses only the losses it has incurred in the standardised approach calculations (and does not include losses incurred by other parts of the bank holding company).

16. In case a subsidiary of a bank belonging to bucket 2 or higher does not meet the qualitative standards for the use of the Loss Component, this subsidiary must calculate the standardised approach capital requirements by applying 100% of the BI Component. In such cases supervisors may require the bank to apply an ILM which is greater than 1.

4. Minimum standards for the use of loss data under the standardised approach

17. Banks with a BI greater than €1bn are required to use loss data as a direct input into the operational risk capital calculations. The soundness of data collection and the quality and integrity of the data are crucial to generating capital outcomes aligned with the bank's operational loss exposure. The minimum loss data standards are outlined in paragraphs 19 to 31. National supervisors should review the quality of banks' loss data periodically.

18. Banks which do not meet the loss data standards are required to hold capital that is at a minimum equal to 100% of the BIC. In such cases supervisors may require the bank to apply an ILM which is greater than 1. The exclusion of internal loss data due to non-compliance with the loss data standards, and the application of any resulting multipliers, must be publicly disclosed.

5. General criteria on loss data identification, collection and treatment

19. The proper identification, collection and treatment of internal loss data are essential prerequisites to capital calculation under the standardised approach. The general criteria for the use of the LC are as follows:

[5] Risk-weighted assets for operational risk are equal to 12.5 times ORC.

(a) Internally generated loss data calculations used for regulatory capital purposes must be based on a 10-year observation period. When the bank first moves to the standardised approach, a five-year observation period is acceptable on an exceptional basis when good-quality data are unavailable for more than five years.

(b) Internal loss data are most relevant when clearly linked to a bank's current business activities, technological processes and risk management procedures. Therefore, a bank must have documented procedures and processes for the identification, collection and treatment of internal loss data. Such procedures and processes must be subject to validation before the use of the loss data within the operational risk capital requirement measurement methodology, and to regular independent reviews by internal and/or external audit functions.

(c) For risk management purposes, and to assist in supervisory validation and/or review, a supervisor may request a bank to map its historical internal loss data into the relevant Level 1 supervisory categories as defined in Annex 9 of the Basel II Framework and to provide this data to supervisors. The bank must document criteria for allocating losses to the specified event types.

(d) A bank's internal loss data must be comprehensive and capture all material activities and exposures from all appropriate subsystems and geographic locations. The minimum threshold for including a loss event in the data collection and calculation of average annual losses is set at €20,000. At national discretion, for the purpose of the calculation of average annual losses, supervisors may increase the threshold to €100,000 for banks in buckets 2 and 3 (ie where the BI is greater than €1 bn).

(e) Aside from information on gross loss amounts, the bank must collect information about the reference dates of operational risk events, including the date when the event happened or first began ("date of occurrence"), where available; the date on which the bank became aware of the event ("date of discovery"); and the date (or dates) when a loss event results in a loss, reserve or provision against a loss being recognised in the bank's profit and loss (P&L) accounts ("date of accounting"). In addition, the bank must collect information on recoveries of gross loss amounts as well as descriptive information about the drivers or causes of the loss event.[6] The level of detail of any descriptive information should be commensurate with the size of the gross loss amount.

(f) Operational loss events related to credit risk and that are accounted for in credit risk RWAs should not be included in the loss data set. Operational loss events that relate to credit risk, but are not accounted for in credit risk RWAs should be included in the loss data set.

(g) Operational risk losses related to market risk are treated as operational risk for the purposes of calculating minimum regulatory capital under this framework and will therefore be subject to the the standardised approach for operational risk.

(h) Banks must have processes to independently review the comprehensiveness and accuracy of loss data.

[6] Tax effects (eg reductions in corporate income tax liability due to operational losses) are not recoveries for purposes of the standardised approach for operational risk.

6. Specific criteria on loss data identification, collection and treatment

Building of the standardised approach loss data set

20. Building an acceptable loss data set from the available internal data requires that the bank develop policies and procedures to address several features, including gross loss definition, reference date and grouped losses.

Gross loss, net loss, and recovery definitions

21. Gross loss is a loss before recoveries of any type. Net loss is defined as the loss after taking into account the impact of recoveries. The recovery is an independent occurrence, related to the original loss event, separate in time, in which funds or inflows of economic benefits are received from a third party.[7]

22. Banks must be able to identify the gross loss amounts, non-insurance recoveries, and insurance recoveries for all operational loss events. Banks should use losses net of recoveries (including insurance recoveries) in the loss dataset. However, recoveries can be used to reduce losses only after the bank receives payment. Receivables do not count as recoveries. Verification of payments received to net losses must be provided to supervisors upon request.

23. The following items must be included in the gross loss computation of the loss data set:

(a) Direct charges, including impairments and settlements, to the bank's P&L accounts and write-downs due to the operational risk event;

(b) Costs incurred as a consequence of the event including external expenses with a direct link to the operational risk event (eg legal expenses directly related to the event and fees paid to advisors, attorneys or suppliers) and costs of repair or replacement, incurred to restore the position that was prevailing before the operational risk event;

(c) Provisions or reserves accounted for in the P&L against the potential operational loss impact;

(d) Losses stemming from operational risk events with a definitive financial impact, which are temporarily booked in transitory and/or suspense accounts and are not yet reflected in the P&L ("pending losses").[8] Material pending losses should be included in the loss data set within a time period commensurate with the size and age of the pending item; and

(e) Negative economic impacts booked in a financial accounting period, due to operational risk events impacting the cash flows or financial statements of previous financial accounting periods (timing losses").[9] Material "timing losses" should be included in the loss data set when they are due to operational risk events that span more than one financial accounting period and give rise to legal risk.

7 Examples of recoveries are payments received from insurers, repayments received from perpetrators of fraud, and recoveries of misdirected transfers.

8 For instance, in some countries, the impact of some events (eg legal events, damage to physical assets) may be known and clearly identifiable before these events are recognised through the establishment of a reserve. Moreover, the way this reserve is established (eg the date of discovery) can vary across banks or countries.

9 Timing impacts typically relate to the occurrence of operational risk events that result in the temporary distortion of an institution's financial accounts (eg revenue overstatement, accounting errors and mark-to-market errors). While these events do not represent a true financial impact on the institution (net impact over time is zero), if the error continues across more than one financial accounting period, it may represent a material misrepresentation of the institution's financial statements.

24. The following items should be excluded from the gross loss computation of the loss data set:

(a) Costs of general maintenance contracts on property, plant or equipment;

(b) Internal or external expenditures to enhance the business after the operational risk losses: upgrades, improvements, risk assessment initiatives and enhancements; and

(c) Insurance premiums.

25. Banks must use the date of accounting for building the loss data set. The bank must use a date no later than the date of accounting for including losses related to legal events in the loss data set. For legal loss events, the date of accounting is the date when a legal reserve is established for the probable estimated loss in the P&L.

26. Losses caused by a common operational risk event or by related operational risk events over time, but posted to the accounts over several years, should be allocated to the corresponding years of the loss database, in line with their accounting treatment.

7. Exclusion of losses from the Loss Component

27. Banking organisations may request supervisory approval to exclude certain operational loss events that are no longer relevant to the banking organisation's risk profile. The exclusion of internal loss events should be rare and supported by strong justification. In evaluating the relevance of operational loss events to the bank's risk profile, supervisors will consider whether the cause of the loss event could occur in other areas of the bank's operations. Taking settled legal exposures and divested businesses as examples, supervisors expect the organisation's analysis to demonstrate that there is no similar or residual legal exposure and that the excluded loss experience has no relevance to other continuing activities or products.

28. The total loss amount and number of exclusions must be disclosed under Pillar 3 with appropriate narratives, including total loss amount and number of exclusions.

29. A request for loss exclusions is subject to a materiality threshold to be set by the supervisor (for example, the excluded loss event should be greater than 5% of the bank's average losses). In addition, losses can only be excluded after being included in a bank's operational risk loss database for a minimum period (for example, three years), to be specified by the supervisor. Losses related to divested activities will not be subject to a minimum operational risk loss database retention period.

8. Exclusions of divested activities from the Business Indicator

30. Banking organisations may request supervisory approval to exclude divested activities from the calculation of the BI. Such exclusions must be disclosed under Pillar 3.

9. Inclusion of losses and BI items related to mergers and acquisitions

31. Losses and the measurement of the BI must include losses and BI items that result from acquisitions of relevant business and mergers.

10. Disclosure

32. All banks with a BI greater than €1bn, or which use internal loss data in the calculation of operational risk capital, are required to disclose their annual loss data for each of the ten years in the ILM calculation window. This includes banks in jurisdictions that have opted to set ILM equal to one. Loss data is required to be reported on both a gross basis and after recoveries and loss exclusions. All banks are required to disclose each of the BI sub-items for each of the three years of the BI component calculation window.[10]

Annex: Definition of Business Indicator components

Business Indicator definitions

<table>
<tr><th>BI Component</th><th>P&L or balance sheet items</th><th>Description</th><th>Typical sub-items</th></tr>
<tr><td rowspan="4">Interest, lease and dividend</td><td>Interest income</td><td>Interest income from all financial assets and other interest income
(includes interest income from financial and operating leases and profits from leased assets)</td><td>• Interest income from loans and advances, assets available for sale, assets held to maturity, trading assets, financial leases and operational leases
• Interest income from hedge accounting derivatives
• Other interest income
• Profits from leased assets</td></tr>
<tr><td>Interest expenses</td><td>Interest expenses from all financial liabilities and other interest expenses
(includes interest expense from financial and operating leases, losses, depreciation and impairment of operating leased assets)</td><td>• Interest expenses from deposits, debt securities issued, financial leases, and operating leases
• Interest expenses from hedge accounting derivatives
• Other interest expenses
• Losses from leased assets
• Depreciation and impairment of operating leased assets</td></tr>
<tr><td>Interest earning assets (balance sheet item)</td><td colspan="2">Total gross outstanding loans, advances, interest bearing securities (including government bonds), and lease assets measured at the end of each financial year</td></tr>
<tr><td>Dividend income</td><td colspan="2">Dividend income from investments in stocks and funds not consolidated in the bank's financial statements, including dividend income from non-consolidated subsidiaries, associates and joint ventures.</td></tr>
<tr><td>Services</td><td>Fee and commission income</td><td>Income received from providing advice and services. Includes income received by the bank as an outsourcer of financial services.</td><td>Fee and commission income from:
• Securities (issuance, origination, reception, transmission, execution of orders on behalf of customers)
• Clearing and settlement; Asset management; Custody; Fiduciary transactions; Payment services; Structured finance; Servicing of securitisations; Loan commitments</td></tr>
</table>

[10] The Committee will undertake a separate public consultation on the operational risk disclosure templates.

			and guarantees given; and foreign transactions
	Fee and commission expenses	Expenses paid for receiving advice and services. Includes outsourcing fees paid by the bank for the supply of financial services, but not outsourcing fees paid for the supply of non-financial services (eg logistical, IT, human resources)	Fee and commission expenses from: • Clearing and settlement; Custody; Servicing of securitisations; Loan commitments and guarantees received; and Foreign transactions
	Other operating income	Income from ordinary banking operations not included in other BI items but of similar nature (income from operating leases should be excluded)	• Rental income from investment properties • Gains from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations (IFRS 5.37)
	Other operating expenses	Expenses and losses from ordinary banking operations not included in other BI items but of similar nature and from operational loss events (expenses from operating leases should be excluded)	• Losses from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations (IFRS 5.37) • Losses incurred as a consequence of operational loss events (eg fines, penalties, settlements, replacement cost of damaged assets), which have not been provisioned/reserved for in previous years • Expenses related to establishing provisions/reserves for operational loss events
Financial	Net profit (loss) on the trading book	• Net profit/loss on trading assets and trading liabilities (derivatives, debt securities, equity securities, loans and advances, short positions, other assets and liabilities) • Net profit/loss from hedge accounting • Net profit/loss from exchange differences	
	Net profit (loss) on the banking book	• Net profit/loss on financial assets and liabilities measured at fair value through profit and loss • Realised gains/losses on financial assets and liabilities not measured at fair value through profit and loss (loans and advances, assets available for sale, assets held to maturity, financial liabilities measured at amortised cost) • Net profit/loss from hedge accounting • Net profit/loss from exchange differences	

The following P&L items do not contribute to any of the items of the BI:

- Income and expenses from insurance or reinsurance businesses
- Premiums paid and reimbursements/payments received from insurance or reinsurance policies purchased
- Administrative expenses, including staff expenses, outsourcing fees paid for the supply of non-financial services (eg logistical, IT, human resources), and other administrative expenses (eg IT, utilities, telephone, travel, office supplies, postage)
- Recovery of administrative expenses including recovery of payments on behalf of customers (eg taxes debited to customers)
- Expenses of premises and fixed assets (except when these expenses result from operational loss events)

- Depreciation/amortisation of tangible and intangible assets (except depreciation related to operating lease assets, which should be included in financial and operating lease expenses)
- Provisions/reversal of provisions (eg on pensions, commitments and guarantees given) except for provisions related to operational loss events
- Expenses due to share capital repayable on demand
- Impairment/reversal of impairment (eg on financial assets, non-financial assets, investments in subsidiaries, joint ventures and associates)
- Changes in goodwill recognised in profit or loss
- Corporate income tax (tax based on profits including current tax and deferred).

Output floor

Introduction

1. To reduce excessive variability of risk-weighted assets and to enhance the comparability of risk-weighted capital ratios, banks will be subject to a floor requirement that is applied to risk-weighted assets. The output floor will ensure that banks' capital requirements do not fall below a certain percentage of capital requirements derived under standardised approaches.

Output floor requirements

2. As set out in the Basel III framework, banks must meet the following capital requirements:

- Common Equity Tier 1 must be at least 4.5% of risk-weighted assets at all times.
- Tier 1 capital must be at least 6.0% of risk-weighted assets at all times.
- Total Capital (Tier 1 capital and Tier 2 capital) must be at least 8.0% of risk-weighted assets at all times.[1]

3. In addition, a Common Equity Tier 1 capital conservation buffer is set at 2.5% of risk-weighted assets for all banks.[2] Banks may also be subject to a countercyclical capital buffer requirement. Banks identified as global systemically-important banks (G-SIBs) are also subject to additional higher-loss absorbency requirements and total loss-absorbing capacity requirements.[3]

4. The risk-weighted assets that banks must use to determine compliance with the requirements set out in paragraphs 2 to 3 above must be calculated as the maximum of: (i) the total risk-weighted assets calculated using the approaches that the bank has supervisory approval to use in accordance with the Basel capital framework (including both standardised and internally-modelled based approaches); and (ii) 72.5% of the total risk weighted assets, calculated using only the standardised approaches listed in paragraph 6. The latter element of this requirement is referred to as the output floor.

5. In light of the forthcoming accounting revisions for expected credit loss, the Committee will review the consistency in the treatment of provisions for the purpose of calculating the output floor.

Calculation of the output floor

6. The standardised approaches to be used when calculating the output floor described in paragraph 4 are as follows:

- Credit risk: the standardised approach for credit risk.[4] When calculating the degree of credit risk mitigation, banks must use the carrying value when applying the simple approach or the

[1] The Basel III framework is available at www.bis.org/publ/bcbs189.pdf.

[2] As set out in the Basel III framework, available at www.bis.org/publ/bcbs189.pdf.

[3] As set out in the FSB TLAC term sheet, available at www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

[4] As set out in the revised standardised approach for credit risk described in this document.

comprehensive approach with standard supervisory haircuts. This also includes failed trades and non-delivery-versus-payment transactions as set out in Annex 3 of the Basel II framework (June 2006).

- Counterparty credit risk: to calculate the exposure for derivatives, banks must use the standardised approach for measuring counterparty credit risk (SA-CCR). The exposure amounts must then be multiplied by the relevant borrower risk weight using the standardised approach for credit risk to calculate RWA under the standardised approach for credit risk.
- Credit valuation adjustment risk: the standardised approach for CVA (SA-CVA), the Basic Approach (BA-CVA) or 100% of a bank's counterparty credit risk capital requirement (depending on which approach the bank uses for CVA risk).[5]
- Securitisation framework: the external ratings-based approach (SEC-ERBA), the standardised approach (SEC-SA) or a risk-weight of 1250%[6]
- Market risk: the standardised approach for market risk. The SEC-ERBA, SEC-SA or a risk-weight of 1250% must also be used when determining the default risk charge component for securitisations held in the trading book.[7]
- Operational risk: the standardised approach for operational risk.[8]

7. The table below provides a simple example of how the capital floor must be calculated.

	Pre-floor RWAs	Standardised RWAs	72.5% of standardised RWAs
Credit risk	62	124	89.9
- of which Asset Class A	45	80	58
- of which Asset Class B	5	32	23.2
- of which Asset Class C (not modelled)	12	12	8.7
Market risk	2	4	2.9
Operational risk (not modelled)	12	12	8.7
Total RWA	76	140	101.5

As the floored RWAs (101.5) are higher than the pre-floor RWAs (76) in this example, the bank would use the former to determine the capital requirements set out in paragraphs 2 to 4.

Disclosure requirements

8. Banks must disclose two sets of risk-weighted capital ratios: (i) ratios that exclude the capital floor in the calculation of risk-weighted assets; and (ii) ratios that include the capital floor in the calculation of risk-weighted assets. In addition, banks must disclose more granular information related to the calculation of their risk-weighted assets under internally-modelled and standardised approaches, which will be set out in forthcoming disclosure templates as part of the Committee's Pillar 3 disclosure framework.

[5] As set out in the revised credit valuation adjustment framework in this document.

[6] As set out in the securitisation framework, available at www.bis.org/bcbs/publ/d374.pdf.

[7] As set out in the revised market risk framework, available at www.bis.org/bcbs/publ/d352.pdf.

[8] As set out in the revised operational risk framework in this document.

Implementation date and transitional measures

9. The output floor will be implemented as of 1 January 2022 , based on the following calibration phase-in arrangement:

Date	Output floor calibration
1 Jan 2022	50%
1 Jan 2023	55%
1 Jan 2024	60%
1 Jan 2025	65%
1 Jan 2026	70%
1 Jan 2027	72.5%

10. During the phase-in period, supervisors may exercise national discretion to cap the incremental increase in a bank's total RWAs that results from the application of the floor. This transitional cap will be set at 25% of a bank's RWAs before the application of the floor. In the example shown in paragraph 7, the application of this national discretion by the supervisor would cap the bank's RWAs to 95 (ie a 25% increase of its pre-floor RWAs of 76).

Leverage ratio

Introduction

1. An underlying cause of the global financial crisis was the build-up of excessive on- and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while reporting strong risk-based capital ratios. At the height of the crisis, financial markets forced the banking sector to reduce its leverage in a manner that amplified downward pressures on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital and contracting credit availability.

2. The Basel III framework introduced a simple, transparent, non-risk-based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements.[1] The leverage ratio is intended to:

- restrict the build-up of leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk-based "backstop" measure.

3. The Committee is of the view that a simple leverage ratio framework is critical and complementary to the risk-based capital framework, and that the leverage ratio should adequately capture both the on- and off-balance sheet sources of banks' leverage.

Definition and requirements

4. The leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), with this ratio expressed as a percentage:

$$\text{Leverage ratio} = \frac{\text{Capital measure}}{\text{Exposure measure}}$$

5. The capital measure for the leverage ratio is Tier 1 capital – comprising Common Equity Tier 1 and/or Additional Tier 1 instruments – as defined in paragraphs 49 to 96 of the Basel III framework. In other words, the capital measure used for the leverage ratio at any particular point in time is the Tier 1 capital measure applicable at that time under the risk-based framework. The exposure measure for the leverage ratio is defined in paragraphs 20 to 59 of this section.

6. Both the capital measure and the exposure measure are to be calculated on a quarter-end basis. However, banks may, subject to supervisory approval, use more frequent calculations (eg daily or monthly averaging) as long as they do so consistently.

7. Banks must meet a 3% leverage ratio minimum requirement at all times.

8. In addition, to maintain the relative roles of the risk-weighted and leverage ratio requirements, banks identified as global systemically-important banks (G-SIBs) according the G-SIB standard must also meet a leverage ratio buffer requirement.[2] Consistent with the capital measure required to meet the

[1] Basel Committee on Banking Supervision, *Basel III: A global regulatory framework for more resilient banks and banking systems*, June 2011, www.bis.org/publ/bcbs189.pdf.

[2] See Basel Committee on Banking Supervision, *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement*, July 2013, www.bis.org/publ/bcbs255.pdf.

leverage ratio minimum described in paragraph 5, G-SIBs must meet the leverage ratio buffer with Tier 1 capital.

9. The leverage ratio buffer will be set at 50% of a G-SIB's higher-loss absorbency risk-weighted requirements. For example, a G-SIB subject to a 2% higher-loss absorbency requirement would be subject to a 1% leverage ratio buffer requirement.

10. The design of the leverage ratio buffer is akin to the capital buffers in the risk-weighted framework. As such, the leverage ratio buffer will include minimum capital conservation ratios divided in five ranges. Capital distribution constraints will be imposed on a G-SIB which does not meet its leverage ratio buffer requirement.

11. The capital distribution constraints imposed on G-SIBs will depend on the G-SIB's CET1 risk-weighted ratio and its leverage ratio. A G-SIB which meets both its CET1 risk-weighted requirements (defined as a 4.5% minimum requirement, a 2.5% capital conservation buffer, the G-SIB higher loss-absorbency requirement and countercyclical capital buffer if applicable) and its Tier 1 leverage ratio requirement (defined as a 3% leverage ratio minimum requirement and the G-SIB leverage ratio buffer) will not be subject to minimum capital conservation standards. A G-SIB which does not meet one of these requirements will be subject to the associated minimum capital conservation standards. A G-SIB which does not meet both requirements will be subject to the higher minimum capital conservation standard related to its risk-weighted capital requirement or leverage ratio.

12. As an example, the table below shows the minimum capital conservation standards for the CET1 risk-weighted requirements and Tier 1 leverage ratio requirements of a G-SIB in the first bucket of the higher loss-absorbency requirements (ie where a 1% risk-weighted G-SIB capital buffer applies).

CET1 risk-weighted ratio	Tier 1 leverage ratio	Minimum capital conservation ratios (expressed as a percentage of earnings)
4.5%–5.375%	3%–3.125%	100%
> 5.375%–6.25%	> 3.125%–3.25%	80%
> 6.25%–7.125%	> 3.25%–3.375%	60%
> 7.125%–8%	> 3.375%–3.50%	40%
> 8.0%	> 3.50%	0%

Implementation and monitoring

13. The implementation timeline for the leverage ratio requirement is as follows:

- 1 January 2018: Implementation of Pillar 1 minimum requirement per the January 2014 version of the standard[3] (in addition to ongoing Pillar 3 disclosure per the same version of the standard).[4]
- 1 January 2022: Implementation of Pillar 1 minimum requirement (in addition to any applicable G-SIB buffer requirement) and associated Pillar 3 disclosure requirements[5] per the revised version of the standard described in this section.

14. The leverage ratio buffer requirement on 1 January 2022 shall be based on the Financial Stability Board's 2020 list of G-SIBs (based on end-2019 data). For banks that are subsequently identified as G-SIBs or which are no longer identified as G-SIBs, the same transitional arrangements will apply as in the higher-loss absorbency requirement framework

15. The leverage ratio buffer requirement will be updated annually to reflect the annual updated list of G-SIB requirements. G-SIBs subject to a revised higher-loss absorbency requirement would also be subject to a revised leverage ratio buffer requirement, calibrated at 50% of the former requirement. Both requirements would follow the same implementation arrangements. Jurisdictions may impose a higher leverage ratio buffer requirement.

16. The Committee will continue to monitor the impact of the leverage ratio framework by means of the Basel III monitoring Quantitative Impact Study (QIS) exercise. The focus of the Committee's monitoring will include assessments of any impact the standard might have on banks' business activities and financial markets in general, including reviewing any impact on SFT markets and market liquidity.

17. In addition, the Committee will continue to monitor the impact of the leverage ratio's treatment of client cleared derivative transactions and, within two years after this publication of this document, conclude a review of the impact of the leverage ratio on banks' provision of clearing services and any consequent impact on the resilience of central counterparty clearing.

Scope of consolidation

18. The leverage ratio framework follows the same scope of regulatory consolidation, including consolidation criteria, as is used for the risk-based capital framework.[6] This is set out in Part I (Scope of Application) of the Basel II framework (June 2006).

19. *Treatment of investments in the capital of banking, financial, insurance and commercial entities that are outside the regulatory scope of consolidation*: where a banking, financial, insurance or commercial entity is outside the scope of regulatory consolidation, only the investment in the capital of such entities (ie only the carrying value of the investment, as opposed to the underlying assets and other exposures of the investee) is to be included in the leverage ratio exposure measure. However, investments in the capital of such entities that are deducted from Tier 1 capital as set out in paragraph 22 may be excluded from the leverage ratio exposure measure.

[3] Basel Committee on Banking Supervision, *Basel III leverage ratio framework and disclosure requirements*, January 2014, www.bis.org/publ/bcbs270.pdf.

[4] The leverage ratio disclosure requirements were implemented on 1 January 2015. Pillar 3 disclosure requirements for the January 2014 version of the leverage ratio framework were consolidated into a consultative document on Pillar 3 requirements published in March 2016. See Basel Committee on Banking Supervision, *Consultative Document – Pillar 3 disclosure requirements – consolidated and enhanced framework*; March 2016, www.bis.org/bcbs/publ/d356.pdf.

[5] The Committee will propose revisions to disclosure requirements to address the revised version of the leverage ratio framework in a forthcoming phase of the Pillar 3 review process.

[6] For example, if proportional consolidation is applied for regulatory consolidation under the risk-based framework, the same criteria shall be applied for leverage ratio purposes.

Exposure measure

20. The leverage ratio exposure measure generally follows gross accounting values.

21. Unless specified differently below, banks must not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the leverage ratio exposure measure, nor may banks net assets and liabilities.

22. To ensure consistency, any item deducted from Tier 1 capital according to the Basel III framework and regulatory adjustments other than those related to liabilities may be deducted from the leverage ratio exposure measure. Three examples follow:

- where a banking, financial or insurance entity is not included in the regulatory scope of consolidation as set out in paragraph 18, the amount of any investment in the capital of that entity that is totally or partially deducted from Common Equity Tier 1 (CET1) capital or from Additional Tier 1 capital of the bank following the corresponding deduction approach in paragraphs 84 to 89 of the Basel III framework may also be deducted from the leverage ratio exposure measure;
- for banks using the internal ratings-based (IRB) approach to determining capital requirements for credit risk, paragraph 73 of the Basel III framework requires any shortfall in the stock of eligible provisions relative to expected loss amounts to be deducted from CET1 capital. The same amount may be deducted from the leverage ratio exposure measure; and
- prudent valuation adjustments (PVAs) for exposures to less liquid positions, other than those related to liabilities, that are deducted from Tier 1 capital as per paragraph 718 (cxii) of the Basel II framework as amended by the standard *Minimum capital requirements for market risk*[7] (hereafter "market risk framework") may be deducted from the leverage ratio exposure measure.

23. Liability items must not be deducted from the leverage ratio exposure measure. For example, gains/losses on fair valued liabilities or accounting value adjustments on derivative liabilities due to changes in the bank's own credit risk as described in paragraph 75 of the Basel III framework must not be deducted from the leverage ratio exposure measure.

24. With regard to traditional securitisations, an originating bank may exclude securitised exposures from its leverage ratio exposure measure if the securitisation meets the operational requirements for the recognition of risk transference according to paragraph 24 of the standard *Revisions to the securitisation framework*.[8] Banks meeting these conditions must include any retained securitisation exposures in their leverage ratio exposure measure. In all other cases, eg traditional securitisations that do not meet the operational requirements for the recognition of risk transference or synthetic securitisations, the securitised exposures must be included in the leverage ratio exposure measure.[9]

25. Banks and supervisors should be particularly vigilant to transactions and structures that have the result of inadequately capturing banks' sources of leverage. Examples of concerns that might arise in such leverage ratio exposure measure minimising transactions and structures may include: securities financing transactions where exposure to the counterparty increases as the counterparty's credit quality decreases or securities financing transactions in which the credit quality of the counterparty is positively correlated

7 Basel Committee on Banking Supervision, *Minimum capital requirements for market risk*, January 2016, www.bis.org/bcbs/publ/d352.pdf.

8 Basel Committee on Banking Supervision, *Revisions to the securitisation framework*, December 2014 (rev. July 2016), www.bis.org/bcbs/publ/d374.pdf.

9 The Committee confirms the treatment specified in paragraph 24 as an interpretation of the January 2014 version of the leverage ratio standard. Therefore, the treatment may also be applied in the January 2014 version of the leverage ratio standard while that version serves as the Pillar 1 minimum requirement.

with the value of the securities received in the transaction (ie the credit quality of the counterparty falls when the value of the securities falls); banks that normally act as principal but adopt an agency model to transact in derivatives and SFTs in order to benefit from the more favourable treatment permitted for agency transactions under the leverage ratio framework; collateral swap trades structured to mitigate inclusion in the leverage ratio exposure measure; or use of structures to move assets off the balance sheet. This list of examples is by no means exhaustive. Where supervisors are concerned that such transactions are not adequately captured in the leverage ratio exposure measure or may lead to a potentially destabilising deleveraging process, they should carefully scrutinise these transactions and consider a range of actions to address such concerns. Supervisory actions may include requiring enhancements in banks' management of leverage, imposing operational requirements (eg additional reporting to supervisors) and/or requiring that the relevant exposure is adequately capitalised through a Pillar 2 capital charge. These examples of supervisory actions are merely indicative and by no means exhaustive.

26. At national discretion, and to facilitate the implementation of monetary policies, a jurisdiction may temporarily exempt central bank reserves from the leverage ratio exposure measure in exceptional macroeconomic circumstances. To maintain the same level of resilience provided by the leverage ratio, a jurisdiction applying this discretion must also increase the calibration of the minimum leverage ratio requirement commensurately to offset the impact of exempting central bank reserves. In addition, in order to maintain the comparability and transparency of the Basel III leverage ratio framework, banks will be required to disclose the impact of any temporary exemption alongside ongoing public disclosure of the leverage ratio without application of such exemption.[10]

27. A bank's total leverage ratio exposure measure is the sum of the following exposures: (a) on-balance sheet exposures (excluding on-balance sheet derivative and securities financing transaction exposures); (b) derivative exposures; (c) securities financing transaction (SFT) exposures; and (d) off-balance sheet (OBS) items. The specific treatments for these four main exposure types are defined below.

(a) On-balance sheet exposures

28. Banks must include all balance sheet assets in their leverage ratio exposure measure, including on-balance sheet derivatives collateral and collateral for SFTs, with the exception of on-balance sheet derivative and SFT assets that are covered in paragraphs 32 to 56 below.[11]

29. On-balance sheet, non-derivative assets are included in the leverage ratio exposure measure at their accounting values less deductions for associated specific provisions. In addition, general provisions or general loan loss reserves as defined in paragraph 60 of the Basel III framework which have reduced Tier 1 capital may be deducted from the leverage ratio exposure measure.[12]

30. The accounting for regular-way purchases or sales[13] of financial assets that have not been settled (hereafter "unsettled trades") differs across and within accounting frameworks, with the result that those unsettled trades can be accounted for either on the trade date (*trade date accounting*) or on the settlement

[10] The treatment specified in paragraph 26 may also be applied in the January 2014 version of the leverage ratio standard while that version serves as the Pillar 1 minimum requirement.

[11] Where a bank according to its operative accounting framework recognises fiduciary assets on the balance sheet, these assets can be excluded from the leverage ratio exposure measure provided that the assets meet the IFRS 9 criteria for derecognition and, where applicable, IFRS 10 for deconsolidation.

[12] Although paragraph 60 of the Basel III framework specifies the treatment of general provisions/general loan-loss reserves for banks using the standardised approach for credit risk, for the purposes of the leverage ratio exposure measure the definition of general provisions/general loan-loss reserves specified in paragraph 60 of the Basel III framework applies to all banks regardless of whether they use the standardised approach or the internal ratings-based (IRB) approach for credit risk for their risk-based capital calculations.

[13] For the purposes of this treatment, "regular-way purchases or sales" are purchases or sales of financial assets under contracts for which the terms require delivery of the assets within the time frame established generally by regulation or convention in the marketplace concerned.

date (*settlement date accounting*). For the purpose of the leverage ratio exposure measure, banks using trade date accounting must reverse out any offsetting between cash receivables for unsettled sales and cash payables for unsettled purchases of financial assets that may be recognised under the applicable accounting framework, but may offset between those cash receivables and cash payables (regardless of whether such offsetting is recognised under the applicable accounting framework) if the following conditions are met:

- the financial assets bought and sold that are associated with cash payables and receivables are fair valued through income and included in the bank's regulatory trading book as specified by paragraphs 8 to 20 of the market risk framework; and
- the transactions of the financial assets are settled on a delivery-versus-payment (DVP) basis.

Banks using settlement date accounting will be subject to the treatment set out in paragraphs 57 to 59 and paragraph 9 of the Annex.

31. Cash pooling refers to arrangements involving treasury products whereby a bank combines the credit and/or debit balances of several individual participating customer accounts into a single account balance to facilitate cash and/or liquidity management. For purposes of the leverage ratio exposure measure, where a cash pooling arrangement entails a transfer at least on a daily basis of the credit and/or debit balances of the individual participating customer accounts into a single account balance, the individual participating customer accounts are deemed to be extinguished and transformed into a single account balance upon the transfer provided the bank is not liable for the balances on an individual basis upon the transfer. Thus, the basis of the leverage ratio exposure measure for such a cash pooling arrangement is the single account balance and not the individual participating customer accounts. When the transfer of credit and/or debit balances of the individual participating customer accounts does not occur daily, for purposes of the leverage ratio exposure measure, extinguishment and transformation into a single account balance is deemed to occur and this single account balance may serve as the basis of the leverage ratio exposure measure provided all of the following conditions are met:

- in addition to providing for the several individual participating customer accounts, the cash pooling arrangement provides for a single account, into which the balances of all individual participating customer accounts can be transferred and thus extinguished;
- the bank (i) has a legally enforceable right to transfer the balances of the individual participating customer accounts into a single account so that the bank is not liable for the balances on an individual basis and (ii) at any point in time, the bank must have the discretion and be in a position to exercise this right;
- the bank's supervisor does not deem as inadequate the frequency by which the balances of individual participating customer accounts are transferred to a single accont;
- there are no maturity mismatches among the balances of the individual participating customer accounts included in the cash pooling arrangement or all balances are either overnight or on demand; and
- the bank charges or pays interest and/or fees based on the combined balance of the individual participating customer accounts included in the cash pooling arrangement.

In the event the abovementioned conditions are not met, the individual balances of the participating customer accounts must be reflected separately in the leverage ratio exposure measure.

(b) Derivative exposures

32. *Treatment of derivatives*: for the purpose of the leverage ratio exposure measure, exposures to derivatives are included by means of two components: (a) replacement cost (RC); and (b) potential future

exposure (PFE). The leverage ratio framework uses the method set out below to capture both of these components.

33. Banks must calculate their exposures associated with all derivative transactions, including where a bank sells protection using a credit derivative, as a scalar multiplier alpha set at 1.4 times the sum of the RC[14] and the PFE, as described in paragraph 34. If the derivative exposure is covered by an eligible bilateral netting contract as specified in the Annex, a specific treatment may be applied.[15] Written credit derivatives are subject to an additional treatment, as set out in paragraphs 44 to 49 below.

34. For derivative transactions not covered by an eligible bilateral netting contract as specified in paragraphs 4 and 5 of the Annex, the amount to be included in the leverage ratio exposure measure is determined, for each transaction separately, as follows:

*exposure measure = alpha * (RC + PFE)*

where

- *alpha* = 1.4;
- *RC* = the replacement cost calculated according to paragraph 2 of the Annex; and
- *PFE* = an amount for PFE calculated according to paragraph 3 of the Annex.

35. *Bilateral netting*: when an eligible bilateral netting contract is in place as specified in paragraphs 4 and 5 of the Annex, the formula in paragraph 34 is applied at the netting set level as described in paragraphs 2 and 3 of the Annex.

36. *Treatment of related collateral*: collateral received in connection with derivative contracts has two countervailing effects on leverage:

- it reduces counterparty exposure; but
- it can also increase the economic resources at the disposal of the bank, as the bank can use the collateral to leverage itself.

37. C*ollateral received* in connection with derivative contracts does not necessarily reduce the leverage inherent in a bank's derivative position, which is generally the case if the settlement exposure arising from the underlying derivative contract is not reduced. As a general principle of the Basel III leverage ratio framework, collateral received may not be netted against derivative exposures whether or not netting is permitted under the bank's operative accounting or risk-based framework. Hence, when calculating the exposure amount by applying paragraphs 33 to 35 above, a bank must not reduce the leverage ratio exposure measure amount by any collateral received from the counterparty. This implies that the RC cannot be reduced by collateral received and that the multiplier referenced in paragraph 3 of

[14] If, under a bank's national accounting standards, there is no accounting measure of exposure for certain derivative instruments because they are held (completely) off balance sheet, the bank must use the sum of positive fair values of these derivatives as the replacement cost.

[15] These are netting rules of the Basel II framework excepting the rules for cross-product netting in Annex 4, Section III (ie netting across product categories such as derivatives and SFTs is not permitted in determining the leverage ratio exposure measure). However, where a bank has a cross-product netting agreement in place that meets the eligibility criteria of paragraphs 4 and 5 of the Annex, it may choose to perform netting separately in each product category provided that all other conditions for netting in this product category that are applicable to the current framework are met.

the Annex is fixed at one for the purpose of the PFE calculation. However, the maturity factor in the PFE add-on calculation can recognise the PFE-reducing effect from the regular exchange of variation margin as specified in paragraph 3 of the Annex.

38. Similarly, with regard to *collateral provided*, banks must gross up their leverage ratio exposure measure by the amount of any derivatives collateral provided where the provision of that collateral has reduced the value of their balance sheet assets under their operative accounting framework.

39. *Treatment of cash variation margin*: in the treatment of derivative exposures for the purpose of the leverage ratio exposure measure, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment if the following conditions are met:

(i) For trades not cleared through a *qualifying* central counterparty (QCCP)[16] the cash received by the recipient counterparty is not segregated. Cash variation margin would satisfy the non-segregation criterion if the *recipient* counterparty has no restrictions by law, regulation, or any agreement with the counterparty on the ability to use the cash received (ie the cash variation margin received is used as its own cash).

(ii) Variation margin is calculated and exchanged on at least a daily basis based on mark-to-market valuation of derivative positions. To meet this criterion, derivative positions must be valued daily and cash variation margin must be transferred at least daily to the counterparty or to the counterparty's account, as appropriate. Cash variation margin exchanged on the morning of the subsequent trading day based on the previous, end-of-day market values would meet this criterion.

(iii) The variation margin is received in a currency specified in the derivative contract, governing master netting agreement (MNA), credit support annex (CSA) to the qualifying MNA or as defined by any netting agreement with a CCP.

(iv) Variation margin exchanged is the full amount that would be necessary to extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty.[17]

(v) Derivative transactions and variation margins are covered by a single MNA between the legal entities that are the counterparties in the derivative transaction. The MNA must explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective (ie it satisfies the conditions in paragraph 4 (c) and paragraph 5 of the Annex) in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency. For the purposes of this paragraph, the term "MNA" includes any netting agreement that provides legally enforceable rights of offset[18] and a Master MNA may be deemed to be a single MNA.

40. If the conditions in paragraph 39 are met, the cash portion of variation margin received may be used to reduce the replacement cost portion of the leverage ratio exposure measure, and the receivables assets from cash variation margin provided may be deducted from the leverage ratio exposure measure as follows:

16 A QCCP is defined as in Annex 4, Section I, A. General Terms of the Basel II framework as amended by the standard *Capital requirements for bank exposures to central counterparties* (Basel Committee on Banking Supervision, *Capital requirements for bank exposures to central counterparties*, April 2014, www.bis.org/publ/bcbs282.pdf).

17 In situations where a margin dispute arises, the amount of non-disputed variation margin that has been exchanged can be recognised.

18 This is to take into account the fact that, for netting agreements employed by CCPs, no standardisation has currently emerged that would be comparable with respect to over-the-counter netting agreements for bilateral trading.

- In the case of cash variation margin received, the receiving bank may reduce the replacement cost (but not the PFE component) of the exposure amount of the derivative asset as specified in paragraph 2 of the Annex.
- In the case of cash variation margin provided to a counterparty, the posting bank may deduct the resulting receivable from its leverage ratio exposure measure where the cash variation margin has been recognised as an asset under the bank's operative accounting framework, and instead include the cash variation margin provided in the calculation of the derivative replacement cost as specified in paragraph 2 of the Annex.

41. *Treatment of clearing services*: where a bank acting as clearing member (CM)[19] offers clearing services to clients, the CM's trade exposures to the central counterparty (CCP) that arise when the CM is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults must be captured by applying the same treatment that applies to any other type of derivative transaction. However, if the CM, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered in the event that a QCCP defaults, the CM need not recognise the resulting trade exposures to the QCCP in the leverage ratio exposure measure. In addition, where a bank provides clearing services as a "higher level client" within a multi-level client structure,[20] the bank need not recognise in its leverage ratio exposure measure the resulting trade exposures to the CM or to an entity that serves as a higher level client to the bank in the leverage ratio exposure measure if it meets all of the following conditions:

- The offsetting transactions are identified by the QCCP as higher level client transactions and collateral to support them is held by the QCCP and/or the CM, as applicable, under arrangements that prevent any losses to the higher level client due to: (i) the default or insolvency of the CM, (ii) the default or insolvency of the CM's other clients, and (iii) the joint default or insolvency of the CM and any of its other clients;[21]
- The bank must have conducted a sufficient legal review (and undertake such further review as necessary to ensure continuing enforceability) and have a well-founded basis to conclude that, in the event of legal challenge, the relevant courts and administrative authorities would find that such arrangements mentioned above would be legal, valid, binding and enforceable under relevant laws of the relevant jurisdiction(s);
- Relevant laws, regulation, rules, contractual or administrative arrangements provide that the offsetting transactions with the defaulted or insolvent CM are highly likely to continue to be indirectly transacted through the QCCP, or by the QCCP, if the CM defaults or becomes insolvent.[22] In such circumstances, the higher level client positions and collateral with the QCCP will be transferred at market value unless the higher level client requests to close out the position at market value; and

[19] For the purposes of this paragraph, the terms "clearing member", "trade exposure", "central counterparty" and "qualifying central counterparty" are defined as in Annex 4, Section I, A. General Terms of the Basel II framework as amended.

[20] A multi-level client structure is one in which banks can centrally clear as indirect clients; that is, when clearing services are provided to the bank by an institution which is not a direct clearing member, but is itself a client of a clearing member or another clearing client. The term "higher level client" refers to the institution that provides clearing services.

[21] That is, upon the insolvency of the clearing member, there is no legal impediment (other than the need to obtain a court order to which the client is entitled) to the transfer of the collateral belonging to clients of a defaulting clearing member to the QCCP, to one of more other surviving clearing members or to the client or the client's nominee.

[22] If there is a clear precedent for transactions being ported at a QCCP and industry intent for this practice to continue, then these factors must be considered when assessing if trades are highly likely to be ported. The fact that QCCP documentation does not prohibit client trades from being ported is not sufficient to say they are highly likely to be ported.

- The bank is not obligated to reimburse its client for any losses suffered in the event of default of either the CM or the QCCP.

42. Where a client enters directly into a derivative transaction with the CCP and the CM guarantees the performance of its client's derivative trade exposures to the CCP, the bank acting as the CM for the client to the CCP must calculate its related leverage ratio exposure resulting from the guarantee as a derivative exposure as set out in paragraphs 33 to 40, as if it had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin.

43. For the purposes of paragraphs 41 and 42, an entity affiliated to the bank acting as a CM may be considered a client if it is outside the relevant scope of regulatory consolidation at the level at which the leverage ratio is applied. In contrast, if an affiliate entity falls within the regulatory scope of consolidation, the trade between the affiliate entity and the CM is eliminated in the course of consolidation but the CM still has a trade exposure to the CCP. In this case, the transaction with the CCP will be considered proprietary and the exemption in paragraph 41 will not apply.

44. *Additional treatment for written credit derivatives*: in addition to the CCR exposure arising from the fair value of the contracts, written credit derivatives create a notional credit exposure arising from the creditworthiness of the reference entity. The Committee therefore believes that it is appropriate to treat written credit derivatives consistently with cash instruments (eg loans, bonds) for the purposes of the leverage ratio exposure measure.

45. In order to capture the credit exposure to the underlying reference entity, in addition to the above treatment for derivatives and related collateral, the effective notional amount referenced by a written credit derivative is to be included in the leverage ratio exposure measure unless the written credit derivative is included in a transaction cleared on the behalf of a client of the bank acting as a CM (or acting as a clearing services provider in a multi-level client structure as referenced in paragraph 41) and the transaction meets the requirements of paragraph 41 for the exclusion of trade exposures to the QCCP (or, in the case of a multi-level client structure, the requirements of paragraph 41 for the exclusion of trade exposures to the CM or the QCCP). The "effective notional amount" is obtained by adjusting the notional amount to reflect the true exposure of contracts that are leveraged or otherwise enhanced by the structure of the transaction. Further, the effective notional amount of a written credit derivative may be reduced by any negative change in fair value amount that has been incorporated into the calculation of Tier 1 capital with respect to the written credit derivative.[23, 24] The resulting amount may be further reduced by the effective notional amount of a purchased credit derivative on the same reference name, provided that:

- the credit protection purchased through credit derivatives is otherwise subject to the same or more conservative material terms as those in the corresponding written credit derivative. This ensures that if a bank provides written protection via some type of credit derivative, the bank

[23] For example, if a written credit derivative had a positive fair value of 20 on one date and has a negative fair value of 10 on a subsequent reporting date, the effective notional amount of the credit derivative may be reduced by 10. The effective notional amount cannot be reduced by 30. However, if on the subsequent reporting date the credit derivative has a positive fair value of five, the effective notional amount cannot be reduced at all.

[24] This treatment is consistent with the rationale that the effective notional amounts included in the exposure measure may be capped at the level of the maximum potential loss, which means that the maximum potential loss at the reporting date is the notional amount of the credit derivative minus any negative fair value that has already reduced Tier 1 capital.

may only recognise offsetting from another purchased credit derivative to the extent that the purchased protection is certain to deliver a payment in all potential future states. Material terms include the level of subordination, optionality, credit events, reference and any other characteristics relevant to the valuation of the derivative;[25]

- the remaining maturity of the credit protection purchased through credit derivatives is equal to or greater than the remaining maturity of the written credit derivative;
- the credit protection purchased through credit derivatives is not purchased from a counterparty whose credit quality is highly correlated with the value of the reference obligation in the sense specified in paragraph 101 of the Basel III framework;[26]
- in the event that the effective notional amount of a written credit derivative is reduced by any negative change in fair value reflected in the bank's Tier 1 capital, the effective notional amount of the offsetting credit protection purchased through credit derivatives must also be reduced by any resulting positive change in fair value reflected in Tier 1 capital; and
- the credit protection purchased through credit derivatives is not included in a transaction that has been cleared on behalf of a client (or that has been cleared by the bank in its role as a clearing services provider in a multi-level client services structure as referenced in paragraph 41) and for which the effective notional amount referenced by the corresponding written credit derivative is excluded from the leverage ratio exposure measure according to this paragraph.

46. For the purposes of paragraph 45, the term "written credit derivative" refers to a broad range of credit derivatives through which a bank effectively provides credit protection and is not limited solely to credit default swaps and total return swaps. For example, all options where the bank has the obligation to provide credit protection under certain conditions qualify as "written credit derivatives". The effective notional amount of such options sold by the bank may be offset by the effective notional amount of options by which the bank has the right to purchase credit protection which fulfils the conditions of paragraph 45. For example, the condition of same or more conservative material terms as those in the corresponding written credit derivatives as referenced in paragraph 45 can be considered met only when the strike price of the underlying purchased credit protection is equal to or lower than the strike price of the underlying sold credit protection.

47. For the purposes of paragraph 45, two reference names are considered identical only if they refer to the same legal entity. Credit protection on a pool of reference names purchased through credit derivatives may offset credit protection sold on individual reference names if the credit protection purchased is economically equivalent to purchasing credit protection separately on each of the individual names in the pool (this would, for example, be the case if a bank were to purchase credit protection on an entire securitisation structure). If a bank purchases credit protection on a pool of reference names through credit derivatives, but the credit protection purchased does not cover the entire pool (ie the protection covers only a subset of the pool, as in the case of an nth-to-default credit derivative or a securitisation tranche), then the written credit derivatives on the individual reference names may not be offset. However,

[25] For example, the application of the same material terms condition would result in the following treatments:
- in the case of single name credit derivatives, the credit protection purchased through credit derivatives is on a reference obligation which ranks pari passu with or is junior to the underlying reference obligation of the written credit derivative. Credit protection purchased through credit derivatives that references a subordinated position may offset written credit derivatives on a more senior position of the same reference entity as long as a credit event on the senior reference asset would result in a credit event on the subordinated reference asset;
- for tranched products, the credit protection purchased through credit derivatives must be on a reference obligation with the same level of seniority.

[26] Specifically, the credit quality of the counterparty must not be positively correlated with the value of the reference obligation (ie the credit quality of the counterparty falls when the value of the reference obligation falls and the value of the purchased credit derivative increases). In making this determination, there does not need to exist a legal connection between the counterparty and the underlying reference entity.

such purchased credit protection may offset written credit derivatives on a pool provided that the credit protection purchased through credit derivatives covers the entirety of the subset of the pool on which the credit protection has been sold.

48. Where a bank purchases credit protection through a total return swap (TRS) and records the net payments received as net income, but does not record offsetting deterioration in the value of the written credit derivative (either through reductions in fair value or by an addition to reserves) in Tier 1 capital, the credit protection will not be recognised for the purpose of offsetting the effective notional amounts related to written credit derivatives.

49. Since written credit derivatives are included in the leverage ratio exposure measure at their effective notional amounts, and are also subject to amounts for PFE, the leverage ratio exposure measure for written credit derivatives may be overstated. Banks may therefore choose to exclude from the netting set for the PFE calculation the portion of a written credit derivative which is not offset according to paragraph 45 and for which the effective notional amount is included in the leverage ratio exposure measure.

(c) Securities financing transaction exposures

50. SFTs[27] are included in the leverage ratio exposure measure according to the treatment described below. The treatment recognises that secured lending and borrowing in the form of SFTs is an important source of leverage, and ensures consistent international implementation by providing a common measure for dealing with the main differences in the operative accounting frameworks.

51. *General treatment (bank acting as principal)*: the sum of the amounts in subparagraphs (i) and (ii) below is to be included in the leverage ratio exposure measure:

(i) Gross SFT assets[28] recognised for accounting purposes (ie with no recognition of accounting netting),[29] adjusted as follows:

- excluding from the leverage ratio exposure measure the value of any securities received under an SFT, where the bank has recognised the securities as an asset on its balance sheet;[30] and
- cash payables and cash receivables in SFTs with the same counterparty may be measured net if all the following criteria are met:
  - (a) transactions have the same explicit final settlement date; in particular, transactions with no explicit end date but which can be unwound at any time by either party to the transaction are not eligible;

[27] SFTs are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements.

[28] For SFT assets subject to novation and cleared through QCCPs, "gross SFT assets recognised for accounting purposes" are replaced by the final contractual exposure, ie the exposure to the QCCP after the process of novation has been applied, given that pre-existing contracts have been replaced by new legal obligations through the novation process. However, banks can only net cash receivables and cash payables with a QCCP if the criteria in paragraph 51 (i) are met. Any other netting permitted by the QCCP is not permitted for the purposes of the Basel III leverage ratio.

[29] Gross SFT assets recognised for accounting purposes must not recognise any *accounting* netting of cash payables against cash receivables (eg as currently permitted under the IFRS and US GAAP accounting frameworks). This regulatory treatment has the benefit of avoiding inconsistencies from netting which may arise across different accounting regimes.

[30] This may apply, for example, under US GAAP, where securities received under an SFT may be recognised as assets if the recipient has the right to rehypothecate but has not done so.

(b) the right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of the counterparty's (i) default; (ii) insolvency; or (iii) bankruptcy; and

(c) the counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement – that is, the cash flows of the transactions are equivalent, in effect, to a single net amount on the settlement date. To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and any issues arising from the securities legs of the SFTs do not interfere with the completion of the net settlement of the cash receivables and payables. In particular, this latter condition means that the failure of any single securities transaction in the settlement mechanism may delay settlement of only the matching cash leg or create an obligation to the settlement mechanism, supported by an associated credit facility. If there is a failure of the securities leg of a transaction in such a mechanism at the end of the window for settlement in the settlement mechanism, then this transaction and its matching cash leg must be split out from the netting set and treated gross.[31]

(ii) A measure of CCR calculated as the current exposure without an add-on for PFE, calculated as follows:

- Where a qualifying MNA[32] is in place, the current exposure (E^*) is the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA ($\sum E_i$), less the total fair value of cash and securities received from the counterparty for those transactions ($\sum C_i$). This is illustrated in the following formula:

$$E^* = \max \{0, [\sum E_i - \sum C_i]\}$$

- Where no qualifying MNA is in place, the current exposure for transactions with a counterparty must be calculated on a transaction-by-transaction basis – that is, each transaction i is treated as its own netting set, as shown in the following formula:

$$E_i^* = \max \{0, [E_i - C_i]\}$$

E_i^* may be set to zero if (i) E_i is the cash lent to a counterparty, (ii) this transaction is treated as its own netting set and (iii) the associated cash receivable is not eligible for the netting treatment in paragraph 51 (i).

For the purposes of this subparagraph, the term "counterparty" includes not only the counterparty of the bilateral repo transactions but also triparty repo agents that receive collateral in deposit and manage the collateral in the case of triparty repo transactions. Therefore, securities deposited at triparty repo agents are included in "total value of securities and cash lent to a counterparty" (E) up to the amount effectively lent to the counterparty in a repo transaction. However, excess collateral that has been deposited at triparty agents but that has not been lent out may be excluded.

31 Specifically, the criteria in paragraph 51 (i) (c) above are not intended to preclude a DVP settlement mechanism or other type of settlement mechanism, provided that the settlement mechanism meets the functional requirements set out in paragraph 51 (i) (c). For example, a settlement mechanism may meet these functional requirements if any failed transactions (ie the securities that failed to transfer and the related cash receivable or payable) can be re-entered in the settlement mechanism until they are settled.

32 A "qualifying" MNA is one that meets the requirements under paragraphs 6 and 7 of the Annex.

52. *Sale accounting transactions*: leverage may remain with the lender of the security in an SFT whether or not sale accounting is achieved under the operative accounting framework. As such, where sale accounting is achieved for an SFT under the bank's operative accounting framework, the bank must reverse all sales-related accounting entries, and then calculate its exposure as if the SFT had been treated as a financing transaction under the operative accounting framework (ie the bank must include the sum of amounts in subparagraphs (i) and (ii) of paragraph 51 for such an SFT) for the purpose of determining its leverage ratio exposure measure.

53. *Bank acting as agent*: a bank acting as agent in an SFT generally provides an indemnity or guarantee to only one of the two parties involved, and only for the difference between the value of the security or cash its customer has lent and the value of collateral the borrower has provided. In this situation, the bank is exposed to the counterparty of its customer for the difference in values rather than to the full exposure to the underlying security or cash of the transaction (as is the case where the bank is one of the principals in the transaction).

54. Where a bank acting as agent in an SFT provides an indemnity or guarantee to a customer or counterparty for any difference between the value of the security or cash the customer has lent and the value of collateral the borrower has provided and the bank does not own or control the underlying cash or security resource, then the bank will be required to calculate its leverage ratio exposure measure by applying only subparagraph (ii) of paragraph 51.[33]

55. A bank acting as agent in an SFT and providing an indemnity or guarantee to a customer or counterparty will be considered eligible for the exceptional treatment set out in paragraph 54 only if the bank's exposure to the transaction is limited to the guaranteed difference between the value of the security or cash its customer has lent and the value of the collateral the borrower has provided. In situations where the bank is further economically exposed (ie beyond the guarantee for the difference) to the underlying security or cash in the transaction,[34] a further exposure equal to the full amount of the security or cash must be included in the leverage ratio exposure measure.

56. Where a bank acting as agent provides an indemnity or guarantee to both parties involved in an SFT (ie securities lender and securities borrower), the bank will be required to calculate its leverage ratio exposure measure in accordance with paragraphs 53 to 55 separately for each party involved in the transaction.

(d) Off-balance sheet (OBS) items

57. This section explains the treatment of OBS items for inclusion in the leverage ratio exposure measure. These treatments reflect those defined in the *standardised approach for credit risk* and the *standard Revisions to the securitisation framework*, as well as treatments unique to the leverage ratio framework. OBS items include commitments (including liquidity facilities), whether or not unconditionally cancellable, direct credit substitutes, acceptances, standby letters of credit and trade letters of credit. If the OBS item is treated as a derivative exposure per the bank's relevant accounting standard, then the item must be measured as a derivative exposure for the purpose of the leverage ratio exposure measure. In this case, the bank does not need to apply the OBS item treatment to the exposure.

33 Where, in addition to the conditions in paragraphs 53 to 55, a bank acting as an agent in an SFT does not provide an indemnity or guarantee to any of the involved parties, the bank is not exposed to the SFT and therefore need not recognise those SFTs in its leverage ratio exposure measure.

34 For example, due to the bank managing collateral received in the bank's name or on its own account rather than on the customer's or borrower's account (eg by on-lending or managing unsegregated collateral, cash or securities). However, this does not apply to client omnibus accounts that are used by agent lenders to hold and manage client collateral provided that client collateral is segregated from the bank's proprietary assets and the bank calculates the exposure on a client-by-client basis.

58. In the risk-based capital framework, OBS items are converted under the standardised approach for credit risk into credit exposure equivalents through the use of credit conversion factors (CCFs). For the purpose of determining the exposure amount of OBS items for the leverage ratio, the CCFs set out in the Annex must be applied to the notional amount.

59. In addition, specific and general provisions set aside against OBS exposures that have decreased Tier 1 capital may be deducted from the credit exposure equivalent amount of those exposures (ie the exposure amount after the application of the relevant CCF). However, the resulting total off-balance sheet equivalent amount for OBS exposures cannot be less than zero.

Annex: Leverage ratio

This annex includes the relevant provisions applicable for the purpose of calculating the leverage ratio.

Derivative exposures

1. The calculation of derivative exposures for the leverage ratio exposure measure is based on a modified version of the standard set out in Annex 4 of the Basel II framework as amended by *The Standardised Approach for measuring counterparty credit risk exposures* (hereafter "SA-CCR framework").[35]

Calculation of replacement cost

2. The replacement cost of a transaction or netting set is measured as follows:

$$RC = \max\left\{V - CVM_r + CVM_p, 0\right\}$$

where (i) V is the market value of the individual derivative transaction or of the derivative transactions in a netting set; (ii) CVM_r is the cash variation margin *received* that meets the conditions set out in paragraph 39 and for which the amount has not already reduced the market value of the derivative transaction V under the bank's operative accounting standard; and (iii) CVM_p is the cash variation margin *provided* by the bank and that meets the same conditions.

Calculation of potential future exposure

3. The potential future exposure (PFE) for derivative exposures must be calculated in accordance with paragraphs 146 to 187 of Annex 4 of the SA-CCR framework. Mathematically:

$$PFE = multiplier \cdot AddOn^{aggregate}$$

For the purposes of the leverage ratio framework, the multiplier is fixed at one. Moreover, when calculating the add-on component, for all margined transactions the maturity factor set out in paragraph 164 of Annex 4 of the SA-CCR framework may be used. Further, as written options create an exposure to the underlying, they must be included in the leverage ratio exposure measure by applying the treatment described in this Annex, even if certain written options are permitted the zero exposure at default (EAD) treatment allowed in the risk-based framework.

Bilateral netting

4. For the purposes of the leverage ratio exposure measure, the following will apply:

(a) Banks may net transactions subject to novation under which any obligation between a bank and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.

[35] Basel Committee on Banking Supervision, *The standardised approach for measuring counterparty credit risk exposures*, March 2014 (rev. April 2014), www.bis.org/publ/bcbs279.pdf.

(b) Banks may also net transactions subject to any legally valid form of bilateral netting not covered in (a), including other forms of novation.

(c) In both cases (a) and (b), a bank will need to satisfy its national supervisors that it has:

(i) a netting contract or agreement with the counterparty that creates a single legal obligation, covering all included transactions, such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event that a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

(ii) written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the bank's exposure to be such a net amount under:

- the law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of jurisdiction in which the branch is located;
- the law that governs the individual transactions; and
- the law that governs any contract or agreement necessary to effect the netting.

The national supervisor, after consultation when necessary with other relevant supervisors, must be satisfied that the netting is enforceable under the laws of each of the relevant jurisdictions;[36] and

(iii) procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.

5. Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating the leverage ratio exposure measure pursuant to this framework. A walkaway clause is a provision that permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

Securities financing transaction exposures

6. *Qualifying master netting agreement*: the effects of bilateral netting agreements[37] for covering SFTs will be recognised on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

(a) provide the non-defaulting party with the right to terminate and close out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;

(b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;

(c) allow for the prompt liquidation or setoff of collateral upon the event of default; and

[36] Thus, if any of these supervisors are dissatisfied about enforceability under its laws, the netting contract or agreement will not meet the condition and neither counterparty could obtain supervisory benefit.

[37] The provisions related to qualifying master netting agreements for SFTs are intended for the calculation of the counterparty credit risk measure of SFTs as set out in paragraph 51 (ii) only.

(d) be, together with the rights arising from provisions required in (a) and (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default regardless of the counterparty's insolvency or bankruptcy.

7. Netting across positions held in the banking book and trading book will only be recognised when the netted transactions fulfil the following conditions:

(a) all transactions are marked to market daily; and

(b) the collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

Off-balance sheet (OBS) items

8. For the purposes of the leverage ratio, OBS items will be converted into credit exposures by multiplying the committed but undrawn amount by a credit conversion factor (CCF). For these purposes, commitment means any contractual arrangement that has been offered by the bank and accepted by the client to extend credit, purchase assets or issue credit substitutes. It includes any such arrangement that can be unconditionally cancelled by the bank at any time without prior notice to the obligor.[38] It also includes any such arrangement that can be cancelled by the bank if the obligor fails to meet conditions set out in the facility document, including conditions that must be met by the obligor prior to any initial or subsequent drawdown arrangement.

9. A 100% CCF will be applied to the following items:

- Direct credit substitutes, eg general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).
- Forward asset purchases, forward forward deposits and partly paid shares and securities, which represent commitments with certain drawdown.
- The exposure amount associated with unsettled financial asset purchases (ie the commitment to pay) where regular-way unsettled trades are accounted for at settlement date. Banks may offset commitments to pay for unsettled purchases and cash to be received for unsettled sales provided that the following conditions are met: (i) the financial assets bought and sold that are associated with cash payables and receivables are fair valued through income and included in the bank's regulatory trading book as specified by paragraphs 8 to 20 of the market risk framework; and (ii) the transactions of the financial assets are settled on a DVP basis.

[38] At national discretion, a jurisdiction may exempt certain arrangements from the definition of commitments provided that the following conditions are met: (i) the bank receives no fees or commissions to establish or maintain the arrangements; (ii) the client is required to apply to the bank for the initial and each subsequent drawdown; (iii) the bank has full authority, regardless of the fulfilment by the client of the conditions set out in the facility documentation, over the execution of each drawdown; and (iv) the bank's decision on the execution of each drawdown is only made after assessing the creditworthiness of the client immediately prior to drawdown. Exempted arrangements that met the above criteria are confined to certain arrangements for corporates and SMEs, where counterparties are closely monitored on an ongoing basis.

- Off-balance sheet items that are credit substitutes not explicitly included in any other category.

10. A 50% CCF will be applied to note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) regardless of the maturity of the underlying facility.

11. A 50% CCF will be applied to certain transaction-related contingent items (eg performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions).

12. A 40% CCF will be applied to commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF.

13. A 20% CCF will be applied to both the issuing and confirming banks of short-term[39] self-liquidating trade letters of credit arising from the movement of goods (eg documentary credits collateralised by the underlying shipment).

14. A 10% CCF will be applied to commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. National supervisors should evaluate various factors in the jurisdiction, which may constrain banks' ability to cancel the commitment in practice, and consider applying a higher CCF to certain commitments as appropriate.

15. Where there is an undertaking to provide a commitment on an off-balance sheet item, banks are to apply the lower of the two applicable CCFs.[40]

16. OBS securitisation exposures must be treated as per the second bullet of paragraph 20 of the Basel III securitisation framework.[41]

[39] That is, with a maturity below one year. For further details see Basel Committee on Banking Supervision, *Treatment of trade finance under the Basel capital framework*, October 2011, www.bis.org/publ/bcbs205.pdf.

[40] For example, if a bank has a commitment to open short-term self-liquidating trade letters of credit arising from the movement of goods, a 20% CCF will be applied (instead of a 40% CCF); and if a bank has an unconditionally cancellable commitment described in paragraph 59 to issue direct credit substitutes, a 10% CCF will be applied (instead of a 100% CCF).

[41] Basel Committee on Banking Supervision, *Revisions to the securitisation framework*, December 2014 (rev July 2016), www.bis.org/bcbs/publ/d303.pdf.

Statutes
of the Bank for International Settlements

(of 20 January 1930; text as amended
on 7 November 2016)[1]

Chapter I

Name, Seat and Objects

Article 1

There is constituted under the name of the Bank for International Settlements (hereinafter referred to as the Bank) a Company limited by shares.

Article 2

The registered office of the Bank shall be situated at Basle, Switzerland.

Article 3

The objects of the Bank are: to promote the co-operation of central banks and to provide additional facilities for international financial operations; and to act as trustee or

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[1] Amendments to the original text of the Statutes of 20 January 1930 were adopted by Extraordinary General Meetings held on 3 May 1937, 12 June 1950, 9 October 1961, 9 June 1969, 10 June 1974, 8 July 1975, 14 June 1993, 13 September 1994, 8 November 1999, 8 January 2001, 10 March 2003, 27 June 2005 and 7 November 2016.

agent in regard to international financial settlements entrusted to it under agreements with the parties concerned.

Chapter II

Capital

Article 4

(1) The authorised capital of the Bank shall be three thousand million Special Drawing Rights (SDR), as defined from time to time by the International Monetary Fund.[2]

(2) It shall be divided into 600,000 shares of equal nominal value, consisting of three tranches of 200,000 shares each.

(3) The nominal value of each share and the amount remaining to be paid up shall be stated on the face of the share certificates which may be issued by the Bank pursuant to Article 16.

Article 5

The two first tranches of 200,000 shares each have already been issued.

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[2] One SDR is the equivalent to the sum of US$ 0.58252, Euro 0.38671, Japanese yen 11.900, Pound sterling 0.085946, and Chinese yuan 1.0174 as approved by the Executive Board of the IMF, effective 1 October 2016; this decision is subject to revision every five years.

Article 6

The Board, upon a decision taken by a two-thirds majority, may, when it considers it advisable, issue on one or more occasions a third tranche of 200,000 shares and distribute them in accordance with the provisions of Article 8.

Article 7

(1) Twenty-five per cent. only of the value of each share shall be paid up at the time of subscription. The balance may be called up at a later date or dates at the discretion of the Board. Three months' notice shall be given of any such calls.

(2) If a shareholder fails to pay any call on a share on the day appointed for payment thereof the Board may, after giving reasonable notice to such shareholder, forfeit the share in respect of which the call remains unpaid. A forfeited share may be sold on such terms and in such manner as the Board may think fit, and the Board may execute a transfer in favour of the person or corporation to whom the share is sold. The proceeds of sale may be received by the Bank, which will pay to the defaulting shareholder any part of the net proceeds over and above the amount of the call due and unpaid.

Article 8

(1) The capital of the Bank may be increased or reduced on the proposal of the Board acting by a two-thirds majority and adopted by a two-thirds majority of the General Meeting.

(2) In the event of an increase in the authorised capital of the Bank and of a further issue of shares, the distribution among countries shall be decided by a two-thirds majority of the Board. The central banks of Belgium, England, France, Germany, Italy and the United States of America, or some other financial institution of the last-named country acceptable to the foregoing central banks, shall be entitled to subscribe or arrange for the subscription in equal proportions of at least fifty-five per cent. of such additional shares.

(3) In extending invitations to subscribe for the amount of the increase in capital not taken up by the banks referred to in clause (2), consideration shall be given by the Board to the desirability of associating with the Bank the largest possible number of central banks that make a substantial contribution to international monetary co-operation and to the Bank's activities.

Article 9

Shares subscribed in pursuance of Article 8 by the banks referred to in clause (2) of that Article may be placed at the Bank's disposal at any time for the purposes of cancellation and the issue of an equivalent number of shares. The necessary measures shall be taken by the Board by a two-thirds majority.

Article 10

No shares shall be issued below par.

Article 11

The liability of shareholders is limited to the nominal value of their shares.

Article 12

(1) The shares shall be registered and transferable in the books of the Bank.

(2) No share may be transferred without the prior consent of the Bank and of the central bank, or the institution acting in lieu of a central bank, by or through whom the shares in question were issued.

Article 13

The shares shall carry equal rights to participate in the profits of the Bank and in any distribution of assets under Articles 51, 52 and 53 of the Statutes.

Article 14

The ownership of shares of the Bank carries no right of voting or representation at the General Meeting. The right of representation and of voting, in proportion to the number of shares subscribed in each country, may be exercised by the central bank of that country or by its nominee. Should the central bank of any country not desire to exercise these rights, they may be exercised by a financial institution of widely recognised standing and of the same nationality, appointed by the Board, and not objected to by the central bank of the country in question. In cases where there is no central bank, these rights may be exercised, if the Board thinks fit, by an appropriate financial institution of the country in question appointed by the Board.

Article 15

Shares may be subscribed or acquired only by central banks, or by financial institutions appointed by the Board in accordance with the terms and conditions laid down in Article 14.

Article 16

The Bank may at its discretion issue share certificates to its shareholders.

Article 17

Ownership of shares of the Bank implies acceptance of the Statutes of the Bank.

Article 18

The registration of the name of a shareholder in the books of the Bank establishes the title to ownership of the shares so registered.

Article 18(A)
(Transitional provisions)

In accordance with the resolutions of the Extraordinary General Meeting held on 8 January 2001 and in order to implement Article 15 of the Statutes as amended, the Bank will, on a compulsory basis, repurchase each share which, as of that date, is registered in the name of a shareholder other than a central bank (a "private shareholder"), against payment of compensation of CHF 16,000 for each share, as follows:

(1) On 8 January 2001, the registration of each private shareholder will be cancelled in the books of the Bank. As from this cancellation, every private shareholder will lose all rights appertaining to shares which are repurchased (including all rights to the payment of any future dividend), subject to the provisions of Article 54; every private shareholder will receive, in exchange for every share which is ipso jure transferred to the Bank, a statutory right to the payment of the amount of compensation referred to above.

(2) With a view to the payment of the compensation, the Bank will promptly send each private shareholder a notice inviting that private shareholder: (a) to provide written confirmation that he or she has not transferred or otherwise disposed of any share registered on 8 January 2001 in his or her name; (b) to provide written instructions for payment of the compensation by the Bank; and (c) to return the corresponding share certificates to the Bank.

(3) Upon receiving a complete response to the notice sent out pursuant to Article 18(A)(2), and after it has carried out all appropriate verifications, the Bank will pay each private shareholder the amount of compensation due to that shareholder. If a private shareholder has transferred or

otherwise disposed of any share for which he or she is the registered shareholder prior to 8 January 2001, and the Bank is aware of that transfer, the Bank will pay the amount of compensation due from it to the successor in title of the registered shareholder after it has carried out all appropriate verifications. If there is any doubt as to any entitlement to compensation in respect of any share, or if there is no response or only an incomplete response to the notice sent by the Bank pursuant to Article 18(A)(2), the Bank may, on such terms as it may deem appropriate, place in escrow the amount of compensation until such time as the interested parties appropriately establish their rights. Any transfer of a share which has not been notified to the Bank before the date on which the compensation is paid will have no effect with regard to the Bank.

(4) The Board will redistribute, in the manner in which it considers appropriate, the shares repurchased from private shareholders either (a) by offering them for sale to central bank shareholders against payment of an amount equal to that of the compensation paid to the private shareholders, or (b) by offering them for subscription as bonus shares by central bank shareholders in proportion to the number of shares held (including, if applicable, any share purchased pursuant to (a) above), it being understood that this redistribution may be achieved by a combination of (a) and (b).

(5) The Board is authorised to take all decisions it deems necessary in connection with the implementation of these transitional provisions, including delegating to the General Manager as appropriate responsibility for practical execution.

Chapter III

Powers of the Bank

Article 19

The operations of the Bank shall be in conformity with the monetary policy of the central banks of the countries concerned.

Before any financial operation is carried out by or on behalf of the Bank on a given market or in a given currency, the Board shall afford to the central bank or central banks directly concerned an opportunity to dissent. In the event of disapproval being expressed within such reasonable time as the Board shall specify, the proposed operation shall not take place. A central bank may make its concurrence subject to conditions and may limit its assent to a specific operation, or enter into a general arrangement permitting the Bank to carry on its operations within such limits as to time, character and amount as may be specified. This Article shall not be read as requiring the assent of any central bank to the withdrawal from its market of funds to the introduction of which no objection had been raised by it, in the absence of stipulations to the contrary by the central bank concerned at the time the original operation was carried out.

Any Governor of a central bank, or his alternate or any other Director specially authorised by the central bank of the country of which he is a national to act on its behalf in this matter, shall, if he is present at the meeting of the Board and does not vote against any such proposed operation, be deemed to have given the valid assent of the central bank in question.

If the representative of the central bank in question is absent or if a central bank is not directly represented on the Board, steps shall be taken to afford the central bank or banks concerned an opportunity to express dissent.

Article 20

The operations of the Bank for its own account shall only be carried out in currencies deemed suitable by the Board.

Article 21

The Board shall determine the nature of the operations to be undertaken by the Bank.

The Bank may in particular:

(a) buy and sell gold coin or bullion for its own account or for the account of central banks;

(b) hold gold for its own account under earmark in central banks;

(c) accept the custody of gold for the account of central banks;

(d) make advances to or borrow from central banks against gold, bills of exchange and other short-term obligations of prime liquidity or other approved securities;

(e) discount, rediscount, purchase or sell with or without its endorsement bills of exchange, cheques and other short-term obligations of prime liquidity, including Treasury bills and other such government short-term securities as are currently marketable;

(f) buy and sell exchange for its own account or for the account of central banks;

(g) buy and sell negotiable securities other than shares for its own account or for the account of central banks;

(h) discount for central banks bills taken from their portfolio and rediscount with central banks bills taken from its own portfolio;

(i) open and maintain current or deposit accounts with central banks;

(j) accept:

(i) deposits from central banks on current or deposit account;

(ii) deposits in connection with trustee agreements that may be made between the Bank and Governments in connection with international settlements;

(iii) such other deposits as in the opinion of the Board come within the scope of the Bank's functions.

The Bank may also:

(k) act as agent or correspondent of any central bank;

(l) arrange with any central bank for the latter to act as its agent or correspondent. If a central bank is unable or unwilling to act in this capacity, the Bank may make other arrangements, provided that the central bank concerned does not object. If in such circumstances it should be deemed advisable that the Bank should establish its own agency, the sanction of a two-thirds majority of the Board will be required;

(m) enter into agreements to act as trustee or agent in connection with international settlements, provided that such agreements shall not encroach on the obligations of the Bank towards third parties; and carry out the various operations laid down therein.

Article 22

Any of the operations which the Bank is authorised to carry out with central banks under the preceding Article may be carried out with banks, bankers, corporations or individuals of any country provided that the central bank of that country does not object.

Article 23

The Bank may enter into special agreements with central banks to facilitate the settlement of international transactions between them.

For this purpose it may arrange with central banks to have gold earmarked for their account and transferable on their order, to open accounts through which central banks can transfer their assets from one currency to another and to take such other measures as the Board may think advisable within the limits of the powers granted by these Statutes. The principles and rules governing such accounts shall be fixed by the Board.

Article 24

The Bank may not:

(a) issue notes payable at sight to bearer;

(b) "accept" bills of exchange;

(c) make advances to Governments;

(d) open current accounts in the name of Governments;

(e) acquire a predominant interest in any business concern;

(f) except so far as is necessary for the conduct of its own business, remain the owner of real property for any longer period than is required in order to realise to proper advantage such real property as may come into the possession of the Bank in satisfaction of claims due to it.

Article 25

The Bank shall be administered with particular regard to maintaining its liquidity, and for this purpose shall retain assets appropriate to the maturity and character of its liabilities. Its short-term liquid assets may include bank-notes, cheques payable on sight drawn on first-class banks, claims in course of collection, deposits at sight or at short notice in first-class banks, and prime bills of exchange of not more than ninety days' usance, of a kind usually accepted for rediscount by central banks.

The proportion of the Bank's assets held in any given currency shall be determined by the Board with due regard to the liabilities of the Bank.

Chapter IV

Board and Management

Article 26

The Board shall determine the strategic and policy direction of the Bank, supervise the management, and fulfil the specific tasks given to it by these Statutes, and shall take the decisions necessary to carry out these responsibilities.

Article 27

The Board shall be composed as follows:

(1) The Governors for the time being of the central banks of Belgium, France, Germany, Great Britain, Italy and the United States of America (hereinafter referred to as *ex-officio* Directors).

Any *ex-officio* Director may appoint one person as his alternate who shall be entitled to attend and exercise the powers of a Director at meetings of the Board if the Governor himself is unable to be present.

(2) Six persons representative of finance, industry or commerce, appointed one each by the Governors of the

central banks mentioned in clause (1), and being of the same nationality as the Governor who appoints him.

If for any reason the Governor of any of the six institutions above mentioned is unable or unwilling to serve as Director, or to make an appointment under the preceding paragraph, the Governors of the other institutions referred to or a majority of them may invite to become members of the Board two nationals of the country of the Governor in question, not objected to by the central bank of that country.

Directors appointed as aforesaid, other than *ex-officio* Directors, shall hold office for three years but shall be eligible for reappointment.

(3) Not more than nine persons to be elected by the Board by a two-thirds majority from among the Governors of the central banks of countries in which shares have been subscribed but of which the central bank does not delegate *ex-officio* Directors to the Board.

The Directors so elected shall remain in office for three years but may be re-elected.

Article 28

In the event of a vacancy occurring on the Board for any reason other than the termination of a period of office in accordance with the preceding Article, the vacancy shall be filled in accordance with the procedure by which the member to be replaced was selected. In the case of Directors other than *ex-officio* Directors, the new Director may hold office for the unexpired period of his/her predecessor's term of office. He/she shall be eligible for re-election at the expiration of that term.

Article 29

[*Deleted.*]

Article 30

No person shall be appointed or hold office as a Director who is a member or an official of a Government unless he is the Governor of a central bank and no person shall be so appointed or hold office who is a member of a legislative body unless he is the Governor or a former Governor of a central bank.

Article 31

(1) Meetings of the Board shall be held not less than six times a year. At least four of these shall be held at the registered office of the Bank.

(2) In addition, decisions of the Board may be taken by means of teleconferencing or videoconferencing, or by correspondence, unless at least five Directors request that the decisions be referred to a meeting of the Board.

Article 32

A member of the Board who is not present in person at a meeting of Directors may give a proxy to any other member authorising him to vote at that meeting on his behalf.

Article 33

Unless otherwise provided by the Statutes, decisions of the Board shall be taken by a simple majority of those present or represented by proxy. In the case of an equality of votes, the Chairman shall have a second or casting vote.

The Board shall not be competent to act unless a quorum of Directors is present. This quorum shall be laid down in a regulation adopted by a two-thirds majority of the Board.

Article 34

The members of the Board may receive, in addition to out-of-pocket expenses, a fee for attendance at meeting and/or a remuneration, the amounts of which will be fixed by the Board, subject to the approval of the General Meeting.

Article 35

The proceedings of the Board shall be summarised in minutes which shall be signed by the Chairman.

Copies of or extracts from these minutes for the purpose of production in a court of justice must be certified by the Chairman of the Board or any other person designated by the Board.

A record of decisions taken at each meeting shall be sent within eight days of the meeting to every member.

Article 36

The Board shall represent the Bank in its dealings with third parties and shall have the exclusive right of entering into engagements on behalf of the Bank. It may, however, delegate this right to the Chairman of the Board, to another member or other members of the Board, to the General Manager or to any other member or members of the permanent staff of the Bank, provided that it defines the powers of each person to whom it delegates this right.

Article 37

The Bank shall be legally committed *vis-à-vis* third parties by the signatures of the Chairman of the Board and another member of the Board, or by the signatures of the General Manager and a member of the staff of the Bank who has been duly authorised by the Board to sign on behalf of the Bank, or by the signatures of two members of the staff of the Bank who have been duly authorised by the Board to sign on behalf of the Bank.

Article 38

The Board shall elect from among its members a Chairman and one or more Vice-Chairmen, one of whom shall preside at meetings of the Board in the absence of the Chairman.

At the meeting at which the Board elects its Chairman, the Chair shall be taken by the longest-serving member of the Board present.

The members of the Board so elected shall remain in office for a maximum of three years, and may be re-elected.

Article 39

(1) A General Manager and a Deputy General Manager shall be appointed by the Board on the proposal of the Chairman of the Board. Each appointment shall be made for a maximum of five years and may be renewed.

(2) The General Manager (chief executive officer) will carry out the policy determined by the Board and will be responsible to the Board for the management of the Bank.

(3) The Deputy General Manager will assist the General Manager in the management of the Bank and will exercise the responsibilities of the General Manager in his absence.

(4) Neither the General Manager nor the Deputy General Manager shall hold any other office which, in the judgement of the Board, might interfere with his duties to the Bank.

(5) Unless otherwise determined by the Board, the General Manager and Deputy General Manager shall be entitled to attend and speak at all meetings of the Board. When attending Board meetings, the General Manager, or in his absence, the Deputy General Manager, shall also be entitled to make proposals to the Board and, if he so desires, to have his opinions specially recorded in the minutes.

Article 40

(1) The departmental organisation of the Bank shall be approved by the Board on the proposal of the General Manager.

(2) The Heads of Departments and any other officers of similar rank shall be appointed by the Board on the proposal of the General Manager.

(3) The remainder of the staff shall be appointed by the General Manager.

Article 41

In carrying out his responsibilities, the General Manager shall be assisted by an advisory committee (Executive Committee). The committee will be chaired by the General Manager and will further comprise the Deputy General Manager, the Heads of Department, and all other officers of similar rank appointed by the Board. The terms of reference for the committee shall be approved by the Board.

Article 42

Except in respect of the core responsibilities of the Board, including those matters for which a two-thirds majority of the Board is required under these Statutes, the Board may, on a temporary basis, delegate certain of its powers to one or more committees chosen from among its members.

Article 43

The Board may appoint one or more advisory committees chosen wholly or partly from among its members.

Chapter V

General Meeting

Article 44

General Meetings of the Bank may be attended by nominees of the central banks or other financial institutions referred to in Article 14.

Voting rights shall be in proportion to the number of shares subscribed in the country of each institution represented at the meeting.

The Chair shall be taken at General Meetings by the Chairman of the Board or in his absence by a Vice-Chairman.

At least three weeks' notice of General Meetings shall be given to those entitled to be represented.

Subject to the provisions of these Statutes, the General Meeting shall decide upon its own procedure.

Article 45

Within four months of the end of each financial year of the Bank, an Annual General Meeting shall be held upon such date as the Board may decide.

The meeting shall take place at the registered office of the Bank.

Voting by proxy will be permitted in such manner as the Board may have provided in advance by regulation.

Article 46

The Annual General Meeting shall be invited:

(a) to approve the Annual Report, the Balance Sheet upon the Report of the Auditors, and the Profit and Loss

Account, and any proposed changes in the remuneration, fees or allowances of the members of the Board;

(b) to make appropriations to reserve and to special funds, and to consider the declaration of a dividend and its amount;

(c) to elect the Auditors for the ensuing year and to fix their remuneration; and

(d) to discharge the Board from all personal responsibility in respect of the past financial year.

Article 47

Extraordinary General Meetings shall be summoned to decide upon any proposals of the Board:

(a) to amend the Statutes;

(b) to increase or decrease the capital of the Bank;

(c) to liquidate the Bank.

Chapter VI

Accounts and Profits

Article 48

The financial year of the Bank will begin on 1st April and end on 31st March. The first financial period will end on 31st March, 1931.

Article 49

The Bank shall publish an Annual Report, and at least once a month a Statement of Account in such form as the Board may prescribe.

The Board shall cause to be prepared a Profit and Loss Account and Balance Sheet of the Bank for each financial year in time for submission to the Annual General Meeting.

Article 50

The Accounts and Balance Sheet shall be audited by independent auditors. The Auditors shall have full power to examine all books and accounts of the Bank and to require full information as to all its transactions. The Auditors shall report to the Board and to the General Meeting and shall state in their Report:

(a) whether they have obtained all the information and explanations they have required; and

(b) whether, in their opinion, the Balance Sheet and the Profit and Loss Account dealt with in the Report are properly drawn up so as to exhibit a true and fair view of the state of the Bank's affairs according to the best of their information and the explanations given to them, and as shown by the books of the Bank.

Article 51

The yearly net profits of the Bank shall be applied as follows:

(1) Five per cent. of such net profits, or such proportion of five per cent. as may be required for the purpose, shall be paid to a reserve fund called the Legal Reserve Fund until that Fund reaches an amount equal in value to ten per cent. of the amount of the paid-up capital of the Bank for the time being.

(2) Thereafter the net profits shall be applied in or towards payment of the dividend which is declared by the General Meeting on the proposal of the Board. The portion of the net

profits so applied shall take into account the amount (if any) which the Board decides to draw from the Special Dividend Reserve Fund of the Bank pursuant to Article 52.

(3) After making provision for the foregoing, one-half of the yearly net profits then remaining shall be paid into the General Reserve Fund of the Bank until it equals the paid-up capital. Thereafter forty per cent. shall be so applied until the General Reserve Fund equals twice the paid-up capital; thirty per cent. until it equals three times the paid-up capital; twenty per cent. until it equals four times the paid-up capital; ten per cent. until it equals five times the paid-up capital; and from that point onward, five per cent.

In case the General Reserve Fund, by reason of losses or by reason of an increase in the paid-up capital, falls below the amounts provided for above after having once attained them, the appropriate proportion of the yearly net profits shall again be applied until the position is restored.

(4) The disposal of the remainder of the net profits shall be determined by the General Meeting on the proposal of the Board, provided that a portion of such remainder may be allotted to the shareholders by way of a transfer to the Special Dividend Reserve Fund.

Article 52
Reserve Funds

The General Reserve Fund shall be available for meeting any losses incurred by the Bank. In case it is not adequate for this purpose, recourse may be had to the Legal Reserve Fund provided for in clause (1) of Article 51.

The Special Dividend Reserve Fund shall be available, in case of need, for paying the whole or any part of the dividend declared pursuant to clause (2) of Article 51.

These reserve funds, in the event of liquidation, and after the discharge of the liabilities of the Bank and the costs of liquidation, shall be divided among the shareholders.

Chapter VII

General Provisions

Article 53

(1) The Bank may not be liquidated except by a three-fourths majority of the General Meeting.

(2) In the event of the liquidation of the Bank, the obligations assumed by the Bank under the Staff Pension Scheme and any related special funds, in particular the corresponding liability as published in the latest Balance Sheet or Statement of Account, shall enjoy priority over the discharge of any other liabilities of the Bank, irrespective of whether or not the pension fund of the Bank, which covers the relevant obligations, has separate legal personality at the time of liquidation.

Article 54

(1) If any dispute shall arise between the Bank, on the one side, and any central bank, financial institution, or other bank referred to in the present Statutes, on the other side, or between the Bank and its shareholders, with regard to the interpretation or application of the Statutes of the Bank, the same shall be referred for final decision to the Tribunal provided for by the Hague Agreement of January, 1930.

(2) In the absence of agreement as to the terms of submission either party to a dispute under this Article may refer the same to the Tribunal, which shall have power to decide all questions (including the question of its own jurisdiction) even in default of appearance by the other party.

(3) Before giving a final decision and without prejudice to the questions at issue, the President of the Tribunal, or, if he is unable to act in any case, a member of the Tribunal to be designated by him forthwith, may, on the request of the first

party applying therefor, order any appropriate provisional measures in order to safeguard the respective rights of the parties.

(4) The provisions of this Article shall not prejudice the right of the parties to a dispute to refer the same by common consent to the President or a member of the Tribunal as sole arbitrator.

Article 55

(1) The Bank shall enjoy immunity from jurisdiction, save:

(a) to the extent that such immunity is formally waived in individual cases by the Chairman of the Board, the General Manager, the Deputy General Manager, or their duly authorised representatives; or

(b) in civil or commercial suits, arising from banking or financial transactions, initiated by contractual counterparties of the Bank, except in those cases in which provision for arbitration has been or shall have been made.

(2) Property and assets of the Bank shall, wherever located and by whomsoever held, be immune from any measure of execution (including seizure, attachment, freeze or any other measure of execution, enforcement or sequestration), except if that measure of execution is sought pursuant to a final judgment rendered against the Bank by any court of competent jurisdiction pursuant to sub-paragraph 1(a) or (b) above.

(3) All deposits entrusted to the Bank, all claims against the Bank and the shares issued by the Bank shall, without the express prior agreement of the Bank, wherever located and by whomsoever held, be immune from any measure of execution (including seizure, attachment, freeze or any other measure of execution, enforcement or sequestration).

Article 56

For the purposes of these Statutes:

(a) central bank means the bank or banking system in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country; or, in a cross-border central banking system, the national central banks and the common central banking institution which are entrusted with such duty;

(b) the Governor of a central bank means the person who, subject to the control of his Board or other competent authority, has the direction of the policy and administration of the bank;

(c) a two-thirds majority of the Board means not less than two-thirds of the votes (whether given in person or by proxy) of the whole directorate;

(d) country means a sovereign state, a monetary zone within a sovereign state or a monetary zone extending over more than one sovereign state.

Article 57

Amendments of any Articles of these Statutes other than those enumerated in Article 58 may be proposed by a two-thirds majority of the Board to the General Meeting and if adopted by a majority of the General Meeting shall come into force, provided that such amendments are not inconsistent with the provisions of the Articles enumerated in Article 58.

Article 58

Articles 2, 3, 8, 14, 19, 24, 27, 44, 51, 54, 57 and 58 cannot be amended except subject to the following conditions: the amendment must be adopted by a two-thirds majority of the Board, approved by a majority of the General Meeting and sanctioned by a law supplementing the Charter of the Bank.

BANK FOR INTERNATIONAL SETTLEMENTS

Triennial Central Bank Survey

Foreign exchange turnover in April 2016

Monetary and Economic Department

September 2016
Annex tables revised on 11 December 2016

Tools to access and download the results of the BIS Triennial Central Bank Survey:

- BIS website – tables in PDF of the BIS's most current data
- BIS Statistics Explorer – a browsing tool for pre-defined views of the BIS's most current data
- BIS Statistics Warehouse – a search tool for customised queries of the BIS's most current data

Questions about the BIS Triennial Central Bank Survey may be addressed to statistics@bis.org.

This publication is available on the BIS website (www.bis.org/publ/rpfx16.htm).

Foreign exchange turnover in April 2016

Contents

This publication presents the global results of the 2016 BIS Triennial Central Bank Survey of turnover in foreign exchange markets. A separate publication presents the results of turnover in over-the-counter interest rate derivatives markets (www.bis.org/publ/rpfx16.htm). Many participating authorities also publish their national results, links to which are available on the BIS website (www.bis.org/statistics/triennialrep/national.htm). The global results for a companion survey on amounts outstanding in OTC derivatives markets will be published in November 2016.

Data are subject to change. Revised data will be released concurrently with the *BIS Quarterly Review* in December 2016. The December 2016 *BIS Quarterly Review* will include several special feature articles that analyse the results of the 2016 Triennial Survey.

Notations

billion	thousand million
trillion	thousand billion
e	estimated
lhs	left-hand scale
rhs	right-hand scale
$	US dollar unless specified otherwise
…	not available
.	not applicable
–	nil or negligible

Differences in totals are due to rounding.

The term "country" as used in this publication also covers territorial entities that are not states as understood by international law and practice but for which data are separately and independently maintained.

Abbreviations

ARS	Argentine peso
AUD	Australian dollar
BGN	Bulgarian lev
BHD	Bahraini dinar
BRL	Brazilian real
CAD	Canadian dollar
CHF	Swiss franc
CLP	Chilean peso
CNY	Chinese yuan (renminbi)
COP	Colombian peso
CZK	Czech koruna
DKK	Danish krone
EUR	euro
GBP	pound sterling
HKD	Hong Kong dollar
HUF	Hungarian forint
IDR	Indonesian rupiah
ILS	Israeli new shekel
INR	Indian rupee
JPY	yen
KRW	Korean won
LTL	Lithuanian litas
LVL	Latvian lats
MXN	Mexican peso
MYR	Malaysian ringgit
NOK	Norwegian krone
NZD	New Zealand dollar
OTH	other currencies
PEN	Peruvian new sol
PHP	Philippine peso
PLN	Polish zloty
RMB	renminbi; see CNY
RON	new Romanian leu
RUB	Russian rouble
SAR	Saudi riyal
SEK	Swedish krona
SGD	Singapore dollar
THB	Thai baht
TRY	Turkish lira
TWD	new Taiwan dollar
USD	US dollar
ZAR	South African rand

1. BIS Triennial Central Bank Survey

The BIS Triennial Central Bank Survey is the most comprehensive source of information on the size and structure of global foreign exchange (FX) and over-the-counter (OTC) derivatives markets. The Triennial Survey aims to increase the transparency of OTC markets and to help central banks, other authorities and market participants monitor developments in global financial markets. It also helps to inform discussions on reforms to OTC markets.

FX market activity has been surveyed every three years since 1986, and OTC interest rate derivatives market activity since 1995.[1] The Triennial Survey is coordinated by the BIS under the auspices of the Markets Committee (for the FX part) and the Committee on the Global Financial System (for the interest rate derivatives part). It is supported through the Data Gaps Initiative endorsed by the G20.

The latest survey of turnover took place in April 2016. Central banks and other authorities in 52 jurisdictions participated in the 2016 survey (see page 15). They collected data from close to 1,300 banks and other dealers in their jurisdictions and reported national aggregates to the BIS, which then calculated global aggregates. Turnover data are reported by the sales desks of reporting dealers, regardless of where a trade is booked, and are reported on an unconsolidated basis, ie including trades between related entities that are part of the same group.

Highlights

Highlights from the 2016 Triennial Survey of turnover in OTC foreign exchange markets:

- Trading in foreign exchange markets averaged $5.1 trillion per day in April 2016. This is down from $5.4 trillion in April 2013, a month which had seen heightened activity in Japanese yen against the background of monetary policy developments at that time.
- For first time since 2001, spot turnover declined. Spot transactions fell to $1.7 trillion per day in April 2016 from $2.0 trillion in 2013. In contrast, the turnover of FX swaps rose further, reaching $2.4 trillion per day in April 2016. This rise was driven in large part by increased trading of FX swaps involving yen.
- The US dollar remained the dominant vehicle currency, being on one side of 88% of all trades in April 2016. The euro, yen and Australian dollar all lost market share. In contrast, many emerging market currencies increased their share. The renminbi doubled its share, to 4%, to become the world's eighth most actively traded currency and the most actively traded emerging market currency, overtaking the Mexican peso. The rise in the share of renminbi was primarily due to the increase in trading against the US dollar. In April 2016, as much as 95% of renminbi trading volume was against the US dollar.
- The share of trading between reporting dealers grew over the three-year period, accounting for 42% of turnover in April 2016, compared with 39% in April 2013. Banks other than reporting dealers accounted for a further 22% of turnover. Institutional investors were the third largest group of counterparties in FX markets, at 16%.
- In April 2016, sales desks in five countries – the United Kingdom, the United States, Singapore, Hong Kong SAR and Japan – intermediated 77% of foreign exchange trading, up from 75% in April 2013 and 71% in April 2010.

[1] More frequent regional surveys are conducted by local foreign exchange committees in Australia, Canada, London, New York, Singapore and Tokyo. These semiannual surveys focus on the structure of local FX markets, and there are some methodological differences compared with the Triennial Survey. In particular, the Triennial Survey collects data based on the location of the sales desk, whereas some regional surveys are based on the location of the trading desk.

2. Turnover in foreign exchange markets

According to the 2016 Triennial Survey, turnover in global FX markets averaged $5.1 trillion per day in 2016 (Table 1). This is down from $5.4 trillion in April 2013, a month which had seen heightened activity in Japanese yen against the background of monetary policy developments at that time.[2] In addition, exchange rate movements influence comparisons with previous surveys. In particular, the appreciation of the US dollar between 2013 and 2016 reduced the US dollar value of turnover in currencies other than the US dollar. When valued at constant (April 2016) exchange rates, turnover increased slightly, by about 4% between April 2016 and April 2013 (Table 1). Nevertheless, the latest developments contrast with the strong growth in turnover observed between Triennial Surveys since 2001.

Turnover by currencies and currency pairs

The US dollar remained the world's dominant vehicle currency. It was on one side of 88% of all trades in April 2016, up slightly from 87% in April 2013 (Graph 1, left-hand panel). In contrast, trading in the next eight most liquid currencies has shifted notably.

The role of the euro in FX markets has continued to decline since the beginning of the euro area sovereign debt crisis in 2010. The market share of the currency declined to 31% in April 2016 from 33% in April 2013 and 39% in April 2010 (Graph 1, left-hand panel, and Table 2). Trading in the four most actively traded euro currency pairs – USD/EUR, EUR/GBP, EUR/JPY and EUR/CHF – fell. USD/EUR average daily turnover declined by $119 billion, while the relative declines were most pronounced for the EUR/JPY and EUR/CHF pairs (Table 3). In contrast, trading in the EUR/SEK and EUR/NOK currency pairs increased.

The share of the yen in global FX trading also declined, by 1 percentage point to 22% by April 2016 (Graph 1, left-hand panel, and Table 2). This contrasts sharply with the currency's 4 percentage point expansion reported in the previous survey, which coincided with the expansionary monetary policy shift of the Bank of Japan in April 2013. Trading in the three most actively traded yen cross rates – USD/JPY, EUR/JPY and JPY/AUD – contracted significantly from 2013 to 2016.

Among the other heavily traded advanced economy currencies, the Australian dollar and Swiss franc also lost market share, from 8.6% to 6.9% and 5.2% to 4.8%, respectively; in contrast, the pound sterling, Canadian dollar, Swedish krona and Norwegian krone gained shares in global FX turnover.

The 2016 Triennial Survey shows a further significant rise in the global importance of several emerging market currencies. The renminbi became the most actively traded emerging market currency, overtaking the Mexican peso to become the world's eighth most actively traded currency (Table 2). The average daily turnover of renminbi almost doubled, from $120 billion to $202 billion, between April 2013 and April 2016, representing a rise in the share in global FX turnover from 2% to 4%. Ninety-five per cent of renminbi turnover is due to trading against the US dollar. The average turnover of USD/CNY rose from $113 billion to $192 billion over the three-year period, with that pair moving up from ninth to sixth place among the most traded currency pairs (Table 3).

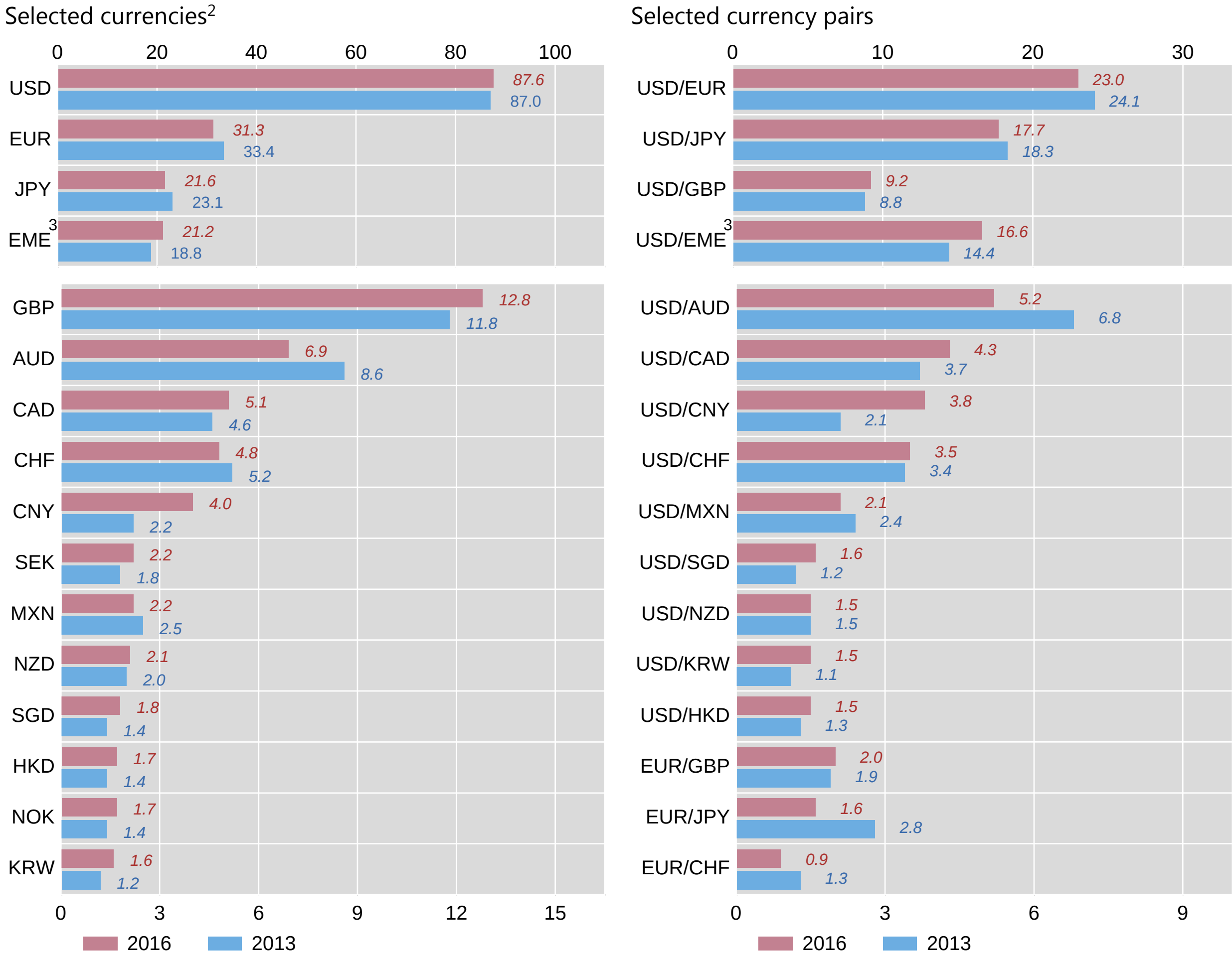
Several other emerging market currencies, particularly from the Asia-Pacific region, gained market share: the Korean won, Indian rupee and Thai baht were among the currencies that advanced in the ranking by two or three places (Table 2). In contrast, the turnover of some emerging market currencies peaked in 2013 and has since exhibited a significant decline (eg the Mexican peso and Russian rouble).

[2] For a discussion of drivers of trading volumes in April 2013, see D Rime and A Schrimpf, "The anatomy of the global FX market through the lens of the 2013 Triennial Survey", *BIS Quarterly Review*, December 2013, pp 27–43, www.bis.org/publ/qtrpdf/r_qt1312e.htm.

Foreign exchange market turnover by currency and currency pairs

Net-net basis,[1] daily averages in April, in per cent

Graph 1



[1] Adjusted for local and cross-border inter-dealer double-counting. [2] As two currencies are involved in each transaction, the sum of shares in individual currencies will total 200%. [3] Emerging market currencies.

Source: BIS Triennial Central Bank Survey. For additional data by currency and currency pairs, see Tables 2 and 3 on pages 10 and 11.

Turnover by instrument and maturity

Trading activity has changed unevenly across the main FX instrument categories. In particular, trading volumes of spot trades and FX swaps, the two largest instrument categories, have evolved in opposite directions.

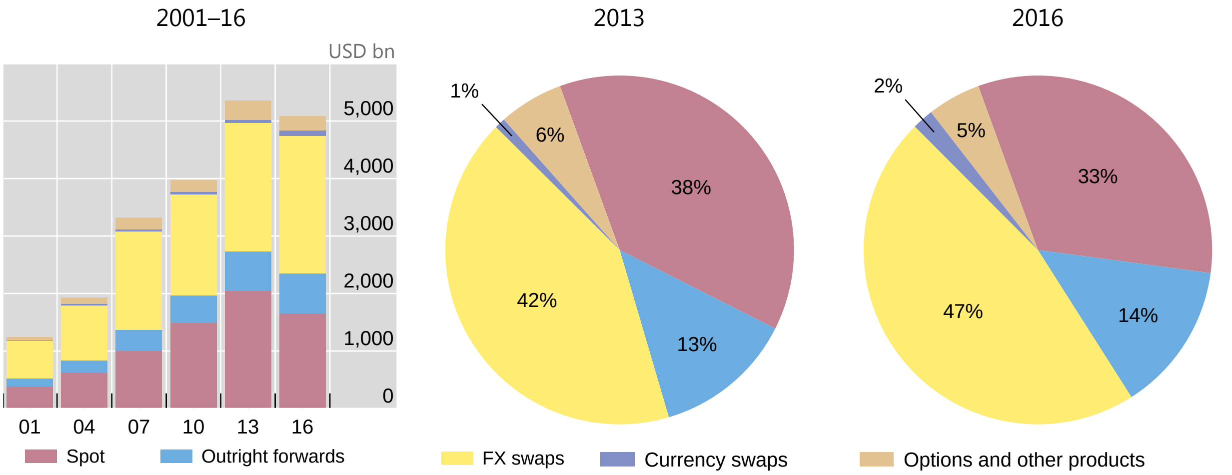
Spot market trading activity fell by 19% to $1.7 trillion per day in April 2016. This is the first time since 2001 that spot turnover has fallen compared with a previous survey (Table 1). The share of spot transactions in total foreign exchange market turnover declined by 5 percentage points between April 2013 and April 2016 to 33% (Graph 2). This decline in spot trading was the main driver behind the overall fall in global FX turnover compared with 2013.

In contrast, turnover in FX swaps rose by 6% to $2.4 trillion per day in April 2016. FX swaps remained the most traded instrument, with their share in turnover rising 5 percentage points to 47% (Table 3). Still, the growth in FX swap turnover was significantly lower than the 27% growth rate between April 2010 and April 2013.

Foreign exchange market turnover by instrument

Net-net basis,[1] daily averages in April

Graph 2



[1] Adjusted for local and cross-border inter-dealer double-counting.

Source: BIS Triennial Central Bank Survey. For additional data by instrument, see Table 1 on page 9.

The US dollar continues to be on one side of 91% of FX swap transactions, a share virtually unchanged compared with previous surveys. The euro was on one side of 34% of FX swap transactions, also a virtually unchanged share since 2013. The share of the yen in total FX swap turnover rose to 19% in April 2016, compared with 15% in 2013.[3]

Trading activity changed unevenly in other parts of the FX OTC derivatives market. Trading volume of outright forwards rose to $700 billion in 2016, a 3% increase from $679 billion in 2013. Trading volume of currency swaps grew much faster than in any other part of the FX market, although this instrument still remains the least traded, owing in part to the long maturity of the contracts. Turnover in currency swaps rose to $96 billion in 2016, a 79% increase from $54 billion in 2013.

In contrast, trading volume of FX options declined to $254 billion in 2016, 24% lower than in 2013. The largest decline took place in yen cross rates, which declined to $74 billion in 2016 (ie by 52% from 2013).[4]

The 2016 survey shows a tendency towards slightly longer maturities of FX swaps and outright forwards. For instance, 30% of FX swaps initiated in April 2016 had a contractual maturity of between seven days and one year, compared with 26% in 2013 (Table 4). Similarly, 59% of outright forwards initiated in April 2016 had a contractual maturity of between seven days and one year, compared with 56% in April 2013.

[3] For an analysis of investor positioning in yen FX swaps and related FX derivatives, see C Borio, R McCauley, P McGuire and V Sushko, "Covered interest parity lost: understanding the cross-currency basis", *BIS Quarterly Review*, September 2016 (forthcoming).

[4] These changes have to be interpreted in the context of the surge in yen options trading in April 2013, when players such as hedge funds used the options market to express their directional views on the yen given the expansionary shift in Japanese monetary policy in April 2013; for a more detailed discussion, see D Rime and A Schrimpf (2013), op cit.

Turnover by counterparty

FX trading continued to be dominated by financial institutions other than reporting dealers, which accounted for 51% of turnover in April 2016 (Graph 3 and Table 4). However, the share of trading between reporting dealers increased for the first time since 1995. Inter-dealer trading, which averaged $2.1 trillion in April 2016, increased from 39% of FX turnover in April 2013 to 42% in April 2016. The rise in inter-dealer trading was primarily driven by the increased trading in FX swaps, an 11% rise since 2013 to $1.2 trillion in April 2016. Turnover in spot activity among reporting dealers declined in absolute terms (Table 4).

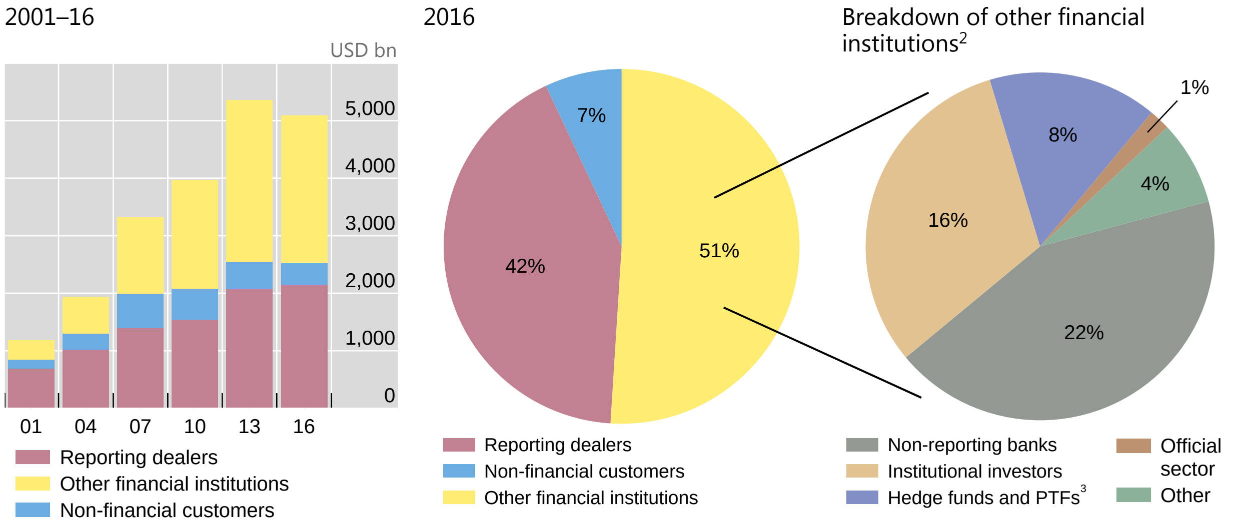
Trading between reporting dealers and other financial institutions fell slightly between 2013 and 2016, to $2.6 trillion. Non-reporting banks – smaller and regional banks that serve as clients of the large FX dealing banks but do not engage in market-making – accounted for roughly 22% of global FX turnover in April 2016 (Graph 3), down from a 24% share in April 2013. At the same time, institutional investors, such as insurance companies and pension funds, further increased their share of FX trading relative to hedge funds and proprietary trading firms: institutional investors were on one side of 16% of daily turnover in April 2016, up from 11% in 2013, whereas the corresponding share of FX trading by hedge funds and proprietary trading firms decreased from 11% to 8%.

The rise in the share of trading by institutional investors is mostly due to an increase in their use of FX swaps. Average daily FX swap turnover with institutional investors as a counterparty rose to $278 billion by April 2016 (Table 5), a 79% increase compared with the 2013 survey.

The fall in the share of trading by non-reporting banks is primarily due to a decline in their activity in the spot market, followed by a decline in their use of FX swaps. Average daily spot turnover with non-reporting banks as a counterparty stood at $354 billion in April 2016, a 30% decline compared with the 2013 survey; and average daily FX swap turnover stood at $564 billion (a 7% decline).

Foreign exchange market turnover by counterparty

Net-net basis,[1] daily averages in April — Graph 3



[1] Adjusted for local and cross-border inter-dealer double-counting. [2] For definitions of counterparties, see page 18. [3] Proprietary trading firms.

Source: BIS Triennial Central Bank Survey. For additional data by counterparty, see Tables 4 and 5 on pages 12 and 13.

The fall in the share of trading by hedge funds and proprietary trading firms was due to a decline in this sector's activity in all three of the main market segments. Average daily spot turnover with hedge funds and proprietary trading firms as a counterparty stood at $200 billion in April 2016, a 29% decline compared with the 2013 survey; trading in outright forwards and FX swaps with this counterparty sector also declined, by 29% and 37%, respectively.

Trading with non-financial customers, such as corporations and governments, contracted, accounting for only 7% of global FX turnover, a continuation of the trend captured in previous surveys.

Geographical distribution of turnover

Trading continues to be concentrated in the largest financial centres. In April 2016, sales desks in five countries – the United Kingdom, the United States, Singapore, Hong Kong SAR and Japan – intermediated 77% of all foreign exchange trading (Table 6). The share of foreign exchange trading taking place in the United States was virtually unchanged relative to the previous survey, at 19% in 2016. Asian financial centres, namely Tokyo, Hong Kong SAR and Singapore, increased their combined share of intermediation to 21%, from 15%.

The share of foreign exchange trading in the United Kingdom declined to 37% in April 2016, from 41%. The decline was broad-based across currency pairs. The market share of the euro area continued to decline, falling to 8% in April 2016 from 9% in 2013, although France maintained its 3% share. The trend decline in the share of trading activity taking place in Switzerland and Australia also continued, to 2% in each country in 2016 compared with 3% in 2013.

Annexes

A Tables

OTC foreign exchange turnover

Net-net basis,[1] daily averages in April, in billions of US dollars — Table 1

Instrument	2001	2004	2007	2010	2013	**2016**
Foreign exchange instruments	1,239	1,934	3,324	3,973	5,357	**5,067**
Spot transactions	386	631	1,005	1,489	2,047	**1,652**
Outright forwards	130	209	362	475	679	**700**
Foreign exchange swaps	656	954	1,714	1,759	2,240	**2,378**
Currency swaps	7	21	31	43	54	**82**
Options and other products[2]	60	119	212	207	337	**254**
Memo:						
Turnover at April 2016 exchange rates[3]	*1,381*	*1,884*	*3,123*	*3,667*	*4,917*	***5,067***
Exchange-traded derivatives[4]	*12*	*25*	*77*	*145*	*145*	***115***

[1] Adjusted for local and cross-border inter-dealer double-counting (ie "net-net" basis). [2] The category "other FX products" covers highly leveraged transactions and/or trades whose notional amount is variable and where a decomposition into individual plain vanilla components was impractical or impossible. [3] Non-US dollar legs of foreign currency transactions were converted into original currency amounts at average exchange rates for April of each survey year and then reconverted into US dollar amounts at average April 2016 exchange rates. [4] Sources: Euromoney Tradedata; Futures Industry Association; The Options Clearing Corporation; BIS derivatives statistics. Foreign exchange futures and options traded worldwide.

Currency distribution of OTC foreign exchange turnover

Net-net basis,[1] percentage shares of average daily turnover in April[2] — Table 2

Currency	2001		2004		2007		2010		2013		**2016**	
	Share	Rank	Share	Rank	Share	Rank	Share	Rank	Share	Rank	**Share**	**Rank**
USD	89.9	1	88.0	1	85.6	1	84.9	1	87.0	1	**87.6**	**1**
EUR	37.9	2	37.4	2	37.0	2	39.0	2	33.4	2	**31.4**	**2**
JPY	23.5	3	20.8	3	17.2	3	19.0	3	23.0	3	**21.6**	**3**
GBP	13.0	4	16.5	4	14.9	4	12.9	4	11.8	4	**12.8**	**4**
AUD	4.3	7	6.0	6	6.6	6	7.6	5	8.6	5	**6.9**	**5**
CAD	4.5	6	4.2	7	4.3	7	5.3	7	4.6	7	**5.1**	**6**
CHF	6.0	5	6.0	5	6.8	5	6.3	6	5.2	6	**4.8**	**7**
CNY[3]	0.0	35	0.1	29	0.5	20	0.9	17	2.2	9	**4.0**	**8**
SEK	2.5	8	2.2	8	2.7	9	2.2	9	1.8	11	**2.2**	**9**
NZD[3]	0.6	16	1.1	13	1.9	11	1.6	10	2.0	10	**2.1**	**10**
MXN[3]	0.8	14	1.1	12	1.3	12	1.3	14	2.5	8	**1.9**	**11**
SGD[3]	1.1	12	0.9	14	1.2	13	1.4	12	1.4	15	**1.8**	**12**
HKD[3]	2.2	9	1.8	9	2.7	8	2.4	8	1.4	13	**1.7**	**13**
NOK[3]	1.5	10	1.4	10	2.1	10	1.3	13	1.4	14	**1.7**	**14**
KRW[3]	0.8	15	1.1	11	1.2	14	1.5	11	1.2	17	**1.7**	**15**
TRY[3]	0.0	30	0.1	28	0.2	26	0.7	19	1.3	16	**1.4**	**16**
RUB[3]	0.3	19	0.6	17	0.7	18	0.9	16	1.6	12	**1.1**	**17**
INR[3]	0.2	21	0.3	20	0.7	19	0.9	15	1.0	20	**1.1**	**18**
BRL[3]	0.5	17	0.3	21	0.4	21	0.7	21	1.1	19	**1.0**	**19**
ZAR[3]	0.9	13	0.7	16	0.9	15	0.7	20	1.1	18	**1.0**	**20**
DKK[3]	1.2	11	0.9	15	0.8	16	0.6	22	0.8	21	**0.8**	**21**
PLN[3]	0.5	18	0.4	19	0.8	17	0.8	18	0.7	22	**0.7**	**22**
TWD[3]	0.3	20	0.4	18	0.4	22	0.5	23	0.5	23	**0.6**	**23**
THB[4]	0.2	24	0.2	22	0.2	25	0.2	26	0.3	27	**0.4**	**24**
MYR[4]	0.1	26	0.1	30	0.1	28	0.3	25	0.4	25	**0.4**	**25**
HUF[3]	0.0	33	0.2	23	0.3	23	0.4	24	0.4	24	**0.3**	**26**
SAR[4]	0.1	27	0.0	32	0.1	32	0.1	34	0.1	34	**0.3**	**27**
CZK[4]	0.2	22	0.2	24	0.2	24	0.2	27	0.4	26	**0.3**	**28**
ILS[4]	0.1	25	0.1	26	0.2	27	0.2	31	0.2	29	**0.3**	**29**
CLP[4]	0.2	23	0.1	25	0.1	30	0.2	29	0.3	28	**0.2**	**30**
IDR[4]	0.0	28	0.1	27	0.1	29	0.2	30	0.2	30	**0.2**	**31**
COP[4]	0.0	31	0.0	33	0.1	33	0.1	32	0.1	33	**0.2**	**32**
PHP[4]	0.0	29	0.0	31	0.1	31	0.2	28	0.1	31	**0.1**	**33**
RON[4]	...	37	...	40	0.0	34	0.1	33	0.1	32	**0.1**	**34**
PEN[4]	0.0	32	0.0	35	0.0	36	0.0	36	0.1	35	**0.1**	**35**
OTH	6.6		6.6		7.7		4.7		1.6		**2.1**	
Total	**200.0**		**200.0**		**200.0**		**200.0**		**200.0**		**200.0**	

[1] Adjusted for local and cross-border inter-dealer double-counting (ie "net-net" basis). [2] Because two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%. [3] Turnover for years prior to 2013 may be underestimated owing to incomplete reporting of offshore trading in previous surveys. Methodological changes in the 2013 survey ensured more complete coverage of activity in emerging market and other currencies. [4] Turnover may be underestimated owing to incomplete reporting of offshore trading.

OTC foreign exchange turnover by currency pair

Net-net basis,[1] daily averages in April, in billions of US dollars and percentages — Table 3

Currency pair	2001		2004		2007		2010		2013		**2016**	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	**Amount**	**%**
USD / EUR	372	30.0	541	28.0	892	26.8	1,099	27.7	1,292	24.1	**1,172**	**23.1**
USD / JPY	250	20.2	328	17.0	438	13.2	567	14.3	980	18.3	**901**	**17.8**
USD / GBP	129	10.4	259	13.4	384	11.6	360	9.1	473	8.8	**470**	**9.3**
USD / AUD	51	4.1	107	5.5	185	5.6	248	6.3	364	6.8	**262**	**5.2**
USD / CAD	54	4.3	77	4.0	126	3.8	182	4.6	200	3.7	**218**	**4.3**
USD / CNY	...	...	...	...	...	...	31	0.8	113	2.1	**192**	**3.8**
USD / CHF	59	4.8	83	4.3	151	4.5	166	4.2	184	3.4	**180**	**3.6**
USD / MXN	...	...	...	...	...	...	...	...	128	2.4	**90**	**1.8**
USD / SGD	...	...	...	...	...	...	...	...	65	1.2	**81**	**1.6**
USD / KRW	...	...	...	...	...	...	58	1.5	60	1.1	**78.0**	**1.5**
USD / NZD	...	...	...	...	...	...	...	...	82	1.5	**77.6**	**1.5**
USD / HKD	...	...	...	...	...	...	85	2.1	69	1.3	**77**	**1.5**
USD / SEK	...	...	...	...	57	1.7	45	1.1	55	1.0	**66**	**1.3**
USD / TRY	...	...	...	...	...	...	...	...	63	1.2	**64**	**1.3**
USD / INR	...	...	...	...	...	...	36	0.9	50	0.9	**56**	**1.1**
USD / RUB	...	...	...	...	...	...	...	...	79	1.5	**53**	**1.1**
USD / NOK	...	...	...	...	...	...	...	...	49	0.9	**48**	**0.9**
USD / BRL	...	...	...	...	...	...	25	0.6	48	0.9	**45**	**0.9**
USD / ZAR	...	...	...	...	...	...	24	0.6	51	1.0	**40**	**0.8**
USD / TWD	...	...	...	...	...	...	...	...	22	0.4	**31**	**0.6**
USD / PLN	...	...	...	...	...	...	...	...	22	0.4	**19**	**0.4**
USD / OTH	199	16.0	307	15.9	612	18.4	446	11.2	214	4.0	**215**	**4.2**
EUR / GBP	27	2.1	47	2.4	69	2.1	109	2.7	102	1.9	**100**	**2.0**
EUR / JPY	36	2.9	61	3.2	86	2.6	111	2.8	148	2.8	**79**	**1.6**
EUR / CHF	13	1.1	30	1.6	62	1.9	71	1.8	71	1.3	**44**	**0.9**
EUR / SEK	...	...	...	...	24	0.7	35	0.9	28	0.5	**36**	**0.7**
EUR / NOK	...	...	...	...	...	...	...	...	20	0.4	**28**	**0.6**
EUR / AUD	1	0.1	4	0.2	9	0.3	12	0.3	21	0.4	**16**	**0.3**
EUR / CAD	1	0.1	2	0.1	7	0.2	14	0.3	15	0.3	**14**	**0.3**
EUR / PLN	...	...	...	...	...	...	...	...	14	0.3	**13**	**0.3**
EUR / DKK	...	...	...	...	...	...	...	...	13	0.2	**13**	**0.2**
EUR / HUF	...	...	...	...	...	...	...	...	10	0.2	**5**	**0.1**
EUR / TRY	...	...	...	...	...	...	...	...	6	0.1	**4**	**0.1**
EUR / CNY	...	...	...	...	...	...	...	...	1	0.0	**2**	**0.0**
EUR / OTH	20	1.6	38	1.9	83	2.5	102	2.6	51	0.9	**65**	**1.3**
JPY / AUD	...	...	...	...	...	...	24	0.6	46	0.9	**31**	**0.6**
JPY / CAD	...	...	...	...	...	...	...	...	6	0.1	**7**	**0.1**
JPY / NZD	...	...	...	...	...	...	4	0.1	5	0.1	**5**	**0.1**
JPY / TRY	...	...	...	...	...	...	...	...	1	0.0	**3**	**0.1**
JPY / ZAR	...	...	...	...	...	...	...	...	4	0.1	**3**	**0.1**
JPY / BRL	...	...	...	...	...	...	...	...	3	0.1	**1**	**0.0**
JPY / OTH	15	1.2	28	1.4	66	2.0	50	1.3	88	1.7	**45**	**0.9**
Other currency pairs	13	1.1	22	1.1	74	2.2	71	1.8	44	0.8	**116**	**2.3**
All currency pairs	1,239	100.0	1,934	100.0	3,324	100.0	3,973	100.0	5,357	100.0	**5,067**	**100.0**

[1] Adjusted for local and cross-border inter-dealer double-counting (ie "net-net" basis).

OTC foreign exchange turnover by instrument, counterparty and maturity

Net-net basis,[1] daily averages in April, in billions of US dollars and percentages

Table 4

Instrument/counterparty/maturity	2001		2004		2007		2010		2013		**2016**	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	**Amount**	**%**
Spot transactions	386	31.2	631	32.6	1,005	30.2	1,489	37.5	2,047	38.2	**1,652**	**32.6**
with reporting dealers	216	56.0	310	49.2	426	42.4	518	34.8	676	33.0	**605**	**36.6**
with other financial institutions	111	28.9	212	33.7	394	39.2	755	50.7	1,183	57.8	**930**	**56.3**
with non-financial customers	58	15.0	108	17.0	184	18.3	217	14.6	188	9.2	**117**	**7.1**
Outright forwards	130	10.5	209	10.8	362	10.9	475	11.9	679	12.7	**700**	**13.8**
with reporting dealers	52	40.0	73	35.1	96	26.5	113	23.7	181	26.6	**189**	**27.0**
with other financial institutions	41	31.3	80	38.3	159	43.9	254	53.5	402	59.2	**431**	**61.6**
with non-financial customers	37	28.7	56	26.6	107	29.6	108	22.8	96	14.2	**80**	**11.4**
Up to 7 days	51	38.8	92	44.3	154	42.6	219	46.1	270	39.7	**270**	**38.6**
Over 7 days and up to 1 year	76	58.4	111	53.2	200	55.4	245	51.5	378	55.6	**412**	**58.9**
Over 1 year	4	2.7	5	2.6	7	2.0	11	2.4	31	4.6	**18**	**2.5**
Foreign exchange swaps	656	52.9	954	49.3	1,714	51.6	1,759	44.3	2,240	41.8	**2,378**	**46.9**
with reporting dealers	419	63.9	573	60.0	796	46.4	834	47.4	1,088	48.6	**1,205**	**50.7**
with other financial institutions	177	27.0	293	30.7	682	39.8	755	42.9	1,002	44.7	**1,026**	**43.1**
with non-financial customers	60	9.1	89	9.3	236	13.8	170	9.7	150	6.7	**147**	**6.2**
Up to 7 days	451	68.7	700	73.4	1,329	77.5	1,300	73.9	1,573	70.2	**1,635**	**68.7**
Over 7 days and up to 1 year	196	29.9	242	25.3	365	21.3	442	25.2	579	25.9	**713**	**30.0**
Over 1 year	8	1.2	10	1.0	18	1.0	15	0.8	87	3.9	**30**	**1.3**
Currency swaps	7	0.6	21	1.1	31	0.9	43	1.1	54	1.0	**82**	**1.6**
with reporting dealers	4	53.5	12	57.7	12	38.6	20	46.8	29	53.7	**38**	**46.1**
with other financial institutions	2	21.3	5	23.4	13	41.1	19	45.0	19	34.7	**37**	**45.5**
with non-financial customers	2	25.2	3	14.2	6	20.4	4	8.2	6	11.6	**7**	**8.5**
FX options and other products[2]	60	4.8	119	6.2	212	6.4	207	5.2	337	6.3	**254**	**5.0**
with reporting dealers	28	47.1	49	41.4	62	29.2	60	29.1	99	29.4	**84**	**32.8**
with other financial institutions	15	26.0	44	36.6	91	42.8	113	54.7	207	61.3	**141**	**55.3**
with non-financial customers	16	26.8	21	17.9	59	28.0	33	16.1	31	9.3	**30**	**11.9**
Total	1,239	100.0	1,934	100.0	3,324	100.0	3,973	100.0	5,357	100.0	**5,067**	**100.0**
with reporting dealers	719	58.1	1,018	52.6	1,392	41.9	1,545	38.9	2,072	38.7	**2,121**	**41.9**
with other financial institutions	346	27.9	634	32.8	1,339	40.3	1,896	47.7	2,812	52.5	**2,564**	**50.6**
with non-financial customers	173	14.0	276	14.3	593	17.8	532	13.4	472	8.8	**382**	**7.5**
Local	525	42.4	743	38.4	1,274	38.3	1,394	35.1	2,259	42.2	**1,798**	**35.5**
Cross-border	713	57.5	1,185	61.2	2,051	61.7	2,579	64.9	3,097	57.8	**3,269**	**64.5**

[1] Adjusted for local and cross-border inter-dealer double-counting (ie “net-net” basis). [2] The category “other FX products” covers highly leveraged transactions and/or trades whose notional amount is variable and where a decomposition into individual plain vanilla components was impractical or impossible.

OTC foreign exchange turnover by instrument, currency and counterparty

Net-net basis,[1] daily averages in April 2016, in billions of US dollars — Table 5

Instrument/currency/counterparty	Total	Spot transactions	Outright forwards	Foreign exchange swaps	Currency swaps	FX options
Total	5,067	1,652	700	2,378	82	254
By currency						
USD	4,438	1,385	600	2,160	74	218
EUR	1,591	519	178	807	22	64
JPY	1,096	395	151	458	18	74
GBP	649	211	92	305	10	30
AUD	348	143	41	138	7	20
CAD	260	105	34	103	4	14
CHF	243	57	30	150	2	5
CNY	202	68	28	86	3	18
SEK	112	34	13	59	1	5
NZD	104	40	11	43	1	8
MXN	97	43	12	36	0	6
SGD	91	28	8	51	2	3
HKD	88	22	6	57	1	1
NOK	85	29	8	44	1	3
KRW	84	29	35	14	1	5
TRY	73	20	6	40	4	4
RUB	58	24	6	27	1	1
INR	58	19	23	13	0	3
BRL	51	13	27	1	2	8
ZAR	49	16	4	24	4	2
DKK	42	7	5	30	0	0
PLN	35	12	4	18	0	1
TWD	32	9	13	8	0	1
HUF	15	4	2	8	0	1
OTH	232	72	61	78	6	15
By counterparty[3]						
with reporting dealers	2,121	605	189	1,205	38	84
local	673	204	59	374	14	23
cross-border	1,447	402	130	831	24	61
with other financial institutions	2,564	930	431	1,026	37	141
local	901	334	158	344	13	52
cross-border	1,664	596	273	682	24	89
non-reporting banks	1,113	354	136	564	18	42
institutional investors	798	290	171	278	6	52
hedge funds and PTFs[2]	389	200	82	66	9	32
official sector	74	14	14	43	2	1
other	190	71	27	76	3	13
with non-financial customers	382	117	80	147	7	30
local	224	82	55	66	3	17
cross-border	158	35	25	81	4	13
Of which: prime brokered	*887*	*564*	*119*	*143*	*3*	*58*
Of which: retail-driven	*283*	*60*	*22*	*178*	*3*	*19*

[1] Adjusted for local and cross-border inter-dealer double-counting (ie "net-net" basis). [2] Proprietary trading firms. [3] See explanatory notes for definitions of counterparties.

Geographical distribution of OTC foreign exchange turnover[1]

Net-gross basis,[2] daily averages in April, in billions of US dollars and percentages

Table 6

Country	2001		2004		2007		2010		2013		**2016**	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	**Amount**	**%**
Argentina	...	...	1	0.0	1	0.0	2	0.0	1	0.0	**1**	**0.0**
Australia	54	3.2	107	4.1	176	4.1	192	3.8	182	2.7	**121**	**1.9**
Austria	8	0.5	15	0.6	19	0.4	20	0.4	15	0.2	**19**	**0.3**
Bahrain	3	0.2	3	0.1	3	0.1	5	0.1	9	0.1	**6**	**0.1**
Belgium	10	0.6	21	0.8	50	1.2	33	0.6	22	0.3	**23**	**0.4**
Brazil	6	0.3	4	0.1	6	0.1	14	0.3	17	0.3	**20**	**0.3**
Bulgaria	...	...	...	...	1	0.0	1	0.0	2	0.0	**2**	**0.0**
Canada	44	2.6	59	2.3	64	1.5	62	1.2	65	1.0	**86**	**1.3**
Chile	2	0.1	2	0.1	4	0.1	6	0.1	12	0.2	**7**	**0.1**
China	...	...	1	0.0	9	0.2	20	0.4	44	0.7	**73**	**1.1**
Chinese Taipei	5	0.3	9	0.4	16	0.4	18	0.4	26	0.4	**27**	**0.4**
Colombia	0	0.0	1	0.0	2	0.0	3	0.1	3	0.0	**4**	**0.1**
Czech Republic	2	0.1	2	0.1	5	0.1	5	0.1	5	0.1	**4**	**0.1**
Denmark	24	1.4	42	1.6	88	2.1	120	2.4	117	1.8	**101**	**1.5**
Estonia	...	...	0	0.0	1	0.0	1	0.0	0	0.0	**...**	**...**
Finland	2	0.1	2	0.1	8	0.2	31	0.6	15	0.2	**14**	**0.2**
France	50	2.9	67	2.6	127	3.0	152	3.0	190	2.8	**181**	**2.8**
Germany	91	5.4	120	4.6	101	2.4	109	2.2	111	1.7	**116**	**1.8**
Greece	5	0.3	4	0.2	5	0.1	5	0.1	3	0.0	**1**	**0.0**
Hong Kong SAR	68	4.0	106	4.1	181	4.2	238	4.7	275	4.1	**437**	**6.7**
Hungary	1	0.0	3	0.1	7	0.2	4	0.1	4	0.1	**3**	**0.1**
India	3	0.2	7	0.3	38	0.9	27	0.5	31	0.5	**34**	**0.5**
Indonesia	4	0.2	2	0.1	3	0.1	3	0.1	5	0.1	**5**	**0.1**
Ireland	9	0.5	7	0.3	11	0.3	15	0.3	11	0.2	**2**	**0.0**
Israel	1	0.1	5	0.2	8	0.2	10	0.2	8	0.1	**8**	**0.1**
Italy	18	1.0	23	0.9	38	0.9	29	0.6	24	0.4	**18**	**0.3**
Japan	153	9.0	207	8.0	250	5.8	312	6.2	374	5.6	**399**	**6.1**
Korea	10	0.6	21	0.8	35	0.8	44	0.9	48	0.7	**48**	**0.7**
Latvia	...	...	2	0.1	3	0.1	2	0.0	2	0.0	**1**	**0.0**
Lithuania	...	...	1	0.0	1	0.0	1	0.0	1	0.0	**0**	**0.0**
Luxembourg	13	0.8	15	0.6	44	1.0	33	0.7	51	0.8	**37**	**0.6**
Malaysia	1	0.1	2	0.1	3	0.1	7	0.1	11	0.2	**8**	**0.1**
Mexico	9	0.5	15	0.6	15	0.4	17	0.3	32	0.5	**20**	**0.3**
Netherlands	31	1.8	52	2.0	25	0.6	18	0.4	112	1.7	**85**	**1.3**
New Zealand	4	0.2	7	0.3	13	0.3	9	0.2	12	0.2	**10**	**0.2**
Norway	13	0.8	14	0.6	32	0.7	22	0.4	21	0.3	**40**	**0.6**
Peru	0	0.0	0	0.0	1	0.0	1	0.0	2	0.0	**1**	**0.0**
Philippines	1	0.1	1	0.0	2	0.1	5	0.1	4	0.1	**3**	**0.0**
Poland	5	0.3	7	0.3	9	0.2	8	0.2	8	0.1	**9**	**0.1**
Portugal	2	0.1	2	0.1	4	0.1	4	0.1	4	0.1	**2**	**0.0**
Romania	...	...	...	...	3	0.1	3	0.1	3	0.1	**3**	**0.0**
Russia	10	0.6	30	1.1	50	1.2	42	0.8	61	0.9	**45**	**0.7**
Saudi Arabia	2	0.1	2	0.1	4	0.1	8	0.1	7	0.1	**8**	**0.1**
Singapore	104	6.1	134	5.1	242	5.6	266	5.3	383	5.7	**517**	**7.9**
Slovakia	1	0.0	2	0.1	3	0.1	0	0.0	1	0.0	**2**	**0.0**
Slovenia	0	0.0	0	0.0	0	0.0	...	...	...	...	**...**	**...**
South Africa	10	0.6	10	0.4	14	0.3	14	0.3	21	0.3	**21**	**0.3**
Spain	8	0.5	14	0.5	17	0.4	29	0.6	43	0.6	**33**	**0.5**
Sweden	25	1.5	32	1.2	44	1.0	45	0.9	44	0.7	**42**	**0.6**
Switzerland	76	4.5	85	3.3	254	5.9	249	4.9	216	3.2	**156**	**2.4**
Thailand	2	0.1	3	0.1	6	0.1	7	0.1	13	0.2	**11**	**0.2**
Turkey	1	0.1	3	0.1	4	0.1	17	0.3	27	0.4	**22**	**0.3**
United Kingdom	542	31.8	835	32.0	1,483	34.6	1,854	36.7	2,726	40.8	**2,406**	**36.9**
United States	273	16.0	499	19.1	745	17.4	904	17.9	1,263	18.9	**1,272**	**19.5**
Total	**1,705**	**100.0**	**2,608**	**100.0**	**4,281**	**100.0**	**5,045**	**100.0**	**6,686**	**100.0**	**6,514**	**100.0**

[1] Data may differ slightly from national survey data owing to differences in aggregation procedures and rounding. The data for the Netherlands are not fully comparable over time due to reporting improvements in 2013. [2] Adjusted for local inter-dealer double-counting (ie "net-gross" basis).

B Explanatory notes

The methodology and structure of the foreign exchange turnover part of the 2016 Triennial Central Bank Survey was unchanged from 2013.

Participating authorities

Central banks and other authorities in 52 jurisdictions participated in the 2016 Triennial Survey. Authorities in the same jurisdictions, plus Estonia, participated in the 2013 survey.

Argentina	Central Bank of Argentina	**Korea**	Bank of Korea
Australia	Reserve Bank of Australia	**Latvia**	Bank of Latvia
Austria	Central Bank of the Republic of Austria	**Lithuania**	Bank of Lithuania
		Luxembourg	Central Bank of Luxembourg
Bahrain	Bahrain Monetary Agency	**Malaysia**	Central Bank of Malaysia
Belgium	National Bank of Belgium	**Mexico**	Bank of Mexico
Brazil	Central Bank of Brazil	**Netherlands**	Netherlands Bank
Bulgaria	Bulgarian National Bank	**New Zealand**	Reserve Bank of New Zealand
Canada	Bank of Canada	**Norway**	Central Bank of Norway
Chile	Central Bank of Chile	**Peru**	Central Reserve Bank of Peru
China	People's Bank of China	**Philippines**	Bangko Sentral ng Pilipinas
	State Administration of Foreign Exchange	**Poland**	National Bank of Poland
		Portugal	Bank of Portugal
Chinese Taipei	Central Bank of China	**Romania**	National Bank of Romania
Colombia	Bank of the Republic	**Russia**	Central Bank of the Russian Federation
Czech Republic	Czech National Bank		
Denmark	Danmarks Nationalbank	**Saudi Arabia**	Saudi Arabian Monetary Agency
Finland	Bank of Finland	**Singapore**	Monetary Authority of Singapore
France	Bank of France	**Slovakia**	National Bank of Slovakia
Germany	Deutsche Bundesbank	**South Africa**	South African Reserve Bank
Greece	Bank of Greece	**Spain**	Bank of Spain
Hong Kong SAR	Hong Kong Monetary Authority	**Sweden**	Sveriges Riksbank
Hungary	Magyar Nemzeti Bank		Statistics Sweden
India	Reserve Bank of India	**Switzerland**	Swiss National Bank
Indonesia	Bank Indonesia	**Thailand**	Bank of Thailand
Ireland	Central Bank of Ireland	**Turkey**	Central Bank of the Republic of Turkey
Israel	Bank of Israel		
Italy	Bank of Italy	**United Kingdom**	Bank of England
Japan	Bank of Japan	**United States**	Federal Reserve Bank of New York

Coverage

The Triennial Survey of foreign exchange turnover covers spot transactions, outright forwards, foreign exchange swaps, currency swaps, currency options and other OTC foreign exchange transactions with exposure to more than one currency.

The basis for reporting was in principle the location of the sales desk of any trade, even if deals entered into in different locations were booked in a central location. Thus, transactions concluded by offices located abroad were not reported by the country of location of the head office, but by that of the office abroad (insofar as the latter was a reporting institution in one of the other reporting countries). Where no sales desk was involved in a deal, the trading desk was used to determine the location of deals.

The survey collected turnover data for both proprietary and commissioned business of the reporting institutions. Commissioned business refers to reporting institutions' transactions as a result of deals as an agent or trustee in their own name, but on behalf of third parties, such as customers or other entities.

Turnover data

Turnover data provide a measure of market activity, and can also be seen as a rough proxy for market liquidity. Turnover is defined as the gross value of all new deals entered into during a given period, and is measured in terms of the nominal or notional amount of the contracts.

No distinction was made between sales and purchases (eg a purchase of $5 million against sterling and a sale of $7 million against sterling would amount to a gross turnover of $12 million). Direct cross-currency transactions were counted as single transactions (eg if a bank sold $5 million of Swiss francs against the Swedish krona, the reported turnover would be $5 million); however, cross-currency transactions passing through a vehicle currency were recorded as two separate deals against the vehicle currency (eg if a bank sold $5 million of Swiss francs against euros first and then used the euros to purchase kronor, the reported turnover would be $10 million). The gross amount of each transaction was recorded once, and netting arrangements and offsets were ignored.

OTC derivatives transactions that are centrally cleared via central counterparties (CCPs) were reported on a pre-novation basis (ie with the original execution counterpart as counterparty). Any post-trade transaction records that arise from central clearing via CCPs (eg through novation) were not reported as additional transactions.

As in the previous foreign exchange surveys, turnover data were collected over a one-month period, the month of April, in order to reduce the likelihood of very short-term variations in activity contaminating the data. The data collected for the survey reflected all transactions entered into during the calendar month of April 2016, regardless of whether delivery or settlement was made during that month. In order to allow comparison across countries, daily averages of turnover were computed by dividing aggregate monthly turnover for the country in question by the number of days in April on which the foreign exchange and derivatives markets in that country were open.

Transactions are reported to the BIS in US dollar equivalents, with non-dollar amounts generally converted into US dollars using the exchange rate prevailing on the date of the trade.

Instruments

The instruments covered in the foreign exchange turnover part of the survey are defined as follows:

Spot transactions	Single outright transactions involving the exchange of two currencies at a rate agreed on the date of the contract for value or delivery (cash settlement) within two business days. The spot legs of swaps are not included among spot transactions but are reported as swap transactions even when they are due for settlement within two days. This means that spot transactions are exclusive of overnight swaps and spot next swaps, as well as other "tomorrow/next day" transactions.
Outright forwards	Transactions involving the exchange of two currencies at a rate agreed on the date of the contract for value or delivery (cash settlement) at some time in the future (more than two business days later). This category also includes forward foreign exchange agreement transactions (FXAs), non-deliverable forwards (NDFs) and other forward contracts for differences. Outright forwards are generally not traded on organised exchanges, and their contractual terms are not standardised.
Foreign exchange swaps	Transactions involving the actual exchange of two currencies (principal amount only) on a specific date at a rate agreed at the time of the conclusion of the contract (the short leg), and a reverse exchange of the same two currencies at a date further in the future at a rate (generally different from the rate applied to the short leg) agreed at the time of the contract (the long leg). Both spot/forward and forward/forward swaps are included. For *turnover*, only the forward leg is reported as such. The spot leg is not reported at all, ie neither as a spot nor as a foreign exchange swap transaction. Short-term swaps carried out as "tomorrow/next day" transactions are also included in this category.
Currency swaps	Contracts which commit two counterparties to exchange streams of interest payments in different currencies for an agreed period of time and/or to exchange principal amounts in different currencies at a pre-agreed exchange rate at maturity.
OTC options	Option contracts that give the right to buy or sell a currency with another currency at a specified exchange rate during a specified period. This category also includes exotic foreign exchange options such as average rate options and barrier options. OTC options include: • The currency swaption: an OTC option to enter into a currency swap contract. • The currency warrant: a long-dated (over one year) OTC currency option.
Other products	Other derivative products are instruments where decomposition into individual plain vanilla instruments such as forwards, swaps or options is impractical or impossible. An example of "other" products is swaps with underlying notional principal in one currency and fixed or floating interest rate payments based on interest rates in currencies other than the notional (differential swaps or "diff swaps").

Counterparties

Reporting institutions were requested to provide for each instrument a breakdown of contracts by counterparty, as follows: reporting dealers, other financial institutions and non-financial customers, with separate information on local and cross-border transactions. The distinction between local and cross-border was determined according to the location of the counterparty and not its nationality. Starting with the 2013 survey of foreign exchange turnover, other financial institutions were further broken down into five subsectors.

Reporting dealers	Financial institutions that participate as reporters in the Triennial Survey. These are mainly large commercial and investment banks and securities houses that (i) participate in the inter-dealer market and/or (ii) have an active business with large customers, such as large corporate firms, governments and non-reporting financial institutions; in other words, reporting dealers are institutions that actively buy and sell currency and OTC derivatives both for their own account and/or in meeting customer demand. In practice, reporting dealers are often those institutions that actively or regularly deal through electronic platforms, such as EBS or Reuters dealing facilities. This category also includes the branches and subsidiaries of institutions operating in multiple locations that do not have a trading desk but do have a sales desk in those locations that conducts active business with large customers. The identification of transactions with reporting dealers allows the BIS to adjust for double-counting in inter-dealer trades.
Other financial institutions	Financial institutions that are not classified as "reporting dealers" in the survey. These are typically regarded as foreign exchange and interest rate derivatives market end users. They mainly cover all other financial institutions, such as smaller commercial banks, investment banks and securities houses, and mutual funds, pension funds, hedge funds, currency funds, money market funds, building societies, leasing companies, insurance companies, other financial subsidiaries of corporate firms and central banks.
Non-reporting banks	Smaller or regional commercial banks, publicly owned banks, securities firms or investment banks not directly participating as reporting dealers.
Institutional investors	Institutional investors such as mutual funds, pension funds, insurance and reinsurance companies and endowments. Primary motives for market participation are to trade FX instruments eg for hedging, investing and risk management purposes. A common label for this counterparty category is "real money investors".
Hedge funds and proprietary trading firms	(i) Investment funds and various types of money managers, including commodity trading advisers (CTAs), which share (a combination of) the following characteristics: they often follow a relatively broad range of investment strategies that are not subject to borrowing and leverage restrictions, with many of them using high levels of leverage; they often have a different regulatory mandate than "institutional investors" and typically cater to sophisticated investors such as high net worth individuals or institutions; and they often hold long and short positions in various markets, asset classes and instruments, with frequent use of derivatives for speculative purposes. (ii) Proprietary trading firms that invest, hedge or speculate for their own account. This category may include specialised high-frequency trading (HFT) firms that employ high-speed algorithmic trading strategies characterised by numerous frequent trades and very short holding periods.
Official sector financial institutions	Central banks, sovereign wealth funds, international financial institutions in the public sector (BIS, IMF etc), development banks and agencies.
Other	All remaining financial institutions (eg retail aggregators) that cannot be classified in any of the four above-mentioned subcategories for other financial institutions.
Non-financial customers	Any counterparty other than those described above, ie mainly non-financial end users, such as corporations and non-financial government entities. May also include private individuals who directly transact with reporting dealers for investment purposes, either on the online retail trading platforms operated by the reporting dealers or by other means (eg giving trading instructions by phone).

Trading relationships

Reporting dealers were requested to identify how much of their total turnover for each instrument and currency pair was attributed to: (i) transactions conducted in a foreign exchange prime brokerage relationship (with the reporting dealer in the role of FX prime broker); and (ii) transactions that are directly or indirectly generated by retail investors. As in previous surveys, reporting dealers were requested to identify how much of their grand total of foreign exchange turnover was attributed to "related party" transactions.

Prime brokers	Institutions (usually large and highly rated banks) facilitating trades for their clients (often institutional funds, hedge funds and other proprietary trading firms). Prime brokers enable their clients to conduct trades, subject to credit limits, with a group of predetermined third-party banks in the prime broker's name. This may also involve granting the client access to electronic platforms that are traditionally available only to large dealers. In an FX prime brokerage relationship, the client trade is normally "given up" to the prime broker, which is interposed between the third-party bank and the client and therefore becomes the counterparty to both legs of the trade.
Retail-driven transactions	Reporting dealers' (i) transactions with "wholesale" financial counterparties that cater to retail investors (ie electronic retail trading platforms and retail margin brokerage firms), and (ii) direct transactions with "non-wholesale" investors (ie private individuals) executed online or by other means (eg phone), if applicable.
Related party trades	Transactions between desks and offices, transactions with branches and subsidiaries, and transactions between affiliated firms. These trades are included regardless of whether the counterparty is resident in the same country as the reporting dealer or in another country. However, trades conducted as back-to-back deals and trades to facilitate internal bookkeeping and internal risk management within a given reporting dealer are excluded, be they on a local or a cross-border basis.

Currencies and currency pairs

All foreign exchange transactions involving the 24 currencies listed in the table below were collected in the survey. This list of currencies for which reporting is compulsory and consistent across all jurisdictions was expanded from eight currencies in the 2010 survey to 24 in the 2013 survey, the latter total being retained for the 2016 survey.[5] These changes in the reporting setup were introduced to better capture offshore trading in non-major currencies, most of which are emerging market currencies.[6]

Currencies collected in the 2016 survey

AUD	CHF	EUR	HUF	KRW	NZD	SEK	TWD
BRL	CNY[1]	GBP	INR	MXN	PLN	SGD	USD
CAD	DKK	HKD	JPY	NOK	RUB	TRY	ZAR

[1] Includes offshore transactions commonly denoted by CNH.

[5] In the past, several technical features in its reporting setup had limited the Triennial Survey's capacity to capture turnover in non-major currencies in a consistent manner globally. This was less of an issue in the past when non-major currencies were mainly traded onshore, but offshore trading of many non-major currencies has expanded significantly. Given the global nature of the Triennial Survey, it is crucial to have consistent reporting of these currencies across all participating jurisdictions.

[6] In previous surveys, only eight "major" currencies were subject to compulsory reporting on a global basis. Reporting of the other "non-major" currencies was only compulsory in the currencies' "home" jurisdictions, whereas the reporting of these currencies' offshore turnover was left to the discretion of the offshore jurisdictions. Potentially inconsistent treatment of non-major currencies across jurisdictions is known to be associated with problems such as "overnetting", which affects the accuracy of the turnover aggregates.

Data were collected for the following 47 currency pairs. Turnover in currency pairs that are not listed was recorded in aggregate under "other" and "residual".

Currency pairs collected in the 2016 survey

	Domestic currency against	USD against	EUR against	JPY against	Residual[1]
G8 currencies	AUD, CAD, CHF, EUR, GBP, JPY, SEK, USD	AUD, CAD, CHF, EUR, GBP, JPY, SEK,	AUD, CAD, CHF, GBP, JPY, SEK	AUD, CAD	
Non-G8 currencies		BRL, CNY, HKD, INR, KRW, MXN, NOK, NZD, PLN, RUB, SGD, TRY, TWD, ZAR	CNY, DKK, HUF, NOK, PLN, TRY	BRL, NZD, TRY, ZAR	
Other	Other[2]	Other[2]	Other[2]	Other[2]	

[1] Transactions that do not involve the domestic currency, USD, EUR or JPY in one leg. [2] Currencies not explicitly listed in the table.

Given the interest in identifying turnover in all reporting countries' currencies, supplementary information for currencies recorded in aggregate under "other" and "residual" was also collected for the following 35 currencies: ARS, AUD, BGN, BHD, BRL, CAD, CHF, CLP, CNY, COP, CZK, DKK, GBP, HKD, HUF, IDR, ILS, INR, KRW, MXN, MYR, NOK, NZD, PEN, PHP, PLN, RON, RUB, SAR, SEK, SGD, THB, TRY, TWD and ZAR.

Transactions conducted in a special unit of account adjusted to inflation (like CLF, COU and MXV) were treated as having been done in the main currency (respectively, CLP, COP and MXN).

Maturities

Transactions in outright forwards and foreign exchange swaps were broken down between the following original maturity bands: seven days or less; over seven days and up to one year; over one year.

For outright forward contracts, the maturity band for the transaction is determined by the difference between the delivery date and the date of the initiation of the contract. For both spot/forward and forward/forward foreign exchange swaps, the maturity band for the contract is determined by the difference between the due date of the second or long leg of the swap and the date of the initiation of the contract.

Elimination of double-counting

Double-counting arises because transactions between two reporting entities are recorded by each of them, ie twice. In order to derive meaningful measures of overall market size, it is therefore necessary to halve the data on transactions between reporting dealers. To permit this, reporters are asked to distinguish deals contracted with other reporters (dealers).

The following methods of adjustment were applied: data on local deals with other reporters were first divided by two, and this figure was subtracted from total gross data to arrive at so-called "net-gross" figures, ie business net of local inter-dealer double-counting. In a second step, data on cross-border deals with other reporters were also divided by two, and this figure was subtracted from total "net-gross" data to obtain so-called "net-net" figures, ie business net of local and cross-border inter-dealer double-counting.

Gross turnover	Minus	= **Net-gross turnover**	Minus	= **Net-net turnover**
Not adjusted for inter-dealer double-counting (ie "gross-gross" basis)	half of the turnover with local reporting dealers	Adjusted for local inter-dealer double-counting (ie "net-gross" basis)	half of the turnover with reporting dealers abroad	Adjusted for local and cross-border inter-dealer double-counting (ie "net-net" basis)

H. R. 4173

One Hundred Eleventh Congress of the United States of America

AT THE SECOND SESSION

Begun and held at the City of Washington on Tuesday, the fifth day of January, two thousand and ten

An Act

To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Dodd-Frank Wall Street Reform and Consumer Protection Act".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Subtitle C—Additional Board of Governors Authority for Certain Nonbank Financial Companies and Bank Holding Companies

TITLE II—ORDERLY LIQUIDATION AUTHORITY

TITLE III—TRANSFER OF POWERS TO THE COMPTROLLER OF THE CURRENCY, THE CORPORATION, AND THE BOARD OF GOVERNORS

Subtitle A—Transfer of Powers and Duties

Subtitle B—Transitional Provisions

SEC. 2. DEFINITIONS.

As used in this Act, the following definitions shall apply, except as the context otherwise requires or as otherwise specifically provided in this Act:

(1) AFFILIATE.—The term "affiliate" has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(2) APPROPRIATE FEDERAL BANKING AGENCY.—On and after the transfer date, the term "appropriate Federal banking agency" has the same meaning as in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), as amended by title III.

(3) BOARD OF GOVERNORS.—The term "Board of Governors" means the Board of Governors of the Federal Reserve System.

(4) BUREAU.—The term "Bureau" means the Bureau of Consumer Financial Protection established under title X.

(5) COMMISSION.—The term "Commission" means the Securities and Exchange Commission, except in the context of the Commodity Futures Trading Commission.

(6) COMMODITY FUTURES TERMS.—The terms "futures commission merchant", "swap", "swap dealer", "swap execution facility", "derivatives clearing organization", "board of trade", "commodity trading advisor", "commodity pool", and "commodity pool operator" have the same meanings as given the terms in section 1a of the Commodity Exchange Act (7 U.S.C. 1 et seq.).

(7) CORPORATION.—The term "Corporation" means the Federal Deposit Insurance Corporation.

(8) COUNCIL.—The term "Council" means the Financial Stability Oversight Council established under title I.

(9) CREDIT UNION.—The term "credit union" means a Federal credit union, State credit union, or State-chartered credit union, as those terms are defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752).

(10) FEDERAL BANKING AGENCY.—The term—

(A) "Federal banking agency" means, individually, the Board of Governors, the Office of the Comptroller of the Currency, and the Corporation; and

(B) "Federal banking agencies" means all of the agencies referred to in subparagraph (A), collectively.

(11) FUNCTIONALLY REGULATED SUBSIDIARY.—The term "functionally regulated subsidiary" has the same meaning as in section 5(c)(5) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(c)(5)).

(12) PRIMARY FINANCIAL REGULATORY AGENCY.—The term "primary financial regulatory agency" means—

(A) the appropriate Federal banking agency, with respect to institutions described in section 3(q) of the Federal Deposit Insurance Act, except to the extent that an institution is or the activities of an institution are otherwise described in subparagraph (B), (C), (D), or (E);

(B) the Securities and Exchange Commission, with respect to—

(i) any broker or dealer that is registered with the Commission under the Securities Exchange Act of 1934, with respect to the activities of the broker or dealer that require the broker or dealer to be registered under that Act;

(ii) any investment company that is registered with the Commission under the Investment Company Act of 1940, with respect to the activities of the investment company that require the investment company to be registered under that Act;

(iii) any investment adviser that is registered with the Commission under the Investment Advisers Act of 1940, with respect to the investment advisory activities of such company and activities that are incidental to such advisory activities;

(iv) any clearing agency registered with the Commission under the Securities Exchange Act of 1934, with respect to the activities of the clearing agency that require the agency to be registered under such Act;

(v) any nationally recognized statistical rating organization registered with the Commission under the Securities Exchange Act of 1934;

(vi) any transfer agent registered with the Commission under the Securities Exchange Act of 1934;

(vii) any exchange registered as a national securities exchange with the Commission under the Securities Exchange Act of 1934;

(viii) any national securities association registered with the Commission under the Securities Exchange Act of 1934;

(ix) any securities information processor registered with the Commission under the Securities Exchange Act of 1934;

(x) the Municipal Securities Rulemaking Board established under the Securities Exchange Act of 1934;

(xi) the Public Company Accounting Oversight Board established under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7211 et seq.);

(xii) the Securities Investor Protection Corporation established under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.); and

(xiii) any security-based swap execution facility, security-based swap data repository, security-based swap dealer or major security-based swap participant registered with the Commission under the Securities Exchange Act of 1934, with respect to the security-based swap activities of the person that require such person to be registered under such Act;

(C) the Commodity Futures Trading Commission, with respect to—

(i) any futures commission merchant registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the futures commission merchant that require the futures commission merchant to be registered under that Act;

(ii) any commodity pool operator registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the commodity pool operator that require the commodity pool operator to be registered under that Act, or a commodity pool, as defined in that Act;

(iii) any commodity trading advisor or introducing broker registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the commodity trading advisor or introducing broker that require the commodity trading adviser or introducing broker to be registered under that Act;

(iv) any derivatives clearing organization registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the derivatives clearing organization that require the derivatives clearing organization to be registered under that Act;

(v) any board of trade designated as a contract market by the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.);

(vi) any futures association registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.);

(vii) any retail foreign exchange dealer registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the retail foreign exchange dealer that require the retail foreign exchange dealer to be registered under that Act;

(viii) any swap execution facility, swap data repository, swap dealer, or major swap participant registered with the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.) with respect to the swap activities of the person that require such person to be registered under that Act; and

(ix) any registered entity under the Commodity Exchange Act (7 U.S.C. 1 et seq.), with respect to the activities of the registered entity that require the registered entity to be registered under that Act;

(D) the State insurance authority of the State in which an insurance company is domiciled, with respect to the insurance activities and activities that are incidental to such insurance activities of an insurance company that is subject to supervision by the State insurance authority under State insurance law; and

(E) the Federal Housing Finance Agency, with respect to Federal Home Loan Banks or the Federal Home Loan Bank System, and with respect to the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.

(13) PRUDENTIAL STANDARDS.—The term "prudential standards" means enhanced supervision and regulatory standards developed by the Board of Governors under section 165.

(14) SECRETARY.—The term "Secretary" means the Secretary of the Treasury.

(15) SECURITIES TERMS.—The—

(A) terms "broker", "dealer", "issuer", "nationally recognized statistical rating organization", "security", and "securities laws" have the same meanings as in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c);

(B) term "investment adviser" has the same meaning as in section 202 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2); and

(C) term "investment company" has the same meaning as in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3).

(16) STATE.—The term "State" means any State, commonwealth, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands.

(17) TRANSFER DATE.—The term "transfer date" means the date established under section 311.

(18) OTHER INCORPORATED DEFINITIONS.—

(A) FEDERAL DEPOSIT INSURANCE ACT.—The terms "bank", "bank holding company", "control", "deposit", "depository institution", "Federal depository institution", "Federal savings association", "foreign bank", "including", "insured branch", "insured depository institution", "national member bank", "national nonmember bank", "savings association", "State bank", "State depository institution", "State member bank", "State nonmember bank", "State savings association", and "subsidiary" have the same meanings as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(B) HOLDING COMPANIES.—The term—

(i) "bank holding company" has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841);

(ii) "financial holding company" has the same meaning as in section 2(p) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(p)); and

(iii) "savings and loan holding company" has the same meaning as in section 10 of the Home Owners' Loan Act (12 U.S.C. 1467a(a)).

SEC. 3. SEVERABILITY.

If any provision of this Act, an amendment made by this Act, or the application of such provision or amendment to any person or circumstance is held to be unconstitutional, the remainder of this Act, the amendments made by this Act, and the application of the provisions of such to any person or circumstance shall not be affected thereby.

SEC. 4. EFFECTIVE DATE.

Except as otherwise specifically provided in this Act or the amendments made by this Act, this Act and such amendments shall take effect 1 day after the date of enactment of this Act.

SEC. 5. BUDGETARY EFFECTS.

The budgetary effects of this Act, for the purpose of complying with the Statutory Pay-As-You-Go-Act of 2010, shall be determined by reference to the latest statement titled "Budgetary Effects of PAYGO Legislation" for this Act, jointly submitted for printing in the Congressional Record by the Chairmen of the House and Senate Budget Committees, provided that such statement has been submitted prior to the vote on passage in the House acting first on this conference report or amendment between the Houses.

SEC. 6. ANTITRUST SAVINGS CLAUSE.

Nothing in this Act, or any amendment made by this Act, shall be construed to modify, impair, or supersede the operation of any of the antitrust laws, unless otherwise specified. For purposes of this section, the term "antitrust laws" has the same meaning as in subsection (a) of the first section of the Clayton Act, except that such term includes section 5 of the Federal Trade Commission Act, to the extent that such section 5 applies to unfair methods of competition.

TITLE I—FINANCIAL STABILITY

SEC. 101. SHORT TITLE.

This title may be cited as the "Financial Stability Act of 2010".

SEC. 102. DEFINITIONS.

(a) IN GENERAL.—For purposes of this title, unless the context otherwise requires, the following definitions shall apply:

(1) BANK HOLDING COMPANY.—The term "bank holding company" has the same meaning as in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841). A foreign bank or company that is treated as a bank holding company for purposes of the Bank Holding Company Act of 1956, pursuant to section 8(a) of the International Banking Act of 1978 (12 U.S.C. 3106(a)), shall be treated as a bank holding company for purposes of this title.

(2) CHAIRPERSON.—The term "Chairperson" means the Chairperson of the Council.

(3) MEMBER AGENCY.—The term "member agency" means an agency represented by a voting member of the Council.

(4) NONBANK FINANCIAL COMPANY DEFINITIONS.—

(A) FOREIGN NONBANK FINANCIAL COMPANY.—The term "foreign nonbank financial company" means a company (other than a company that is, or is treated in the United States as, a bank holding company) that is—

(i) incorporated or organized in a country other than the United States; and

(ii) predominantly engaged in, including through a branch in the United States, financial activities, as defined in paragraph (6).

(B) U.S. NONBANK FINANCIAL COMPANY.—The term "U.S. nonbank financial company" means a company (other than a bank holding company, a Farm Credit System institution chartered and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.), or a national securities exchange (or parent thereof), clearing agency (or parent thereof, unless the parent is a bank holding company), security-based swap execution facility, or security-based swap data repository registered with the Commission, or a board of trade designated as a contract market (or parent thereof), or a derivatives clearing organization (or parent thereof, unless the parent is a bank holding company), swap execution facility or a swap data repository registered with the Commodity Futures Trading Commission), that is—

(i) incorporated or organized under the laws of the United States or any State; and

(ii) predominantly engaged in financial activities, as defined in paragraph (6).

(C) NONBANK FINANCIAL COMPANY.—The term "nonbank financial company" means a U.S. nonbank financial company and a foreign nonbank financial company.

(D) NONBANK FINANCIAL COMPANY SUPERVISED BY THE BOARD OF GOVERNORS.—The term "nonbank financial company supervised by the Board of Governors" means a nonbank financial company that the Council has determined under section 113 shall be supervised by the Board of Governors.

(5) OFFICE OF FINANCIAL RESEARCH.—The term "Office of Financial Research" means the office established under section 152.

(6) PREDOMINANTLY ENGAGED.—A company is "predominantly engaged in financial activities" if—

(A) the annual gross revenues derived by the company and all of its subsidiaries from activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956) and, if applicable, from the ownership or control of one or more insured depository institutions, represents 85 percent or more of the consolidated annual gross revenues of the company; or

(B) the consolidated assets of the company and all of its subsidiaries related to activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956) and, if applicable, related to the ownership or control of one or more insured depository institutions, represents 85 percent or more of the consolidated assets of the company.

(7) SIGNIFICANT INSTITUTIONS.—The terms "significant nonbank financial company" and "significant bank holding company" have the meanings given those terms by rule of the Board of Governors, but in no instance shall the term "significant nonbank financial company" include those entities that are excluded under paragraph (4)(B).

(b) DEFINITIONAL CRITERIA.—The Board of Governors shall establish, by regulation, the requirements for determining if a company is predominantly engaged in financial activities, as defined in subsection (a)(6).

(c) FOREIGN NONBANK FINANCIAL COMPANIES.—For purposes of the application of subtitles A and C (other than section 113(b)) with respect to a foreign nonbank financial company, references in this title to "company" or "subsidiary" include only the United States activities and subsidiaries of such foreign company, except as otherwise provided.

Subtitle A—Financial Stability Oversight Council

SEC. 111. FINANCIAL STABILITY OVERSIGHT COUNCIL ESTABLISHED.

(a) ESTABLISHMENT.—Effective on the date of enactment of this Act, there is established the Financial Stability Oversight Council.

(b) MEMBERSHIP.—The Council shall consist of the following members:

(1) VOTING MEMBERS.—The voting members, who shall each have 1 vote on the Council shall be—

(A) the Secretary of the Treasury, who shall serve as Chairperson of the Council;

(B) the Chairman of the Board of Governors;

(C) the Comptroller of the Currency;

(D) the Director of the Bureau;

(E) the Chairman of the Commission;

(F) the Chairperson of the Corporation;

(G) the Chairperson of the Commodity Futures Trading Commission;

(H) the Director of the Federal Housing Finance Agency;

(I) the Chairman of the National Credit Union Administration Board; and

(J) an independent member appointed by the President, by and with the advice and consent of the Senate, having insurance expertise.

(2) NONVOTING MEMBERS.—The nonvoting members, who shall serve in an advisory capacity as a nonvoting member of the Council, shall be—

(A) the Director of the Office of Financial Research;

(B) the Director of the Federal Insurance Office;

(C) a State insurance commissioner, to be designated by a selection process determined by the State insurance commissioners;

(D) a State banking supervisor, to be designated by a selection process determined by the State banking supervisors; and

(E) a State securities commissioner (or an officer performing like functions), to be designated by a selection process determined by such State securities commissioners.

(3) NONVOTING MEMBER PARTICIPATION.—The nonvoting members of the Council shall not be excluded from any of the proceedings, meetings, discussions, or deliberations of the Council, except that the Chairperson may, upon an affirmative vote of the member agencies, exclude the nonvoting members from any of the proceedings, meetings, discussions, or deliberations of the Council when necessary to safeguard and promote the free exchange of confidential supervisory information.

(c) TERMS; VACANCY.—

(1) TERMS.—The independent member of the Council shall serve for a term of 6 years, and each nonvoting member described in subparagraphs (C), (D), and (E) of subsection (b)(2) shall serve for a term of 2 years.

(2) VACANCY.—Any vacancy on the Council shall be filled in the manner in which the original appointment was made.

(3) ACTING OFFICIALS MAY SERVE.—In the event of a vacancy in the office of the head of a member agency or department, and pending the appointment of a successor, or during the absence or disability of the head of a member agency or department, the acting head of the member agency or department shall serve as a member of the Council in the place of that agency or department head.

(d) TECHNICAL AND PROFESSIONAL ADVISORY COMMITTEES.—The Council may appoint such special advisory, technical, or professional committees as may be useful in carrying out the functions of the Council, including an advisory committee consisting of State regulators, and the members of such committees may be members of the Council, or other persons, or both.

(e) MEETINGS.—

(1) TIMING.—The Council shall meet at the call of the Chairperson or a majority of the members then serving, but not less frequently than quarterly.

(2) RULES FOR CONDUCTING BUSINESS.—The Council shall adopt such rules as may be necessary for the conduct of the business of the Council. Such rules shall be rules of agency organization, procedure, or practice for purposes of section 553 of title 5, United States Code.

(f) VOTING.—Unless otherwise specified, the Council shall make all decisions that it is authorized or required to make by a majority vote of the voting members then serving.

(g) NONAPPLICABILITY OF FACA.—The Federal Advisory Committee Act (5 U.S.C. App.) shall not apply to the Council, or to any special advisory, technical, or professional committee appointed by the Council, except that, if an advisory, technical, or professional committee has one or more members who are not employees of or affiliated with the United States Government, the Council shall publish a list of the names of the members of such committee.

(h) ASSISTANCE FROM FEDERAL AGENCIES.—Any department or agency of the United States may provide to the Council and any special advisory, technical, or professional committee appointed by the Council, such services, funds, facilities, staff, and other support services as the Council may determine advisable.

(i) COMPENSATION OF MEMBERS.—

(1) FEDERAL EMPLOYEE MEMBERS.—All members of the Council who are officers or employees of the United States shall serve without compensation in addition to that received for their services as officers or employees of the United States.

(2) COMPENSATION FOR NON-FEDERAL MEMBER.—Section 5314 of title 5, United States Code, is amended by adding at the end the following:

"Independent Member of the Financial Stability Oversight Council (1).".

(j) DETAIL OF GOVERNMENT EMPLOYEES.—Any employee of the Federal Government may be detailed to the Council without reimbursement, and such detail shall be without interruption or loss of civil service status or privilege. An employee of the Federal Government detailed to the Council shall report to and be subject to oversight by the Council during the assignment to the Council, and shall be compensated by the department or agency from which the employee was detailed.

SEC. 112. COUNCIL AUTHORITY.

(a) PURPOSES AND DUTIES OF THE COUNCIL.—

(1) IN GENERAL.—The purposes of the Council are—

(A) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace;

(B) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the Government will shield them from losses in the event of failure; and

(C) to respond to emerging threats to the stability of the United States financial system.

(2) DUTIES.—The Council shall, in accordance with this title—

(A) collect information from member agencies, other Federal and State financial regulatory agencies, the Federal Insurance Office and, if necessary to assess risks to the United States financial system, direct the Office of Financial Research to collect information from bank holding companies and nonbank financial companies;

(B) provide direction to, and request data and analyses from, the Office of Financial Research to support the work of the Council;

(C) monitor the financial services marketplace in order to identify potential threats to the financial stability of the United States;

(D) to monitor domestic and international financial regulatory proposals and developments, including insurance and accounting issues, and to advise Congress and make recommendations in such areas that will enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets;

(E) facilitate information sharing and coordination among the member agencies and other Federal and State agencies regarding domestic financial services policy development, rulemaking, examinations, reporting requirements, and enforcement actions;

(F) recommend to the member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies;

(G) identify gaps in regulation that could pose risks to the financial stability of the United States;

(H) require supervision by the Board of Governors for nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure, or because of their activities pursuant to section 113;

(I) make recommendations to the Board of Governors concerning the establishment of heightened prudential standards for risk-based capital, leverage, liquidity, contingent capital, resolution plans and credit exposure reports, concentration limits, enhanced public disclosures, and overall risk management for nonbank financial companies and large, interconnected bank holding companies supervised by the Board of Governors;

(J) identify systemically important financial market utilities and payment, clearing, and settlement activities (as that term is defined in title VIII);

(K) make recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and United States financial markets;

(L) review and, as appropriate, may submit comments to the Commission and any standard-setting body with respect to an existing or proposed accounting principle, standard, or procedure;

(M) provide a forum for—

(i) discussion and analysis of emerging market developments and financial regulatory issues; and

(ii) resolution of jurisdictional disputes among the members of the Council; and

(N) annually report to and testify before Congress on—

(i) the activities of the Council;

(ii) significant financial market and regulatory developments, including insurance and accounting regulations and standards, along with an assessment of those developments on the stability of the financial system;

(iii) potential emerging threats to the financial stability of the United States;

(iv) all determinations made under section 113 or title VIII, and the basis for such determinations;

(v) all recommendations made under section 119 and the result of such recommendations; and

(vi) recommendations—

(I) to enhance the integrity, efficiency, competitiveness, and stability of United States financial markets;

(II) to promote market discipline; and

(III) to maintain investor confidence.

(b) STATEMENTS BY VOTING MEMBERS OF THE COUNCIL.—At the time at which each report is submitted under subsection (a), each voting member of the Council shall—

(1) if such member believes that the Council, the Government, and the private sector are taking all reasonable steps to ensure financial stability and to mitigate systemic risk that would negatively affect the economy, submit a signed statement to Congress stating such belief; or

(2) if such member does not believe that all reasonable steps described under paragraph (1) are being taken, submit a signed statement to Congress stating what actions such member believes need to be taken in order to ensure that all reasonable steps described under paragraph (1) are taken.

(c) TESTIMONY BY THE CHAIRPERSON.—The Chairperson shall appear before the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate at an annual hearing, after the report is submitted under subsection (a)—

(1) to discuss the efforts, activities, objectives, and plans of the Council; and

(2) to discuss and answer questions concerning such report.

(d) AUTHORITY TO OBTAIN INFORMATION.—

(1) IN GENERAL.—The Council may receive, and may request the submission of, any data or information from the Office of Financial Research, member agencies, and the Federal Insurance Office, as necessary—

(A) to monitor the financial services marketplace to identify potential risks to the financial stability of the United States; or

(B) to otherwise carry out any of the provisions of this title.

(2) SUBMISSIONS BY THE OFFICE AND MEMBER AGENCIES.—Notwithstanding any other provision of law, the Office of Financial Research, any member agency, and the Federal Insurance Office, are authorized to submit information to the Council.

(3) FINANCIAL DATA COLLECTION.—

(A) IN GENERAL.—The Council, acting through the Office of Financial Research, may require the submission of periodic and other reports from any nonbank financial company or bank holding company for the purpose of assessing the extent to which a financial activity or financial market in which the nonbank financial company or bank holding company participates, or the nonbank financial company or bank holding company itself, poses a threat to the financial stability of the United States.

(B) MITIGATION OF REPORT BURDEN.—Before requiring the submission of reports from any nonbank financial company or bank holding company that is regulated by a member agency or any primary financial regulatory agency, the Council, acting through the Office of Financial Research, shall coordinate with such agencies and shall, whenever possible, rely on information available from the Office of Financial Research or such agencies.

(C) MITIGATION IN CASE OF FOREIGN FINANCIAL COMPANIES.—Before requiring the submission of reports from a company that is a foreign nonbank financial company or foreign-based bank holding company, the Council shall, acting through the Office of Financial Research, to the extent appropriate, consult with the appropriate foreign regulator of such company and, whenever possible, rely on information already being collected by such foreign regulator, with English translation.

(4) BACK-UP EXAMINATION BY THE BOARD OF GOVERNORS.—If the Council is unable to determine whether the financial activities of a U.S. nonbank financial company pose a threat to the financial stability of the United States, based on information or reports obtained under paragraphs (1) and (3), discussions with management, and publicly available information, the Council may request the Board of Governors, and the Board of Governors is authorized, to conduct an examination of the U.S. nonbank financial company for the sole purpose of determining whether the nonbank financial company should be supervised by the Board of Governors for purposes of this title.

(5) CONFIDENTIALITY.—

(A) IN GENERAL.—The Council, the Office of Financial Research, and the other member agencies shall maintain the confidentiality of any data, information, and reports submitted under this title.

(B) RETENTION OF PRIVILEGE.—The submission of any nonpublicly available data or information under this subsection and subtitle B shall not constitute a waiver of, or otherwise affect, any privilege arising under Federal or State law (including the rules of any Federal or State court) to which the data or information is otherwise subject.

(C) FREEDOM OF INFORMATION ACT.—Section 552 of title 5, United States Code, including the exceptions thereunder, shall apply to any data or information submitted under this subsection and subtitle B.

SEC. 113. AUTHORITY TO REQUIRE SUPERVISION AND REGULATION OF CERTAIN NONBANK FINANCIAL COMPANIES.

(a) U.S. NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS.—

(1) DETERMINATION.—The Council, on a nondelegable basis and by a vote of not fewer than ⅔ of the voting members then serving, including an affirmative vote by the Chairperson, may determine that a U.S. nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title, if the Council determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States.

(2) CONSIDERATIONS.—In making a determination under paragraph (1), the Council shall consider—

(A) the extent of the leverage of the company;

(B) the extent and nature of the off-balance-sheet exposures of the company;

(C) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;

(D) the importance of the company as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the United States financial system;

(E) the importance of the company as a source of credit for low-income, minority, or underserved communities, and the impact that the failure of such company would have on the availability of credit in such communities;

(F) the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse;

(G) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;

(H) the degree to which the company is already regulated by 1 or more primary financial regulatory agencies;

(I) the amount and nature of the financial assets of the company;

(J) the amount and types of the liabilities of the company, including the degree of reliance on short-term funding; and

(K) any other risk-related factors that the Council deems appropriate.

(b) FOREIGN NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS.—

(1) DETERMINATION.—The Council, on a nondelegable basis and by a vote of not fewer than ⅔ of the voting members then serving, including an affirmative vote by the Chairperson,

may determine that a foreign nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards, in accordance with this title, if the Council determines that material financial distress at the foreign nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the foreign nonbank financial company, could pose a threat to the financial stability of the United States.

(2) CONSIDERATIONS.—In making a determination under paragraph (1), the Council shall consider—

(A) the extent of the leverage of the company;

(B) the extent and nature of the United States related off-balance-sheet exposures of the company;

(C) the extent and nature of the transactions and relationships of the company with other significant nonbank financial companies and significant bank holding companies;

(D) the importance of the company as a source of credit for United States households, businesses, and State and local governments and as a source of liquidity for the United States financial system;

(E) the importance of the company as a source of credit for low-income, minority, or underserved communities in the United States, and the impact that the failure of such company would have on the availability of credit in such communities;

(F) the extent to which assets are managed rather than owned by the company and the extent to which ownership of assets under management is diffuse;

(G) the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of the company;

(H) the extent to which the company is subject to prudential standards on a consolidated basis in its home country that are administered and enforced by a comparable foreign supervisory authority;

(I) the amount and nature of the United States financial assets of the company;

(J) the amount and nature of the liabilities of the company used to fund activities and operations in the United States, including the degree of reliance on short-term funding; and

(K) any other risk-related factors that the Council deems appropriate.

(c) ANTIEVASION.—

(1) DETERMINATIONS.—In order to avoid evasion of this title, the Council, on its own initiative or at the request of the Board of Governors, may determine, on a nondelegable basis and by a vote of not fewer than ⅔ of the voting members then serving, including an affirmative vote by the Chairperson, that—

(A) material financial distress related to, or the nature, scope, size, scale, concentration, interconnectedness, or mix of, the financial activities conducted directly or indirectly by a company incorporated or organized under the laws of the United States or any State or the financial activities in the United States of a company incorporated or organized in a country other than the United States would pose a threat to the financial stability of the United States, based on consideration of the factors in subsection (a)(2) or (b)(2), as applicable;

(B) the company is organized or operates in such a manner as to evade the application of this title; and

(C) such financial activities of the company shall be supervised by the Board of Governors and subject to prudential standards in accordance with this title, consistent with paragraph (3).

(2) REPORT.—Upon making a determination under paragraph (1), the Council shall submit a report to the appropriate committees of Congress detailing the reasons for making such determination.

(3) CONSOLIDATED SUPERVISION OF ONLY FINANCIAL ACTIVITIES; ESTABLISHMENT OF AN INTERMEDIATE HOLDING COMPANY.—

(A) ESTABLISHMENT OF AN INTERMEDIATE HOLDING COMPANY.—Upon a determination under paragraph (1), the company that is the subject of the determination may establish an intermediate holding company in which the financial activities of such company and its subsidiaries shall be conducted (other than the activities described in section 167(b)(2)) in compliance with any regulations or guidance provided by the Board of Governors. Such intermediate holding company shall be subject to the supervision of the Board of Governors and to prudential standards under this title as if the intermediate holding company were a nonbank financial company supervised by the Board of Governors.

(B) ACTION OF THE BOARD OF GOVERNORS.—To facilitate the supervision of the financial activities subject to the determination in paragraph (1), the Board of Governors may require a company to establish an intermediate holding company, as provided for in section 167, which would be subject to the supervision of the Board of Governors and to prudential standards under this title, as if the intermediate holding company were a nonbank financial company supervised by the Board of Governors.

(4) NOTICE AND OPPORTUNITY FOR HEARING AND FINAL DETERMINATION; JUDICIAL REVIEW.—Subsections (d) through (h) shall apply to determinations made by the Council pursuant to paragraph (1) in the same manner as such subsections apply to nonbank financial companies.

(5) COVERED FINANCIAL ACTIVITIES.—For purposes of this subsection, the term "financial activities"—

(A) means activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956);

(B) includes the ownership or control of one or more insured depository institutions; and

(C) does not include internal financial activities conducted for the company or any affiliate thereof, including internal treasury, investment, and employee benefit functions.

(6) ONLY FINANCIAL ACTIVITIES SUBJECT TO PRUDENTIAL SUPERVISION.—Nonfinancial activities of the company shall not

be subject to supervision by the Board of Governors and prudential standards of the Board. For purposes of this Act, the financial activities that are the subject of the determination in paragraph (1) shall be subject to the same requirements as a nonbank financial company supervised by the Board of Governors. Nothing in this paragraph shall prohibit or limit the authority of the Board of Governors to apply prudential standards under this title to the financial activities that are subject to the determination in paragraph (1).

(d) REEVALUATION AND RESCISSION.—The Council shall—

(1) not less frequently than annually, reevaluate each determination made under subsections (a) and (b) with respect to such nonbank financial company supervised by the Board of Governors; and

(2) rescind any such determination, if the Council, by a vote of not fewer than ⅔ of the voting members then serving, including an affirmative vote by the Chairperson, determines that the nonbank financial company no longer meets the standards under subsection (a) or (b), as applicable.

(e) NOTICE AND OPPORTUNITY FOR HEARING AND FINAL DETERMINATION.—

(1) IN GENERAL.—The Council shall provide to a nonbank financial company written notice of a proposed determination of the Council, including an explanation of the basis of the proposed determination of the Council, that a nonbank financial company shall be supervised by the Board of Governors and shall be subject to prudential standards in accordance with this title.

(2) HEARING.—Not later than 30 days after the date of receipt of any notice of a proposed determination under paragraph (1), the nonbank financial company may request, in writing, an opportunity for a written or oral hearing before the Council to contest the proposed determination. Upon receipt of a timely request, the Council shall fix a time (not later than 30 days after the date of receipt of the request) and place at which such company may appear, personally or through counsel, to submit written materials (or, at the sole discretion of the Council, oral testimony and oral argument).

(3) FINAL DETERMINATION.—Not later than 60 days after the date of a hearing under paragraph (2), the Council shall notify the nonbank financial company of the final determination of the Council, which shall contain a statement of the basis for the decision of the Council.

(4) NO HEARING REQUESTED.—If a nonbank financial company does not make a timely request for a hearing, the Council shall notify the nonbank financial company, in writing, of the final determination of the Council under subsection (a) or (b), as applicable, not later than 10 days after the date by which the company may request a hearing under paragraph (2).

(f) EMERGENCY EXCEPTION.—

(1) IN GENERAL.—The Council may waive or modify the requirements of subsection (e) with respect to a nonbank financial company, if the Council determines, by a vote of not fewer than ⅔ of the voting members then serving, including an affirmative vote by the Chairperson, that such waiver or modification is necessary or appropriate to prevent or mitigate

threats posed by the nonbank financial company to the financial stability of the United States.

(2) NOTICE.—The Council shall provide notice of a waiver or modification under this subsection to the nonbank financial company concerned as soon as practicable, but not later than 24 hours after the waiver or modification is granted.

(3) INTERNATIONAL COORDINATION.—In making a determination under paragraph (1), the Council shall consult with the appropriate home country supervisor, if any, of the foreign nonbank financial company that is being considered for such a determination.

(4) OPPORTUNITY FOR HEARING.—The Council shall allow a nonbank financial company to request, in writing, an opportunity for a written or oral hearing before the Council to contest a waiver or modification under this subsection, not later than 10 days after the date of receipt of notice of the waiver or modification by the company. Upon receipt of a timely request, the Council shall fix a time (not later than 15 days after the date of receipt of the request) and place at which the nonbank financial company may appear, personally or through counsel, to submit written materials (or, at the sole discretion of the Council, oral testimony and oral argument).

(5) NOTICE OF FINAL DETERMINATION.—Not later than 30 days after the date of any hearing under paragraph (4), the Council shall notify the subject nonbank financial company of the final determination of the Council under this subsection, which shall contain a statement of the basis for the decision of the Council.

(g) CONSULTATION.—The Council shall consult with the primary financial regulatory agency, if any, for each nonbank financial company or subsidiary of a nonbank financial company that is being considered for supervision by the Board of Governors under this section before the Council makes any final determination with respect to such nonbank financial company under subsection (a), (b), or (c).

(h) JUDICIAL REVIEW.—If the Council makes a final determination under this section with respect to a nonbank financial company, such nonbank financial company may, not later than 30 days after the date of receipt of the notice of final determination under subsection (d)(2), (e)(3), or (f)(5), bring an action in the United States district court for the judicial district in which the home office of such nonbank financial company is located, or in the United States District Court for the District of Columbia, for an order requiring that the final determination be rescinded, and the court shall, upon review, dismiss such action or direct the final determination to be rescinded. Review of such an action shall be limited to whether the final determination made under this section was arbitrary and capricious.

(i) INTERNATIONAL COORDINATION.—In exercising its duties under this title with respect to foreign nonbank financial companies, foreign-based bank holding companies, and cross-border activities and markets, the Council shall consult with appropriate foreign regulatory authorities, to the extent appropriate.

SEC. 114. REGISTRATION OF NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS.

Not later than 180 days after the date of a final Council determination under section 113 that a nonbank financial company is to be supervised by the Board of Governors, such company shall register with the Board of Governors, on forms prescribed by the Board of Governors, which shall include such information as the Board of Governors, in consultation with the Council, may deem necessary or appropriate to carry out this title.

SEC. 115. ENHANCED SUPERVISION AND PRUDENTIAL STANDARDS FOR NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS AND CERTAIN BANK HOLDING COMPANIES.

(a) IN GENERAL.—

(1) PURPOSE.—In order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress, failure, or ongoing activities of large, interconnected financial institutions, the Council may make recommendations to the Board of Governors concerning the establishment and refinement of prudential standards and reporting and disclosure requirements applicable to nonbank financial companies supervised by the Board of Governors and large, interconnected bank holding companies, that—

(A) are more stringent than those applicable to other nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States; and

(B) increase in stringency, based on the considerations identified in subsection (b)(3).

(2) RECOMMENDED APPLICATION OF REQUIRED STANDARDS.—In making recommendations under this section, the Council may—

(A) differentiate among companies that are subject to heightened standards on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Council deems appropriate; or

(B) recommend an asset threshold that is higher than $50,000,000,000 for the application of any standard described in subsections (c) through (g).

(b) DEVELOPMENT OF PRUDENTIAL STANDARDS.—

(1) IN GENERAL.—The recommendations of the Council under subsection (a) may include—

(A) risk-based capital requirements;

(B) leverage limits;

(C) liquidity requirements;

(D) resolution plan and credit exposure report requirements;

(E) concentration limits;

(F) a contingent capital requirement;

(G) enhanced public disclosures;

(H) short-term debt limits; and

(I) overall risk management requirements.

(2) PRUDENTIAL STANDARDS FOR FOREIGN FINANCIAL COMPANIES.—In making recommendations concerning the standards set forth in paragraph (1) that would apply to foreign nonbank financial companies supervised by the Board of Governors or foreign-based bank holding companies, the Council shall—

(A) give due regard to the principle of national treatment and equality of competitive opportunity; and

(B) take into account the extent to which the foreign nonbank financial company or foreign-based bank holding company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

(3) CONSIDERATIONS.—In making recommendations concerning prudential standards under paragraph (1), the Council shall—

(A) take into account differences among nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), based on—

(i) the factors described in subsections (a) and (b) of section 113;

(ii) whether the company owns an insured depository institution;

(iii) nonfinancial activities and affiliations of the company; and

(iv) any other factors that the Council determines appropriate;

(B) to the extent possible, ensure that small changes in the factors listed in subsections (a) and (b) of section 113 would not result in sharp, discontinuous changes in the prudential standards established under section 165; and

(C) adapt its recommendations as appropriate in light of any predominant line of business of such company, including assets under management or other activities for which particular standards may not be appropriate.

(c) CONTINGENT CAPITAL.—

(1) STUDY REQUIRED.—The Council shall conduct a study of the feasibility, benefits, costs, and structure of a contingent capital requirement for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), which study shall include—

(A) an evaluation of the degree to which such requirement would enhance the safety and soundness of companies subject to the requirement, promote the financial stability of the United States, and reduce risks to United States taxpayers;

(B) an evaluation of the characteristics and amounts of contingent capital that should be required;

(C) an analysis of potential prudential standards that should be used to determine whether the contingent capital of a company would be converted to equity in times of financial stress;

(D) an evaluation of the costs to companies, the effects on the structure and operation of credit and other financial markets, and other economic effects of requiring contingent capital;

(E) an evaluation of the effects of such requirement on the international competitiveness of companies subject to the requirement and the prospects for international coordination in establishing such requirement; and

(F) recommendations for implementing regulations.

(2) REPORT.—The Council shall submit a report to Congress regarding the study required by paragraph (1) not later than 2 years after the date of enactment of this Act.

(3) RECOMMENDATIONS.—

(A) IN GENERAL.—Subsequent to submitting a report to Congress under paragraph (2), the Council may make recommendations to the Board of Governors to require any nonbank financial company supervised by the Board of Governors and any bank holding company described in subsection (a) to maintain a minimum amount of contingent capital that is convertible to equity in times of financial stress.

(B) FACTORS TO CONSIDER.—In making recommendations under this subsection, the Council shall consider—

(i) an appropriate transition period for implementation of a conversion under this subsection;

(ii) the factors described in subsection (b)(3);

(iii) capital requirements applicable to a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), and subsidiaries thereof;

(iv) results of the study required by paragraph (1); and

(v) any other factor that the Council deems appropriate.

(d) RESOLUTION PLAN AND CREDIT EXPOSURE REPORTS.—

(1) RESOLUTION PLAN.—The Council may make recommendations to the Board of Governors concerning the requirement that each nonbank financial company supervised by the Board of Governors and each bank holding company described in subsection (a) report periodically to the Council, the Board of Governors, and the Corporation, the plan of such company for rapid and orderly resolution in the event of material financial distress or failure.

(2) CREDIT EXPOSURE REPORT.—The Council may make recommendations to the Board of Governors concerning the advisability of requiring each nonbank financial company supervised by the Board of Governors and bank holding company described in subsection (a) to report periodically to the Council, the Board of Governors, and the Corporation on—

(A) the nature and extent to which the company has credit exposure to other significant nonbank financial companies and significant bank holding companies; and

(B) the nature and extent to which other such significant nonbank financial companies and significant bank holding companies have credit exposure to that company.

(e) CONCENTRATION LIMITS.—In order to limit the risks that the failure of any individual company could pose to nonbank financial companies supervised by the Board of Governors or bank holding companies described in subsection (a), the Council may make recommendations to the Board of Governors to prescribe standards to limit such risks, as set forth in section 165.

(f) ENHANCED PUBLIC DISCLOSURES.—The Council may make recommendations to the Board of Governors to require periodic public disclosures by bank holding companies described in subsection (a) and by nonbank financial companies supervised by the Board of Governors, in order to support market evaluation of the risk profile, capital adequacy, and risk management capabilities thereof.

(g) SHORT-TERM DEBT LIMITS.—The Council may make recommendations to the Board of Governors to require short-term debt limits to mitigate the risks that an over-accumulation of such debt could pose to bank holding companies described in subsection (a), nonbank financial companies supervised by the Board of Governors, or the financial system.

SEC. 116. REPORTS.

(a) IN GENERAL.—Subject to subsection (b), the Council, acting through the Office of Financial Research, may require a bank holding company with total consolidated assets of $50,000,000,000 or greater or a nonbank financial company supervised by the Board of Governors, and any subsidiary thereof, to submit certified reports to keep the Council informed as to—

(1) the financial condition of the company;

(2) systems for monitoring and controlling financial, operating, and other risks;

(3) transactions with any subsidiary that is a depository institution; and

(4) the extent to which the activities and operations of the company and any subsidiary thereof, could, under adverse circumstances, have the potential to disrupt financial markets or affect the overall financial stability of the United States.

(b) USE OF EXISTING REPORTS.—

(1) IN GENERAL.—For purposes of compliance with subsection (a), the Council, acting through the Office of Financial Research, shall, to the fullest extent possible, use—

(A) reports that a bank holding company, nonbank financial company supervised by the Board of Governors, or any functionally regulated subsidiary of such company has been required to provide to other Federal or State regulatory agencies or to a relevant foreign supervisory authority;

(B) information that is otherwise required to be reported publicly; and

(C) externally audited financial statements.

(2) AVAILABILITY.—Each bank holding company described in subsection (a) and nonbank financial company supervised by the Board of Governors, and any subsidiary thereof, shall provide to the Council, at the request of the Council, copies of all reports referred to in paragraph (1).

(3) CONFIDENTIALITY.—The Council shall maintain the confidentiality of the reports obtained under subsection (a) and paragraph (1)(A) of this subsection.

SEC. 117. TREATMENT OF CERTAIN COMPANIES THAT CEASE TO BE BANK HOLDING COMPANIES.

(a) APPLICABILITY.—This section shall apply to—

(1) any entity that—

(A) was a bank holding company having total consolidated assets equal to or greater than $50,000,000,000 as of January 1, 2010; and

(B) received financial assistance under or participated in the Capital Purchase Program established under the Troubled Asset Relief Program authorized by the Emergency Economic Stabilization Act of 2008; and

(2) any successor entity (as defined by the Board of Governors, in consultation with the Council) to an entity described in paragraph (1).

(b) TREATMENT.—If an entity described in subsection (a) ceases to be a bank holding company at any time after January 1, 2010, then such entity shall be treated as a nonbank financial company supervised by the Board of Governors, as if the Council had made a determination under section 113 with respect to that entity.

(c) APPEAL.—

(1) REQUEST FOR HEARING.—An entity may request, in writing, an opportunity for a written or oral hearing before the Council to appeal its treatment as a nonbank financial company supervised by the Board of Governors in accordance with this section. Upon receipt of the request, the Council shall fix a time (not later than 30 days after the date of receipt of the request) and place at which such entity may appear, personally or through counsel, to submit written materials (or, at the sole discretion of the Council, oral testimony and oral argument).

(2) DECISION.—

(A) PROPOSED DECISION.—A Council decision to grant an appeal under this subsection shall be made by a vote of not fewer than ⅔ of the voting members then serving, including an affirmative vote by the Chairperson. Not later than 60 days after the date of a hearing under paragraph (1), the Council shall submit a report to, and may testify before, the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the proposed decision of the Council regarding an appeal under paragraph (1), which report shall include a statement of the basis for the proposed decision of the Council.

(B) NOTICE OF FINAL DECISION.—The Council shall notify the subject entity of the final decision of the Council regarding an appeal under paragraph (1), which notice shall contain a statement of the basis for the final decision of the Council, not later than 60 days after the later of—

(i) the date of the submission of the report under subparagraph (A); or

(ii) if, not later than 1 year after the date of submission of the report under subparagraph (A), the Committee on Banking, Housing, and Urban Affairs of the Senate or the Committee on Financial Services of the House of Representatives holds one or more hearings regarding such report, the date of the last such hearing.

(C) CONSIDERATIONS.—In making a decision regarding an appeal under paragraph (1), the Council shall consider whether the company meets the standards under section 113(a) or 113(b), as applicable, and the definition of the term "nonbank financial company" under section 102. The decision of the Council shall be final, subject to the review under paragraph (3).

(3) REVIEW.—If the Council denies an appeal under this subsection, the Council shall, not less frequently than annually, review and reevaluate the decision.

SEC. 118. COUNCIL FUNDING.

Any expenses of the Council shall be treated as expenses of, and paid by, the Office of Financial Research.

SEC. 119. RESOLUTION OF SUPERVISORY JURISDICTIONAL DISPUTES AMONG MEMBER AGENCIES.

(a) REQUEST FOR COUNCIL RECOMMENDATION.—The Council shall seek to resolve a dispute among 2 or more member agencies, if—

(1) a member agency has a dispute with another member agency about the respective jurisdiction over a particular bank holding company, nonbank financial company, or financial activity or product (excluding matters for which another dispute mechanism specifically has been provided under title X);

(2) the Council determines that the disputing agencies cannot, after a demonstrated good faith effort, resolve the dispute without the intervention of the Council; and

(3) any of the member agencies involved in the dispute—

(A) provides all other disputants prior notice of the intent to request dispute resolution by the Council; and

(B) requests in writing, not earlier than 14 days after providing the notice described in subparagraph (A), that the Council seek to resolve the dispute.

(b) COUNCIL RECOMMENDATION.—The Council shall seek to resolve each dispute described in subsection (a)—

(1) within a reasonable time after receiving the dispute resolution request;

(2) after consideration of relevant information provided by each agency party to the dispute; and

(3) by agreeing with 1 of the disputants regarding the entirety of the matter, or by determining a compromise position.

(c) FORM OF RECOMMENDATION.—Any Council recommendation under this section shall—

(1) be in writing;

(2) include an explanation of the reasons therefor; and

(3) be approved by the affirmative vote of ⅔ of the voting members of the Council then serving.

(d) NONBINDING EFFECT.—Any recommendation made by the Council under subsection (c) shall not be binding on the Federal agencies that are parties to the dispute.

SEC. 120. ADDITIONAL STANDARDS APPLICABLE TO ACTIVITIES OR PRACTICES FOR FINANCIAL STABILITY PURPOSES.

(a) IN GENERAL.—The Council may provide for more stringent regulation of a financial activity by issuing recommendations to the primary financial regulatory agencies to apply new or heightened standards and safeguards, including standards enumerated in section 115, for a financial activity or practice conducted by bank holding companies or nonbank financial companies under their respective jurisdictions, if the Council determines that the conduct, scope, nature, size, scale, concentration, or interconnectedness of such activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities.

(b) PROCEDURE FOR RECOMMENDATIONS TO REGULATORS.—

(1) NOTICE AND OPPORTUNITY FOR COMMENT.—The Council shall consult with the primary financial regulatory agencies and provide notice to the public and opportunity for comment for any proposed recommendation that the primary financial regulatory agencies apply new or heightened standards and safeguards for a financial activity or practice.

(2) CRITERIA.—The new or heightened standards and safeguards for a financial activity or practice recommended under paragraph (1)—

(A) shall take costs to long-term economic growth into account; and

(B) may include prescribing the conduct of the activity or practice in specific ways (such as by limiting its scope, or applying particular capital or risk management requirements to the conduct of the activity) or prohibiting the activity or practice.

(c) IMPLEMENTATION OF RECOMMENDED STANDARDS.—

(1) ROLE OF PRIMARY FINANCIAL REGULATORY AGENCY.—

(A) IN GENERAL.—Each primary financial regulatory agency may impose, require reports regarding, examine for compliance with, and enforce standards in accordance with this section with respect to those entities for which it is the primary financial regulatory agency.

(B) RULE OF CONSTRUCTION.—The authority under this paragraph is in addition to, and does not limit, any other authority of a primary financial regulatory agency. Compliance by an entity with actions taken by a primary financial regulatory agency under this section shall be enforceable in accordance with the statutes governing the respective jurisdiction of the primary financial regulatory agency over the entity, as if the agency action were taken under those statutes.

(2) IMPOSITION OF STANDARDS.—The primary financial regulatory agency shall impose the standards recommended by the Council in accordance with subsection (a), or similar standards that the Council deems acceptable, or shall explain in writing to the Council, not later than 90 days after the date on which the Council issues the recommendation, why the agency has determined not to follow the recommendation of the Council.

(d) REPORT TO CONGRESS.—The Council shall report to Congress on—

(1) any recommendations issued by the Council under this section;

(2) the implementation of, or failure to implement, such recommendation on the part of a primary financial regulatory agency; and

(3) in any case in which no primary financial regulatory agency exists for the nonbank financial company conducting financial activities or practices referred to in subsection (a),

recommendations for legislation that would prevent such activities or practices from threatening the stability of the financial system of the United States.

(e) EFFECT OF RESCISSION OF IDENTIFICATION.—

(1) NOTICE.—The Council may recommend to the relevant primary financial regulatory agency that a financial activity or practice no longer requires any standards or safeguards implemented under this section.

(2) DETERMINATION OF PRIMARY FINANCIAL REGULATORY AGENCY TO CONTINUE.—

(A) IN GENERAL.—Upon receipt of a recommendation under paragraph (1), a primary financial regulatory agency that has imposed standards under this section shall determine whether such standards should remain in effect.

(B) APPEAL PROCESS.—Each primary financial regulatory agency that has imposed standards under this section shall promulgate regulations to establish a procedure under which entities under its jurisdiction may appeal a determination by such agency under this paragraph that standards imposed under this section should remain in effect.

SEC. 121. MITIGATION OF RISKS TO FINANCIAL STABILITY.

(a) MITIGATORY ACTIONS.—If the Board of Governors determines that a bank holding company with total consolidated assets of $50,000,000,000 or more, or a nonbank financial company supervised by the Board of Governors, poses a grave threat to the financial stability of the United States, the Board of Governors, upon an affirmative vote of not fewer than ⅔ of the voting members of the Council then serving, shall—

(1) limit the ability of the company to merge with, acquire, consolidate with, or otherwise become affiliated with another company;

(2) restrict the ability of the company to offer a financial product or products;

(3) require the company to terminate one or more activities;

(4) impose conditions on the manner in which the company conducts 1 or more activities; or

(5) if the Board of Governors determines that the actions described in paragraphs (1) through (4) are inadequate to mitigate a threat to the financial stability of the United States in its recommendation, require the company to sell or otherwise transfer assets or off-balance-sheet items to unaffiliated entities.

(b) NOTICE AND HEARING.—

(1) IN GENERAL.—The Board of Governors, in consultation with the Council, shall provide to a company described in subsection (a) written notice that such company is being considered for mitigatory action pursuant to this section, including an explanation of the basis for, and description of, the proposed mitigatory action.

(2) HEARING.—Not later than 30 days after the date of receipt of notice under paragraph (1), the company may request, in writing, an opportunity for a written or oral hearing before the Board of Governors to contest the proposed mitigatory action. Upon receipt of a timely request, the Board of Governors shall fix a time (not later than 30 days after the date of

receipt of the request) and place at which such company may appear, personally or through counsel, to submit written materials (or, at the discretion of the Board of Governors, in consultation with the Council, oral testimony and oral argument).

(3) DECISION.—Not later than 60 days after the date of a hearing under paragraph (2), or not later than 60 days after the provision of a notice under paragraph (1) if no hearing was held, the Board of Governors shall notify the company of the final decision of the Board of Governors, including the results of the vote of the Council, as described in subsection (a).

(c) FACTORS FOR CONSIDERATION.—The Board of Governors and the Council shall take into consideration the factors set forth in subsection (a) or (b) of section 113, as applicable, in making any determination under subsection (a).

(d) APPLICATION TO FOREIGN FINANCIAL COMPANIES.—The Board of Governors may prescribe regulations regarding the application of this section to foreign nonbank financial companies supervised by the Board of Governors and foreign-based bank holding companies—

(1) giving due regard to the principle of national treatment and equality of competitive opportunity; and

(2) taking into account the extent to which the foreign nonbank financial company or foreign-based bank holding company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

SEC. 122. GAO AUDIT OF COUNCIL.

(a) AUTHORITY TO AUDIT.—The Comptroller General of the United States may audit the activities of—

(1) the Council; and

(2) any person or entity acting on behalf of or under the authority of the Council, to the extent that such activities relate to work for the Council by such person or entity.

(b) ACCESS TO INFORMATION.—

(1) IN GENERAL.—Notwithstanding any other provision of law, the Comptroller General shall, upon request and at such reasonable time and in such reasonable form as the Comptroller General may request, have access to—

(A) any records or other information under the control of or used by the Council;

(B) any records or other information under the control of a person or entity acting on behalf of or under the authority of the Council, to the extent that such records or other information is relevant to an audit under subsection (a); and

(C) the officers, directors, employees, financial advisors, staff, working groups, and agents and representatives of the Council (as related to the activities on behalf of the Council of such agent or representative), at such reasonable times as the Comptroller General may request.

(2) COPIES.—The Comptroller General may make and retain copies of such books, accounts, and other records, access to which is granted under this section, as the Comptroller General considers appropriate.

SEC. 123. STUDY OF THE EFFECTS OF SIZE AND COMPLEXITY OF FINANCIAL INSTITUTIONS ON CAPITAL MARKET EFFICIENCY AND ECONOMIC GROWTH.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—The Chairperson of the Council shall carry out a study of the economic impact of possible financial services regulatory limitations intended to reduce systemic risk. Such study shall estimate the benefits and costs on the efficiency of capital markets, on the financial sector, and on national economic growth, of—

(A) explicit or implicit limits on the maximum size of banks, bank holding companies, and other large financial institutions;

(B) limits on the organizational complexity and diversification of large financial institutions;

(C) requirements for operational separation between business units of large financial institutions in order to expedite resolution in case of failure;

(D) limits on risk transfer between business units of large financial institutions;

(E) requirements to carry contingent capital or similar mechanisms;

(F) limits on commingling of commercial and financial activities by large financial institutions;

(G) segregation requirements between traditional financial activities and trading or other high-risk operations in large financial institutions; and

(H) other limitations on the activities or structure of large financial institutions that may be useful to limit systemic risk.

(2) RECOMMENDATIONS.—The study required by this section shall include recommendations for the optimal structure of any limits considered in subparagraphs (A) through (E), in order to maximize their effectiveness and minimize their economic impact.

(b) REPORT.—Not later than the end of the 180-day period beginning on the date of enactment of this title, and not later than every 5 years thereafter, the Chairperson shall issue a report to the Congress containing any findings and determinations made in carrying out the study required under subsection (a).

Subtitle B—Office of Financial Research

SEC. 151. DEFINITIONS.

For purposes of this subtitle—

(1) the terms "Office" and "Director" mean the Office of Financial Research established under this subtitle and the Director thereof, respectively;

(2) the term "financial company" has the same meaning as in title II, and includes an insured depository institution and an insurance company;

(3) the term "Data Center" means the data center established under section 154;

(4) the term "Research and Analysis Center" means the research and analysis center established under section 154;

(5) the term "financial transaction data" means the structure and legal description of a financial contract, with sufficient detail to describe the rights and obligations between counterparties and make possible an independent valuation;

(6) the term "position data"—

(A) means data on financial assets or liabilities held on the balance sheet of a financial company, where positions are created or changed by the execution of a financial transaction; and

(B) includes information that identifies counterparties, the valuation by the financial company of the position, and information that makes possible an independent valuation of the position;

(7) the term "financial contract" means a legally binding agreement between 2 or more counterparties, describing rights and obligations relating to the future delivery of items of intrinsic or extrinsic value among the counterparties; and

(8) the term "financial instrument" means a financial contract in which the terms and conditions are publicly available, and the roles of one or more of the counterparties are assignable without the consent of any of the other counterparties (including common stock of a publicly traded company, government bonds, or exchange traded futures and options contracts).

SEC. 152. OFFICE OF FINANCIAL RESEARCH ESTABLISHED.

(a) ESTABLISHMENT.—There is established within the Department of the Treasury the Office of Financial Research.

(b) DIRECTOR.—

(1) IN GENERAL.—The Office shall be headed by a Director, who shall be appointed by the President, by and with the advice and consent of the Senate.

(2) TERM OF SERVICE.—The Director shall serve for a term of 6 years, except that, in the event that a successor is not nominated and confirmed by the end of the term of service of a Director, the Director may continue to serve until such time as the next Director is appointed and confirmed.

(3) EXECUTIVE LEVEL.—The Director shall be compensated at Level III of the Executive Schedule.

(4) PROHIBITION ON DUAL SERVICE.—The individual serving in the position of Director may not, during such service, also serve as the head of any financial regulatory agency.

(5) RESPONSIBILITIES, DUTIES, AND AUTHORITY.—The Director shall have sole discretion in the manner in which the Director fulfills the responsibilities and duties and exercises the authorities described in this subtitle.

(c) BUDGET.—The Director, in consultation with the Chairperson, shall establish the annual budget of the Office.

(d) OFFICE PERSONNEL.—

(1) IN GENERAL.—The Director, in consultation with the Chairperson, may fix the number of, and appoint and direct, all employees of the Office.

(2) COMPENSATION.—The Director, in consultation with the Chairperson, shall fix, adjust, and administer the pay for all employees of the Office, without regard to chapter 51 or subchapter III of chapter 53 of title 5, United States Code, relating to classification of positions and General Schedule pay rates.

(3) COMPARABILITY.—Section 1206(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 1833b(a)) is amended—

(A) by striking "Finance Board," and inserting "Finance Board, the Office of Financial Research, and the Bureau of Consumer Financial Protection"; and

(B) by striking "and the Office of Thrift Supervision,".

(4) SENIOR EXECUTIVES.—Section 3132(a)(1)(D) of title 5, United States Code, is amended by striking "and the National Credit Union Administration;" and inserting "the National Credit Union Administration, the Bureau of Consumer Financial Protection, and the Office of Financial Research;".

(e) ASSISTANCE FROM FEDERAL AGENCIES.—Any department or agency of the United States may provide to the Office and any special advisory, technical, or professional committees appointed by the Office, such services, funds, facilities, staff, and other support services as the Office may determine advisable. Any Federal Government employee may be detailed to the Office without reimbursement, and such detail shall be without interruption or loss of civil service status or privilege.

(f) PROCUREMENT OF TEMPORARY AND INTERMITTENT SERVICES.—The Director may procure temporary and intermittent services under section 3109(b) of title 5, United States Code, at rates for individuals which do not exceed the daily equivalent of the annual rate of basic pay prescribed for Level V of the Executive Schedule under section 5316 of such title.

(g) POST-EMPLOYMENT PROHIBITIONS.—The Secretary, with the concurrence of the Director of the Office of Government Ethics, shall issue regulations prohibiting the Director and any employee of the Office who has had access to the transaction or position data maintained by the Data Center or other business confidential information about financial entities required to report to the Office from being employed by or providing advice or consulting services to a financial company, for a period of 1 year after last having had access in the course of official duties to such transaction or position data or business confidential information, regardless of whether that entity is required to report to the Office. For employees whose access to business confidential information was limited, the regulations may provide, on a case-by-case basis, for a shorter period of post-employment prohibition, provided that the shorter period does not compromise business confidential information.

(h) TECHNICAL AND PROFESSIONAL ADVISORY COMMITTEES.—The Office, in consultation with the Chairperson, may appoint such special advisory, technical, or professional committees as may be useful in carrying out the functions of the Office, and the members of such committees may be staff of the Office, or other persons, or both.

(i) FELLOWSHIP PROGRAM.—The Office, in consultation with the Chairperson, may establish and maintain an academic and professional fellowship program, under which qualified academics and professionals shall be invited to spend not longer than 2 years at the Office, to perform research and to provide advanced training for Office personnel.

(j) EXECUTIVE SCHEDULE COMPENSATION.—Section 5314 of title 5, United States Code, is amended by adding at the end the following new item:

"Director of the Office of Financial Research.".

SEC. 153. PURPOSE AND DUTIES OF THE OFFICE.

(a) PURPOSE AND DUTIES.—The purpose of the Office is to support the Council in fulfilling the purposes and duties of the Council, as set forth in subtitle A, and to support member agencies, by—

(1) collecting data on behalf of the Council, and providing such data to the Council and member agencies;

(2) standardizing the types and formats of data reported and collected;

(3) performing applied research and essential long-term research;

(4) developing tools for risk measurement and monitoring;

(5) performing other related services;

(6) making the results of the activities of the Office available to financial regulatory agencies; and

(7) assisting such member agencies in determining the types and formats of data authorized by this Act to be collected by such member agencies.

(b) ADMINISTRATIVE AUTHORITY.—The Office may—

(1) share data and information, including software developed by the Office, with the Council, member agencies, and the Bureau of Economic Analysis, which shared data, information, and software—

(A) shall be maintained with at least the same level of security as is used by the Office; and

(B) may not be shared with any individual or entity without the permission of the Council;

(2) sponsor and conduct research projects; and

(3) assist, on a reimbursable basis, with financial analyses undertaken at the request of other Federal agencies that are not member agencies.

(c) RULEMAKING AUTHORITY.—

(1) SCOPE.—The Office, in consultation with the Chairperson, shall issue rules, regulations, and orders only to the extent necessary to carry out the purposes and duties described in paragraphs (1), (2), and (7) of subsection (a).

(2) STANDARDIZATION.—Member agencies, in consultation with the Office, shall implement regulations promulgated by the Office under paragraph (1) to standardize the types and formats of data reported and collected on behalf of the Council, as described in subsection (a)(2). If a member agency fails to implement such regulations prior to the expiration of the 3-year period following the date of publication of final regulations, the Office, in consultation with the Chairperson, may implement such regulations with respect to the financial entities under the jurisdiction of the member agency. This paragraph shall not supersede or interfere with the independent authority of a member agency under other law to collect data, in such format and manner as the member agency requires.

(d) TESTIMONY.—

(1) IN GENERAL.—The Director of the Office shall report to and testify before the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives annually on the activities of the Office, including the work of the Data Center and the Research and Analysis Center, and the assessment of the

Office of significant financial market developments and potential emerging threats to the financial stability of the United States.

(2) NO PRIOR REVIEW.—No officer or agency of the United States shall have any authority to require the Director to submit the testimony required under paragraph (1) or other congressional testimony to any officer or agency of the United States for approval, comment, or review prior to the submission of such testimony. Any such testimony to Congress shall include a statement that the views expressed therein are those of the Director and do not necessarily represent the views of the President.

(e) ADDITIONAL REPORTS.—The Director may provide additional reports to Congress concerning the financial stability of the United States. The Director shall notify the Council of any such additional reports provided to Congress.

(f) SUBPOENA.—

(1) IN GENERAL.—The Director may require from a financial company, by subpoena, the production of the data requested under subsection (a)(1) and section 154(b)(1), but only upon a written finding by the Director that—

(A) such data is required to carry out the functions described under this subtitle; and

(B) the Office has coordinated with the relevant primary financial regulatory agency, as required under section 154(b)(1)(B)(ii).

(2) FORMAT.—Subpoenas under paragraph (1) shall bear the signature of the Director, and shall be served by any person or class of persons designated by the Director for that purpose.

(3) ENFORCEMENT.—In the case of contumacy or failure to obey a subpoena, the subpoena shall be enforceable by order of any appropriate district court of the United States. Any failure to obey the order of the court may be punished by the court as a contempt of court.

SEC. 154. ORGANIZATIONAL STRUCTURE; RESPONSIBILITIES OF PRIMARY PROGRAMMATIC UNITS.

(a) IN GENERAL.—There are established within the Office, to carry out the programmatic responsibilities of the Office—

(1) the Data Center; and

(2) the Research and Analysis Center.

(b) DATA CENTER.—

(1) GENERAL DUTIES.—

(A) DATA COLLECTION.—The Data Center, on behalf of the Council, shall collect, validate, and maintain all data necessary to carry out the duties of the Data Center, as described in this subtitle. The data assembled shall be obtained from member agencies, commercial data providers, publicly available data sources, and financial entities under subparagraph (B).

(B) AUTHORITY.—

(i) IN GENERAL.—The Office may, as determined by the Council or by the Director in consultation with the Council, require the submission of periodic and other reports from any financial company for the purpose of assessing the extent to which a financial activity or financial market in which the financial company participates, or the financial company itself, poses a threat to the financial stability of the United States.

(ii) MITIGATION OF REPORT BURDEN.—Before requiring the submission of a report from any financial company that is regulated by a member agency, any primary financial regulatory agency, a foreign supervisory authority, or the Office shall coordinate with such agencies or authority, and shall, whenever possible, rely on information available from such agencies or authority.

(iii) COLLECTION OF FINANCIAL TRANSACTION AND POSITION DATA.—The Office shall collect, on a schedule determined by the Director, in consultation with the Council, financial transaction data and position data from financial companies.

(C) RULEMAKING.—The Office shall promulgate regulations pursuant to subsections (a)(1), (a)(2), (a)(7), and (c)(1) of section 153 regarding the type and scope of the data to be collected by the Data Center under this paragraph.

(2) RESPONSIBILITIES.—

(A) PUBLICATION.—The Data Center shall prepare and publish, in a manner that is easily accessible to the public—

(i) a financial company reference database;

(ii) a financial instrument reference database; and

(iii) formats and standards for Office data, including standards for reporting financial transaction and position data to the Office.

(B) CONFIDENTIALITY.—The Data Center shall not publish any confidential data under subparagraph (A).

(3) INFORMATION SECURITY.—The Director shall ensure that data collected and maintained by the Data Center are kept secure and protected against unauthorized disclosure.

(4) CATALOG OF FINANCIAL ENTITIES AND INSTRUMENTS.—The Data Center shall maintain a catalog of the financial entities and instruments reported to the Office.

(5) AVAILABILITY TO THE COUNCIL AND MEMBER AGENCIES.—The Data Center shall make data collected and maintained by the Data Center available to the Council and member agencies, as necessary to support their regulatory responsibilities.

(6) OTHER AUTHORITY.—The Office shall, after consultation with the member agencies, provide certain data to financial industry participants and to the general public to increase market transparency and facilitate research on the financial system, to the extent that intellectual property rights are not violated, business confidential information is properly protected, and the sharing of such information poses no significant threats to the financial system of the United States.

(c) RESEARCH AND ANALYSIS CENTER.—

(1) GENERAL DUTIES.—The Research and Analysis Center, on behalf of the Council, shall develop and maintain independent analytical capabilities and computing resources—

(A) to develop and maintain metrics and reporting systems for risks to the financial stability of the United States;

(B) to monitor, investigate, and report on changes in systemwide risk levels and patterns to the Council and Congress;

(C) to conduct, coordinate, and sponsor research to support and improve regulation of financial entities and markets;

(D) to evaluate and report on stress tests or other stability-related evaluations of financial entities overseen by the member agencies;

(E) to maintain expertise in such areas as may be necessary to support specific requests for advice and assistance from financial regulators;

(F) to investigate disruptions and failures in the financial markets, report findings, and make recommendations to the Council based on those findings;

(G) to conduct studies and provide advice on the impact of policies related to systemic risk; and

(H) to promote best practices for financial risk management.

(d) REPORTING RESPONSIBILITIES.—

(1) REQUIRED REPORTS.—Not later than 2 years after the date of enactment of this Act, and not later than 120 days after the end of each fiscal year thereafter, the Office shall prepare and submit a report to Congress.

(2) CONTENT.—Each report required by this subsection shall assess the state of the United States financial system, including—

(A) an analysis of any threats to the financial stability of the United States;

(B) the status of the efforts of the Office in meeting the mission of the Office; and

(C) key findings from the research and analysis of the financial system by the Office.

SEC. 155. FUNDING.

(a) FINANCIAL RESEARCH FUND.—

(1) FUND ESTABLISHED.—There is established in the Treasury of the United States a separate fund to be known as the "Financial Research Fund".

(2) FUND RECEIPTS.—All amounts provided to the Office under subsection (c), and all assessments that the Office receives under subsection (d) shall be deposited into the Financial Research Fund.

(3) INVESTMENTS AUTHORIZED.—

(A) AMOUNTS IN FUND MAY BE INVESTED.—The Director may request the Secretary to invest the portion of the Financial Research Fund that is not, in the judgment of the Director, required to meet the needs of the Office.

(B) ELIGIBLE INVESTMENTS.—Investments shall be made by the Secretary in obligations of the United States or obligations that are guaranteed as to principal and interest by the United States, with maturities suitable to the needs of the Financial Research Fund, as determined by the Director.

(4) INTEREST AND PROCEEDS CREDITED.—The interest on, and the proceeds from the sale or redemption of, any obligations

held in the Financial Research Fund shall be credited to and form a part of the Financial Research Fund.

(b) USE OF FUNDS.—

(1) IN GENERAL.—Funds obtained by, transferred to, or credited to the Financial Research Fund shall be immediately available to the Office, and shall remain available until expended, to pay the expenses of the Office in carrying out the duties and responsibilities of the Office.

(2) FEES, ASSESSMENTS, AND OTHER FUNDS NOT GOVERNMENT FUNDS.—Funds obtained by, transferred to, or credited to the Financial Research Fund shall not be construed to be Government funds or appropriated moneys.

(3) AMOUNTS NOT SUBJECT TO APPORTIONMENT.—Notwithstanding any other provision of law, amounts in the Financial Research Fund shall not be subject to apportionment for purposes of chapter 15 of title 31, United States Code, or under any other authority, or for any other purpose.

(c) INTERIM FUNDING.—During the 2-year period following the date of enactment of this Act, the Board of Governors shall provide to the Office an amount sufficient to cover the expenses of the Office.

(d) PERMANENT SELF-FUNDING.—Beginning 2 years after the date of enactment of this Act, the Secretary shall establish, by regulation, and with the approval of the Council, an assessment schedule, including the assessment base and rates, applicable to bank holding companies with total consolidated assets of $50,000,000,000 or greater and nonbank financial companies supervised by the Board of Governors, that takes into account differences among such companies, based on the considerations for establishing the prudential standards under section 115, to collect assessments equal to the total expenses of the Office.

SEC. 156. TRANSITION OVERSIGHT.

(a) PURPOSE.—The purpose of this section is to ensure that the Office—

(1) has an orderly and organized startup;

(2) attracts and retains a qualified workforce; and

(3) establishes comprehensive employee training and benefits programs.

(b) REPORTING REQUIREMENT.—

(1) IN GENERAL.—The Office shall submit an annual report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives that includes the plans described in paragraph (2).

(2) PLANS.—The plans described in this paragraph are as follows:

(A) TRAINING AND WORKFORCE DEVELOPMENT PLAN.—The Office shall submit a training and workforce development plan that includes, to the extent practicable—

(i) identification of skill and technical expertise needs and actions taken to meet those requirements;

(ii) steps taken to foster innovation and creativity;

(iii) leadership development and succession planning; and

(iv) effective use of technology by employees.

(B) WORKPLACE FLEXIBILITY PLAN.—The Office shall submit a workforce flexibility plan that includes, to the extent practicable—

(i) telework;

(ii) flexible work schedules;

(iii) phased retirement;

(iv) reemployed annuitants;

(v) part-time work;

(vi) job sharing;

(vii) parental leave benefits and childcare assistance;

(viii) domestic partner benefits;

(ix) other workplace flexibilities; or

(x) any combination of the items described in clauses (i) through (ix).

(C) RECRUITMENT AND RETENTION PLAN.—The Office shall submit a recruitment and retention plan that includes, to the extent practicable, provisions relating to—

(i) the steps necessary to target highly qualified applicant pools with diverse backgrounds;

(ii) streamlined employment application processes;

(iii) the provision of timely notification of the status of employment applications to applicants; and

(iv) the collection of information to measure indicators of hiring effectiveness.

(c) EXPIRATION.—The reporting requirement under subsection (b) shall terminate 5 years after the date of enactment of this Act.

(d) RULE OF CONSTRUCTION.—Nothing in this section may be construed to affect—

(1) a collective bargaining agreement, as that term is defined in section 7103(a)(8) of title 5, United States Code, that is in effect on the date of enactment of this Act; or

(2) the rights of employees under chapter 71 of title 5, United States Code.

Subtitle C—Additional Board of Governors Authority for Certain Nonbank Financial Companies and Bank Holding Companies

SEC. 161. REPORTS BY AND EXAMINATIONS OF NONBANK FINANCIAL COMPANIES BY THE BOARD OF GOVERNORS.

(a) REPORTS.—

(1) IN GENERAL.—The Board of Governors may require each nonbank financial company supervised by the Board of Governors, and any subsidiary thereof, to submit reports under oath, to keep the Board of Governors informed as to—

(A) the financial condition of the company or subsidiary, systems of the company or subsidiary for monitoring and controlling financial, operating, and other risks, and the extent to which the activities and operations of the company or subsidiary pose a threat to the financial stability of the United States; and

(B) compliance by the company or subsidiary with the requirements of this title.

(2) USE OF EXISTING REPORTS AND INFORMATION.—In carrying out subsection (a), the Board of Governors shall, to the fullest extent possible, use—

(A) reports and supervisory information that a nonbank financial company or subsidiary thereof has been required to provide to other Federal or State regulatory agencies;

(B) information otherwise obtainable from Federal or State regulatory agencies;

(C) information that is otherwise required to be reported publicly; and

(D) externally audited financial statements of such company or subsidiary.

(3) AVAILABILITY.—Upon the request of the Board of Governors, a nonbank financial company supervised by the Board of Governors, or a subsidiary thereof, shall promptly provide to the Board of Governors any information described in paragraph (2).

(b) EXAMINATIONS.—

(1) IN GENERAL.—Subject to paragraph (2), the Board of Governors may examine any nonbank financial company supervised by the Board of Governors and any subsidiary of such company, to inform the Board of Governors of—

(A) the nature of the operations and financial condition of the company and such subsidiary;

(B) the financial, operational, and other risks of the company or such subsidiary that may pose a threat to the safety and soundness of such company or subsidiary or to the financial stability of the United States;

(C) the systems for monitoring and controlling such risks; and

(D) compliance by the company or such subsidiary with the requirements of this title.

(2) USE OF EXAMINATION REPORTS AND INFORMATION.—For purposes of this subsection, the Board of Governors shall, to the fullest extent possible, rely on reports of examination of any subsidiary depository institution or functionally regulated subsidiary made by the primary financial regulatory agency for that subsidiary, and on information described in subsection (a)(2).

(c) COORDINATION WITH PRIMARY FINANCIAL REGULATORY AGENCY.—The Board of Governors shall—

(1) provide reasonable notice to, and consult with, the primary financial regulatory agency for any subsidiary before requiring a report or commencing an examination of such subsidiary under this section; and

(2) avoid duplication of examination activities, reporting requirements, and requests for information, to the fullest extent possible.

SEC. 162. ENFORCEMENT.

(a) IN GENERAL.—Except as provided in subsection (b), a nonbank financial company supervised by the Board of Governors and any subsidiaries of such company (other than any depository institution subsidiary) shall be subject to the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), in the same manner and to the same extent as if the company were a bank holding company, as provided in section 8(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)(3)).

(b) ENFORCEMENT AUTHORITY FOR FUNCTIONALLY REGULATED SUBSIDIARIES.—

(1) REFERRAL.—If the Board of Governors determines that a condition, practice, or activity of a depository institution subsidiary or functionally regulated subsidiary of a nonbank financial company supervised by the Board of Governors does not comply with the regulations or orders prescribed by the Board of Governors under this Act, or otherwise poses a threat to the financial stability of the United States, the Board of Governors may recommend, in writing, to the primary financial regulatory agency for the subsidiary that such agency initiate a supervisory action or enforcement proceeding. The recommendation shall be accompanied by a written explanation of the concerns giving rise to the recommendation.

(2) BACK-UP AUTHORITY OF THE BOARD OF GOVERNORS.—If, during the 60-day period beginning on the date on which the primary financial regulatory agency receives a recommendation under paragraph (1), the primary financial regulatory agency does not take supervisory or enforcement action against a subsidiary that is acceptable to the Board of Governors, the Board of Governors (upon a vote of its members) may take the recommended supervisory or enforcement action, as if the subsidiary were a bank holding company subject to supervision by the Board of Governors.

SEC. 163. ACQUISITIONS.

(a) ACQUISITIONS OF BANKS; TREATMENT AS A BANK HOLDING COMPANY.—For purposes of section 3 of the Bank Holding Company Act of 1956 (12 U.S.C. 1842), a nonbank financial company supervised by the Board of Governors shall be deemed to be, and shall be treated as, a bank holding company.

(b) ACQUISITION OF NONBANK COMPANIES.—

(1) PRIOR NOTICE FOR LARGE ACQUISITIONS.—Notwithstanding section 4(k)(6)(B) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)(6)(B)), a bank holding company with total consolidated assets equal to or greater than $50,000,000,000 or a nonbank financial company supervised by the Board of Governors shall not acquire direct or indirect ownership or control of any voting shares of any company (other than an insured depository institution) that is engaged in activities described in section 4(k) of the Bank Holding Company Act of 1956 having total consolidated assets of $10,000,000,000 or more, without providing written notice to the Board of Governors in advance of the transaction.

(2) EXEMPTIONS.—The prior notice requirement in paragraph (1) shall not apply with regard to the acquisition of shares that would qualify for the exemptions in section 4(c) or section 4(k)(4)(E) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c) and (k)(4)(E)).

(3) NOTICE PROCEDURES.—The notice procedures set forth in section 4(j)(1) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(j)(1)), without regard to section 4(j)(3) of that Act, shall apply to an acquisition of any company (other than an insured depository institution) by a bank holding company with total consolidated assets equal to or greater than

$50,000,000,000 or a nonbank financial company supervised by the Board of Governors, as described in paragraph (1), including any such company engaged in activities described in section 4(k) of that Act.

(4) STANDARDS FOR REVIEW.—In addition to the standards provided in section 4(j)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(j)(2)), the Board of Governors shall consider the extent to which the proposed acquisition would result in greater or more concentrated risks to global or United States financial stability or the United States economy.

(5) HART-SCOTT-RODINO FILING REQUIREMENT.—Solely for purposes of section 7A(c)(8) of the Clayton Act (15 U.S.C. 18a(c)(8)), the transactions subject to the requirements of paragraph (1) shall be treated as if Board of Governors approval is not required.

SEC. 164. PROHIBITION AGAINST MANAGEMENT INTERLOCKS BETWEEN CERTAIN FINANCIAL COMPANIES.

A nonbank financial company supervised by the Board of Governors shall be treated as a bank holding company for purposes of the Depository Institutions Management Interlocks Act (12 U.S.C. 3201 et seq.), except that the Board of Governors shall not exercise the authority provided in section 7 of that Act (12 U.S.C. 3207) to permit service by a management official of a nonbank financial company supervised by the Board of Governors as a management official of any bank holding company with total consolidated assets equal to or greater than $50,000,000,000, or other nonaffiliated nonbank financial company supervised by the Board of Governors (other than to provide a temporary exemption for interlocks resulting from a merger, acquisition, or consolidation).

SEC. 165. ENHANCED SUPERVISION AND PRUDENTIAL STANDARDS FOR NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS AND CERTAIN BANK HOLDING COMPANIES.

(a) IN GENERAL.—

(1) PURPOSE.—In order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions, the Board of Governors shall, on its own or pursuant to recommendations by the Council under section 115, establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than $50,000,000,000 that—

(A) are more stringent than the standards and requirements applicable to nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States; and

(B) increase in stringency, based on the considerations identified in subsection (b)(3).

(2) TAILORED APPLICATION.—

(A) IN GENERAL.—In prescribing more stringent prudential standards under this section, the Board of Governors may, on its own or pursuant to a recommendation by the Council in accordance with section 115, differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other risk-related factors that the Board of Governors deems appropriate.

(B) ADJUSTMENT OF THRESHOLD FOR APPLICATION OF CERTAIN STANDARDS.—The Board of Governors may, pursuant to a recommendation by the Council in accordance with section 115, establish an asset threshold above $50,000,000,000 for the application of any standard established under subsections (c) through (g).

(b) DEVELOPMENT OF PRUDENTIAL STANDARDS.—

(1) IN GENERAL.—

(A) REQUIRED STANDARDS.—The Board of Governors shall establish prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that shall include—

(i) risk-based capital requirements and leverage limits, unless the Board of Governors, in consultation with the Council, determines that such requirements are not appropriate for a company subject to more stringent prudential standards because of the activities of such company (such as investment company activities or assets under management) or structure, in which case, the Board of Governors shall apply other standards that result in similarly stringent risk controls;

(ii) liquidity requirements;

(iii) overall risk management requirements;

(iv) resolution plan and credit exposure report requirements; and

(v) concentration limits.

(B) ADDITIONAL STANDARDS AUTHORIZED.—The Board of Governors may establish additional prudential standards for nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), that include—

(i) a contingent capital requirement;

(ii) enhanced public disclosures;

(iii) short-term debt limits; and

(iv) such other prudential standards as the Board or Governors, on its own or pursuant to a recommendation made by the Council in accordance with section 115, determines are appropriate.

(2) STANDARDS FOR FOREIGN FINANCIAL COMPANIES.—In applying the standards set forth in paragraph (1) to any foreign nonbank financial company supervised by the Board of Governors or foreign-based bank holding company, the Board of Governors shall—

(A) give due regard to the principle of national treatment and equality of competitive opportunity; and

(B) take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

(3) CONSIDERATIONS.—In prescribing prudential standards under paragraph (1), the Board of Governors shall—

(A) take into account differences among nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a), based on—

(i) the factors described in subsections (a) and (b) of section 113;

(ii) whether the company owns an insured depository institution;

(iii) nonfinancial activities and affiliations of the company; and

(iv) any other risk-related factors that the Board of Governors determines appropriate;

(B) to the extent possible, ensure that small changes in the factors listed in subsections (a) and (b) of section 113 would not result in sharp, discontinuous changes in the prudential standards established under paragraph (1) of this subsection;

(C) take into account any recommendations of the Council under section 115; and

(D) adapt the required standards as appropriate in light of any predominant line of business of such company, including assets under management or other activities for which particular standards may not be appropriate.

(4) CONSULTATION.—Before imposing prudential standards or any other requirements pursuant to this section, including notices of deficiencies in resolution plans and more stringent requirements or divestiture orders resulting from such notices, that are likely to have a significant impact on a functionally regulated subsidiary or depository institution subsidiary of a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), the Board of Governors shall consult with each Council member that primarily supervises any such subsidiary with respect to any such standard or requirement.

(5) REPORT.—The Board of Governors shall submit an annual report to Congress regarding the implementation of the prudential standards required pursuant to paragraph (1), including the use of such standards to mitigate risks to the financial stability of the United States.

(c) CONTINGENT CAPITAL.—

(1) IN GENERAL.—Subsequent to submission by the Council of a report to Congress under section 115(c), the Board of Governors may issue regulations that require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection (a) to maintain a minimum amount of contingent capital that is convertible to equity in times of financial stress.

(2) FACTORS TO CONSIDER.—In issuing regulations under this subsection, the Board of Governors shall consider—

(A) the results of the study undertaken by the Council, and any recommendations of the Council, under section 115(c);

(B) an appropriate transition period for implementation of contingent capital under this subsection;

(C) the factors described in subsection (b)(3)(A);

(D) capital requirements applicable to the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), and subsidiaries thereof; and

(E) any other factor that the Board of Governors deems appropriate.

(d) RESOLUTION PLAN AND CREDIT EXPOSURE REPORTS.—

(1) RESOLUTION PLAN.—The Board of Governors shall require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection (a) to report periodically to the Board of Governors, the Council, and the Corporation the plan of such company for rapid and orderly resolution in the event of material financial distress or failure, which shall include—

(A) information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company;

(B) full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company;

(C) identification of the cross-guarantees tied to different securities, identification of major counterparties, and a process for determining to whom the collateral of the company is pledged; and

(D) any other information that the Board of Governors and the Corporation jointly require by rule or order.

(2) CREDIT EXPOSURE REPORT.—The Board of Governors shall require each nonbank financial company supervised by the Board of Governors and bank holding companies described in subsection (a) to report periodically to the Board of Governors, the Council, and the Corporation on—

(A) the nature and extent to which the company has credit exposure to other significant nonbank financial companies and significant bank holding companies; and

(B) the nature and extent to which other significant nonbank financial companies and significant bank holding companies have credit exposure to that company.

(3) REVIEW.—The Board of Governors and the Corporation shall review the information provided in accordance with this subsection by each nonbank financial company supervised by the Board of Governors and bank holding company described in subsection (a).

(4) NOTICE OF DEFICIENCIES.—If the Board of Governors and the Corporation jointly determine, based on their review under paragraph (3), that the resolution plan of a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) is not credible or would not facilitate an orderly resolution of the company under title 11, United States Code—

(A) the Board of Governors and the Corporation shall notify the company of the deficiencies in the resolution plan; and

(B) the company shall resubmit the resolution plan within a timeframe determined by the Board of Governors and the Corporation, with revisions demonstrating that the plan is credible and would result in an orderly resolution under title 11, United States Code, including any proposed changes in business operations and corporate structure to facilitate implementation of the plan.

(5) FAILURE TO RESUBMIT CREDIBLE PLAN.—

(A) IN GENERAL.—If a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) fails to timely resubmit the resolution plan as required under paragraph (4), with such revisions as are required under subparagraph (B), the Board of Governors and the Corporation may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of the company, or any subsidiary thereof, until such time as the company resubmits a plan that remedies the deficiencies.

(B) DIVESTITURE.—The Board of Governors and the Corporation, in consultation with the Council, may jointly direct a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), by order, to divest certain assets or operations identified by the Board of Governors and the Corporation, to facilitate an orderly resolution of such company under title 11, United States Code, in the event of the failure of such company, in any case in which—

(i) the Board of Governors and the Corporation have jointly imposed more stringent requirements on the company pursuant to subparagraph (A); and

(ii) the company has failed, within the 2-year period beginning on the date of the imposition of such requirements under subparagraph (A), to resubmit the resolution plan with such revisions as were required under paragraph (4)(B).

(6) NO LIMITING EFFECT.—A resolution plan submitted in accordance with this subsection shall not be binding on a bankruptcy court, a receiver appointed under title II, or any other authority that is authorized or required to resolve the nonbank financial company supervised by the Board, any bank holding company, or any subsidiary or affiliate of the foregoing.

(7) NO PRIVATE RIGHT OF ACTION.—No private right of action may be based on any resolution plan submitted in accordance with this subsection.

(8) RULES.—Not later than 18 months after the date of enactment of this Act, the Board of Governors and the Corporation shall jointly issue final rules implementing this subsection.

(e) CONCENTRATION LIMITS.—

(1) STANDARDS.—In order to limit the risks that the failure of any individual company could pose to a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), the Board of Governors, by regulation, shall prescribe standards that limit such risks.

(2) LIMITATION ON CREDIT EXPOSURE.—The regulations prescribed by the Board of Governors under paragraph (1) shall prohibit each nonbank financial company supervised by the Board of Governors and bank holding company described in subsection (a) from having credit exposure to any unaffiliated company that exceeds 25 percent of the capital stock and surplus (or such lower amount as the Board of Governors may

determine by regulation to be necessary to mitigate risks to the financial stability of the United States) of the company.

(3) CREDIT EXPOSURE.—For purposes of paragraph (2), "credit exposure" to a company means—

(A) all extensions of credit to the company, including loans, deposits, and lines of credit;

(B) all repurchase agreements and reverse repurchase agreements with the company, and all securities borrowing and lending transactions with the company, to the extent that such transactions create credit exposure for the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a);

(C) all guarantees, acceptances, or letters of credit (including endorsement or standby letters of credit) issued on behalf of the company;

(D) all purchases of or investment in securities issued by the company;

(E) counterparty credit exposure to the company in connection with a derivative transaction between the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) and the company; and

(F) any other similar transactions that the Board of Governors, by regulation, determines to be a credit exposure for purposes of this section.

(4) ATTRIBUTION RULE.—For purposes of this subsection, any transaction by a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a) with any person is a transaction with a company, to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that company.

(5) RULEMAKING.—The Board of Governors may issue such regulations and orders, including definitions consistent with this section, as may be necessary to administer and carry out this subsection.

(6) EXEMPTIONS.—This subsection shall not apply to any Federal home loan bank. The Board of Governors may, by regulation or order, exempt transactions, in whole or in part, from the definition of the term "credit exposure" for purposes of this subsection, if the Board of Governors finds that the exemption is in the public interest and is consistent with the purpose of this subsection.

(7) TRANSITION PERIOD.—

(A) IN GENERAL.—This subsection and any regulations and orders of the Board of Governors under this subsection shall not be effective until 3 years after the date of enactment of this Act.

(B) EXTENSION AUTHORIZED.—The Board of Governors may extend the period specified in subparagraph (A) for not longer than an additional 2 years.

(f) ENHANCED PUBLIC DISCLOSURES.—The Board of Governors may prescribe, by regulation, periodic public disclosures by nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a) in order to support market evaluation of the risk profile, capital adequacy, and risk management capabilities thereof.

(g) SHORT-TERM DEBT LIMITS.—

(1) IN GENERAL.—In order to mitigate the risks that an over-accumulation of short-term debt could pose to financial companies and to the stability of the United States financial system, the Board of Governors may, by regulation, prescribe a limit on the amount of short-term debt, including off-balance sheet exposures, that may be accumulated by any bank holding company described in subsection (a) and any nonbank financial company supervised by the Board of Governors.

(2) BASIS OF LIMIT.—Any limit prescribed under paragraph (1) shall be based on the short-term debt of the company described in paragraph (1) as a percentage of capital stock and surplus of the company or on such other measure as the Board of Governors considers appropriate.

(3) SHORT-TERM DEBT DEFINED.—For purposes of this subsection, the term "short-term debt" means such liabilities with short-dated maturity that the Board of Governors identifies, by regulation, except that such term does not include insured deposits.

(4) RULEMAKING AUTHORITY.—In addition to prescribing regulations under paragraphs (1) and (3), the Board of Governors may prescribe such regulations, including definitions consistent with this subsection, and issue such orders, as may be necessary to carry out this subsection.

(5) AUTHORITY TO ISSUE EXEMPTIONS AND ADJUSTMENTS.—Notwithstanding the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.), the Board of Governors may, if it determines such action is necessary to ensure appropriate heightened prudential supervision, with respect to a company described in paragraph (1) that does not control an insured depository institution, issue to such company an exemption from or adjustment to the limit prescribed under paragraph (1).

(h) RISK COMMITTEE.—

(1) NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD OF GOVERNORS.—The Board of Governors shall require each nonbank financial company supervised by the Board of Governors that is a publicly traded company to establish a risk committee, as set forth in paragraph (3), not later than 1 year after the date of receipt of a notice of final determination under section 113(e)(3) with respect to such nonbank financial company supervised by the Board of Governors.

(2) CERTAIN BANK HOLDING COMPANIES.—

(A) MANDATORY REGULATIONS.—The Board of Governors shall issue regulations requiring each bank holding company that is a publicly traded company and that has total consolidated assets of not less than $10,000,000,000 to establish a risk committee, as set forth in paragraph (3).

(B) PERMISSIVE REGULATIONS.—The Board of Governors may require each bank holding company that is a publicly traded company and that has total consolidated assets of less than $10,000,000,000 to establish a risk committee, as set forth in paragraph (3), as determined necessary or appropriate by the Board of Governors to promote sound risk management practices.

(3) RISK COMMITTEE.—A risk committee required by this subsection shall—

(A) be responsible for the oversight of the enterprise-wide risk management practices of the nonbank financial company supervised by the Board of Governors or bank holding company described in subsection (a), as applicable;

(B) include such number of independent directors as the Board of Governors may determine appropriate, based on the nature of operations, size of assets, and other appropriate criteria related to the nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), as applicable; and

(C) include at least 1 risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms.

(4) RULEMAKING.—The Board of Governors shall issue final rules to carry out this subsection, not later than 1 year after the transfer date, to take effect not later than 15 months after the transfer date.

(i) STRESS TESTS.—

(1) BY THE BOARD OF GOVERNORS.—

(A) ANNUAL TESTS REQUIRED.—The Board of Governors, in coordination with the appropriate primary financial regulatory agencies and the Federal Insurance Office, shall conduct annual analyses in which nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a) are subject to evaluation of whether such companies have the capital, on a total consolidated basis, necessary to absorb losses as a result of adverse economic conditions.

(B) TEST PARAMETERS AND CONSEQUENCES.—The Board of Governors—

(i) shall provide for at least 3 different sets of conditions under which the evaluation required by this subsection shall be conducted, including baseline, adverse, and severely adverse;

(ii) may require the tests described in subparagraph (A) at bank holding companies and nonbank financial companies, in addition to those for which annual tests are required under subparagraph (A);

(iii) may develop and apply such other analytic techniques as are necessary to identify, measure, and monitor risks to the financial stability of the United States;

(iv) shall require the companies described in subparagraph (A) to update their resolution plans required under subsection (d)(1), as the Board of Governors determines appropriate, based on the results of the analyses; and

(v) shall publish a summary of the results of the tests required under subparagraph (A) or clause (ii) of this subparagraph.

(2) BY THE COMPANY.—

(A) REQUIREMENT.—A nonbank financial company supervised by the Board of Governors and a bank holding company described in subsection (a) shall conduct semi-annual stress tests. All other financial companies that have total consolidated assets of more than $10,000,000,000 and are regulated by a primary Federal financial regulatory agency shall conduct annual stress tests. The tests required under this subparagraph shall be conducted in accordance with the regulations prescribed under subparagraph (C).

(B) REPORT.—A company required to conduct stress tests under subparagraph (A) shall submit a report to the Board of Governors and to its primary financial regulatory agency at such time, in such form, and containing such information as the primary financial regulatory agency shall require.

(C) REGULATIONS.—Each Federal primary financial regulatory agency, in coordination with the Board of Governors and the Federal Insurance Office, shall issue consistent and comparable regulations to implement this paragraph that shall—

(i) define the term "stress test" for purposes of this paragraph;

(ii) establish methodologies for the conduct of stress tests required by this paragraph that shall provide for at least 3 different sets of conditions, including baseline, adverse, and severely adverse;

(iii) establish the form and content of the report required by subparagraph (B); and

(iv) require companies subject to this paragraph to publish a summary of the results of the required stress tests.

(j) LEVERAGE LIMITATION.—

(1) REQUIREMENT.—The Board of Governors shall require a bank holding company with total consolidated assets equal to or greater than $50,000,000,000 or a nonbank financial company supervised by the Board of Governors to maintain a debt to equity ratio of no more than 15 to 1, upon a determination by the Council that such company poses a grave threat to the financial stability of the United States and that the imposition of such requirement is necessary to mitigate the risk that such company poses to the financial stability of the United States. Nothing in this paragraph shall apply to a Federal home loan bank.

(2) CONSIDERATIONS.—In making a determination under this subsection, the Council shall consider the factors described in subsections (a) and (b) of section 113 and any other risk-related factors that the Council deems appropriate.

(3) REGULATIONS.—The Board of Governors shall promulgate regulations to establish procedures and timelines for complying with the requirements of this subsection.

(k) INCLUSION OF OFF-BALANCE-SHEET ACTIVITIES IN COMPUTING CAPITAL REQUIREMENTS.—

(1) IN GENERAL.—In the case of any bank holding company described in subsection (a) or nonbank financial company supervised by the Board of Governors, the computation of capital for purposes of meeting capital requirements shall take into account any off-balance-sheet activities of the company.

(2) EXEMPTIONS.—If the Board of Governors determines that an exemption from the requirement under paragraph (1) is appropriate, the Board of Governors may exempt a company, or any transaction or transactions engaged in by such company, from the requirements of paragraph (1).

(3) OFF-BALANCE-SHEET ACTIVITIES DEFINED.—For purposes of this subsection, the term "off-balance-sheet activities" means an existing liability of a company that is not currently a balance sheet liability, but may become one upon the happening of some future event, including the following transactions, to the extent that they may create a liability:

(A) Direct credit substitutes in which a bank substitutes its own credit for a third party, including standby letters of credit.

(B) Irrevocable letters of credit that guarantee repayment of commercial paper or tax-exempt securities.

(C) Risk participations in bankers' acceptances.

(D) Sale and repurchase agreements.

(E) Asset sales with recourse against the seller.

(F) Interest rate swaps.

(G) Credit swaps.

(H) Commodities contracts.

(I) Forward contracts.

(J) Securities contracts.

(K) Such other activities or transactions as the Board of Governors may, by rule, define.

SEC. 166. EARLY REMEDIATION REQUIREMENTS.

(a) IN GENERAL.—The Board of Governors, in consultation with the Council and the Corporation, shall prescribe regulations establishing requirements to provide for the early remediation of financial distress of a nonbank financial company supervised by the Board of Governors or a bank holding company described in section 165(a), except that nothing in this subsection authorizes the provision of financial assistance from the Federal Government.

(b) PURPOSE OF THE EARLY REMEDIATION REQUIREMENTS.—The purpose of the early remediation requirements under subsection (a) shall be to establish a series of specific remedial actions to be taken by a nonbank financial company supervised by the Board of Governors or a bank holding company described in section 165(a) that is experiencing increasing financial distress, in order to minimize the probability that the company will become insolvent and the potential harm of such insolvency to the financial stability of the United States.

(c) REMEDIATION REQUIREMENTS.—The regulations prescribed by the Board of Governors under subsection (a) shall—

(1) define measures of the financial condition of the company, including regulatory capital, liquidity measures, and other forward-looking indicators; and

(2) establish requirements that increase in stringency as the financial condition of the company declines, including—

(A) requirements in the initial stages of financial decline, including limits on capital distributions, acquisitions, and asset growth; and

(B) requirements at later stages of financial decline, including a capital restoration plan and capital-raising requirements, limits on transactions with affiliates, management changes, and asset sales.

SEC. 167. AFFILIATIONS.

(a) AFFILIATIONS.—Nothing in this subtitle shall be construed to require a nonbank financial company supervised by the Board of Governors, or a company that controls a nonbank financial company supervised by the Board of Governors, to conform the activities thereof to the requirements of section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843).

(b) REQUIREMENT.—

(1) IN GENERAL.—

(A) BOARD AUTHORITY.—If a nonbank financial company supervised by the Board of Governors conducts activities other than those that are determined to be financial in nature or incidental thereto under section 4(k) of the Bank Holding Company Act of 1956, the Board of Governors may require such company to establish and conduct all or a portion of such activities that are determined to be financial in nature or incidental thereto in or through an intermediate holding company established pursuant to regulation of the Board of Governors, not later than 90 days (or such longer period as the Board of Governors may deem appropriate) after the date on which the nonbank financial company supervised by the Board of Governors is notified of the determination of the Board of Governors under this section.

(B) NECESSARY ACTIONS.—Notwithstanding subparagraph (A), the Board of Governors shall require a nonbank financial company supervised by the Board of Governors to establish an intermediate holding company if the Board of Governors makes a determination that the establishment of such intermediate holding company is necessary to—

(i) appropriately supervise activities that are determined to be financial in nature or incidental thereto; or

(ii) to ensure that supervision by the Board of Governors does not extend to the commercial activities of such nonbank financial company.

(2) INTERNAL FINANCIAL ACTIVITIES.—For purposes of this subsection, activities that are determined to be financial in nature or incidental thereto under section 4(k) of the Bank Holding Company Act of 1956, as described in paragraph (1), shall not include internal financial activities, including internal treasury, investment, and employee benefit functions. With respect to any internal financial activity engaged in for the company or an affiliate and a non-affiliate of such company during the year prior to the date of enactment of this Act, such company (or an affiliate that is not an intermediate holding company or subsidiary of an intermediate holding company) may continue to engage in such activity, as long as not less than 2/3 of the assets or 2/3 of the revenues generated from the activity are from or attributable to such company or an affiliate, subject to review by the Board of Governors, to determine whether engaging in such activity presents undue risk to such company or to the financial stability of the United States.

(3) SOURCE OF STRENGTH.—A company that directly or indirectly controls an intermediate holding company established under this section shall serve as a source of strength to its subsidiary intermediate holding company.

(4) PARENT COMPANY REPORTS.—The Board of Governors may, from time to time, require reports under oath from a

company that controls an intermediate holding company, and from the appropriate officers or directors of such company, solely for purposes of ensuring compliance with the provisions of this section, including assessing the ability of the company to serve as a source of strength to its subsidiary intermediate holding company pursuant to paragraph (3) and enforcing such compliance.

(5) LIMITED PARENT COMPANY ENFORCEMENT.—

(A) IN GENERAL.—In addition to any other authority of the Board of Governors, the Board of Governors may enforce compliance with the provisions of this subsection that are applicable to any company described in paragraph (1) that controls an intermediate holding company under section 8 of the Federal Deposit Insurance Act, and such company shall be subject to such section (solely for such purposes) in the same manner and to the same extent as if such company were a bank holding company.

(B) APPLICATION OF OTHER ACT.—Any violation of this subsection by any company that controls an intermediate holding company may also be treated as a violation of the Federal Deposit Insurance Act for purposes of subparagraph (A).

(C) NO EFFECT ON OTHER AUTHORITY.—No provision of this paragraph shall be construed as limiting any authority of the Board of Governors or any other Federal agency under any other provision of law.

(c) REGULATIONS.—The Board of Governors—

(1) shall promulgate regulations to establish the criteria for determining whether to require a nonbank financial company supervised by the Board of Governors to establish an intermediate holding company under subsection (b); and

(2) may promulgate regulations to establish any restrictions or limitations on transactions between an intermediate holding company or a nonbank financial company supervised by the Board of Governors and its affiliates, as necessary to prevent unsafe and unsound practices in connection with transactions between such company, or any subsidiary thereof, and its parent company or affiliates that are not subsidiaries of such company, except that such regulations shall not restrict or limit any transaction in connection with the bona fide acquisition or lease by an unaffiliated person of assets, goods, or services.

SEC. 168. REGULATIONS.

The Board of Governors shall have authority to issue regulations to implement subtitles A and C and the amendments made thereunder. Except as otherwise specified in subtitle A or C, not later than 18 months after the effective date of this Act, the Board of Governors shall issue final regulations to implement subtitles A and C, and the amendments made thereunder.

SEC. 169. AVOIDING DUPLICATION.

The Board of Governors shall take any action that the Board of Governors deems appropriate to avoid imposing requirements under this subtitle that are duplicative of requirements applicable to bank holding companies and nonbank financial companies under other provisions of law.

SEC. 170. SAFE HARBOR.

(a) REGULATIONS.—The Board of Governors shall promulgate regulations on behalf of, and in consultation with, the Council setting forth the criteria for exempting certain types or classes of U.S. nonbank financial companies or foreign nonbank financial companies from supervision by the Board of Governors.

(b) CONSIDERATIONS.—In developing the criteria under subsection (a), the Board of Governors shall take into account the factors for consideration described in subsections (a) and (b) of section 113 in determining whether a U.S. nonbank financial company or foreign nonbank financial company shall be supervised by the Board of Governors.

(c) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to require supervision by the Board of Governors of a U.S. nonbank financial company or foreign nonbank financial company, if such company does not meet the criteria for exemption established under subsection (a).

(d) REVISIONS.—

(1) IN GENERAL.—The Board of Governors shall, in consultation with the Council, review the regulations promulgated under subsection (a), not less frequently than every 5 years, and based upon the review, the Board of Governors may revise such regulations on behalf of, and in consultation with, the Council to update as necessary the criteria set forth in such regulations.

(2) TRANSITION PERIOD.—No revisions under paragraph (1) shall take effect before the end of the 2-year period after the date of publication of such revisions in final form.

(e) REPORT.—The Chairman of the Board of Governors and the Chairperson of the Council shall submit a joint report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives not later than 30 days after the date of the issuance in final form of regulations under subsection (a), or any subsequent revision to such regulations under subsection (d), as applicable. Such report shall include, at a minimum, the rationale for exemption and empirical evidence to support the criteria for exemption.

SEC. 171. LEVERAGE AND RISK-BASED CAPITAL REQUIREMENTS.

(a) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

(1) GENERALLY APPLICABLE LEVERAGE CAPITAL REQUIREMENTS.—The term "generally applicable leverage capital requirements" means—

(A) the minimum ratios of tier 1 capital to average total assets, as established by the appropriate Federal banking agencies to apply to insured depository institutions under the prompt corrective action regulations implementing section 38 of the Federal Deposit Insurance Act, regardless of total consolidated asset size or foreign financial exposure; and

(B) includes the regulatory capital components in the numerator of that capital requirement, average total assets in the denominator of that capital requirement, and the required ratio of the numerator to the denominator.

(2) GENERALLY APPLICABLE RISK-BASED CAPITAL REQUIREMENTS.—The term "generally applicable risk-based capital requirements" means—

(A) the risk-based capital requirements, as established by the appropriate Federal banking agencies to apply to insured depository institutions under the prompt corrective action regulations implementing section 38 of the Federal Deposit Insurance Act, regardless of total consolidated asset size or foreign financial exposure; and

(B) includes the regulatory capital components in the numerator of those capital requirements, the risk-weighted assets in the denominator of those capital requirements, and the required ratio of the numerator to the denominator.

(3) DEFINITION OF DEPOSITORY INSTITUTION HOLDING COMPANY.—The term "depository institution holding company" means a bank holding company or a savings and loan holding company (as those terms are defined in section 3 of the Federal Deposit Insurance Act) that is organized in the United States, including any bank or savings and loan holding company that is owned or controlled by a foreign organization, but does not include the foreign organization.

(b) MINIMUM CAPITAL REQUIREMENTS.—

(1) MINIMUM LEVERAGE CAPITAL REQUIREMENTS.—The appropriate Federal banking agencies shall establish minimum leverage capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board of Governors. The minimum leverage capital requirements established under this paragraph shall not be less than the generally applicable leverage capital requirements, which shall serve as a floor for any capital requirements that the agency may require, nor quantitatively lower than the generally applicable leverage capital requirements that were in effect for insured depository institutions as of the date of enactment of this Act.

(2) MINIMUM RISK-BASED CAPITAL REQUIREMENTS.—The appropriate Federal banking agencies shall establish minimum risk-based capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board of Governors. The minimum risk-based capital requirements established under this paragraph shall not be less than the generally applicable risk-based capital requirements, which shall serve as a floor for any capital requirements that the agency may require, nor quantitatively lower than the generally applicable risk-based capital requirements that were in effect for insured depository institutions as of the date of enactment of this Act.

(3) INVESTMENTS IN FINANCIAL SUBSIDIARIES.—For purposes of this section, investments in financial subsidiaries that insured depository institutions are required to deduct from regulatory capital under section 5136A of the Revised Statutes of the United States or section 46(a)(2) of the Federal Deposit Insurance Act need not be deducted from regulatory capital by depository institution holding companies or nonbank financial companies supervised by the Board of Governors, unless such capital deduction is required by the Board of Governors

or the primary financial regulatory agency in the case of nonbank financial companies supervised by the Board of Governors.

(4) EFFECTIVE DATES AND PHASE-IN PERIODS.—

(A) DEBT OR EQUITY INSTRUMENTS ON OR AFTER MAY 19, 2010.—For debt or equity instruments issued on or after May 19, 2010, by depository institution holding companies or by nonbank financial companies supervised by the Board of Governors, this section shall be deemed to have become effective as of May 19, 2010.

(B) DEBT OR EQUITY INSTRUMENTS ISSUED BEFORE MAY 19, 2010.—For debt or equity instruments issued before May 19, 2010, by depository institution holding companies or by nonbank financial companies supervised by the Board of Governors, any regulatory capital deductions required under this section shall be phased in incrementally over a period of 3 years, with the phase-in period to begin on January 1, 2013, except as set forth in subparagraph (C).

(C) DEBT OR EQUITY INSTRUMENTS OF SMALLER INSTITUTIONS.—For debt or equity instruments issued before May 19, 2010, by depository institution holding companies with total consolidated assets of less than $15,000,000,000 as of December 31, 2009, and by organizations that were mutual holding companies on May 19, 2010, the capital deductions that would be required for other institutions under this section are not required as a result of this section.

(D) DEPOSITORY INSTITUTION HOLDING COMPANIES NOT PREVIOUSLY SUPERVISED BY THE BOARD OF GOVERNORS.—For any depository institution holding company that was not supervised by the Board of Governors as of May 19, 2010, the requirements of this section, except as set forth in subparagraphs (A) and (B), shall be effective 5 years after the date of enactment of this Act

(E) CERTAIN BANK HOLDING COMPANY SUBSIDIARIES OF FOREIGN BANKING ORGANIZATIONS.—For bank holding company subsidiaries of foreign banking organizations that have relied on Supervision and Regulation Letter SR-01-1 issued by the Board of Governors (as in effect on May 19, 2010), the requirements of this section, except as set forth in subparagraph (A), shall be effective 5 years after the date of enactment of this Act.

(5) EXCEPTIONS.—This section shall not apply to—

(A) debt or equity instruments issued to the United States or any agency or instrumentality thereof pursuant to the Emergency Economic Stabilization Act of 2008, and prior to October 4, 2010;

(B) any Federal home loan bank; or

(C) any small bank holding company that is subject to the Small Bank Holding Company Policy Statement of the Board of Governors, as in effect on May 19, 2010.

(6) STUDY AND REPORT ON SMALL INSTITUTION ACCESS TO CAPITAL.—

(A) STUDY REQUIRED.—The Comptroller General of the United States, after consultation with the Federal banking agencies, shall conduct a study of access to capital by smaller insured depository institutions.

(B) SCOPE.—For purposes of this study required by subparagraph (A), the term "smaller insured depository institution" means an insured depository institution with total consolidated assets of $5,000,000,000 or less.

(C) REPORT TO CONGRESS.—Not later than 18 months after the date of enactment of this Act, the Comptroller General of the United States shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report summarizing the results of the study conducted under subparagraph (A), together with any recommendations for legislative or regulatory action that would enhance the access to capital of smaller insured depository institutions, in a manner that is consistent with safe and sound banking operations.

(7) CAPITAL REQUIREMENTS TO ADDRESS ACTIVITIES THAT POSE RISKS TO THE FINANCIAL SYSTEM.—

(A) IN GENERAL.—Subject to the recommendations of the Council, in accordance with section 120, the Federal banking agencies shall develop capital requirements applicable to insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board of Governors that address the risks that the activities of such institutions pose, not only to the institution engaging in the activity, but to other public and private stakeholders in the event of adverse performance, disruption, or failure of the institution or the activity.

(B) CONTENT.—Such rules shall address, at a minimum, the risks arising from—

(i) significant volumes of activity in derivatives, securitized products purchased and sold, financial guarantees purchased and sold, securities borrowing and lending, and repurchase agreements and reverse repurchase agreements;

(ii) concentrations in assets for which the values presented in financial reports are based on models rather than historical cost or prices deriving from deep and liquid 2-way markets; and

(iii) concentrations in market share for any activity that would substantially disrupt financial markets if the institution is forced to unexpectedly cease the activity.

SEC. 172. EXAMINATION AND ENFORCEMENT ACTIONS FOR INSURANCE AND ORDERLY LIQUIDATION PURPOSES.

(a) EXAMINATIONS FOR INSURANCE AND RESOLUTION PURPOSES.—Section 10(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1820(b)(3)) is amended—

(1) by striking "In addition" and inserting the following: "(A) IN GENERAL.—In addition"; and

(2) by striking "whenever the board of directors determines" and all that follows through the period and inserting the following: "or nonbank financial company supervised by the Board of Governors or a bank holding company described in section

165(a) of the Financial Stability Act of 2010, whenever the Board of Directors determines that a special examination of any such depository institution is necessary to determine the condition of such depository institution for insurance purposes, or of such nonbank financial company supervised by the Board of Governors or bank holding company described in section 165(a) of the Financial Stability Act of 2010, for the purpose of implementing its authority to provide for orderly liquidation of any such company under title II of that Act, provided that such authority may not be used with respect to any such company that is in a generally sound condition.

"(B) LIMITATION.—Before conducting a special examination of a nonbank financial company supervised by the Board of Governors or a bank holding company described in section 165(a) of the Financial Stability Act of 2010, the Corporation shall review any available and acceptable resolution plan that the company has submitted in accordance with section 165(d) of that Act, consistent with the nonbinding effect of such plan, and available reports of examination, and shall coordinate to the maximum extent practicable with the Board of Governors, in order to minimize duplicative or conflicting examinations.".

(b) ENFORCEMENT AUTHORITY.—Section 8(t) of the Federal Deposit Insurance Act (12 U.S.C. 1818(t)) is amended—

(1) in paragraph (1), by inserting ", any depository institution holding company," before "or any institution-affiliated party";

(2) in paragraph (2)—

(A) by striking "or" at the end of subparagraph (B);

(B) at the end of subparagraph (C), by striking the period and inserting "or"; and

(C) by inserting at the end the following new subparagraph:

"(D) the conduct or threatened conduct (including any acts or omissions) of the depository institution holding company poses a risk to the Deposit Insurance Fund, provided that such authority may not be used with respect to a depository institution holding company that is in generally sound condition and whose conduct does not pose a foreseeable and material risk of loss to the Deposit Insurance Fund;"; and

(3) by adding at the end the following:

"(6) POWERS AND DUTIES WITH RESPECT TO DEPOSITORY INSTITUTION HOLDING COMPANIES.—For purposes of exercising the backup authority provided in this subsection—

"(A) the Corporation shall have the same powers with respect to a depository institution holding company and its affiliates as the appropriate Federal banking agency has with respect to the holding company and its affiliates; and

"(B) the holding company and its affiliates shall have the same duties and obligations with respect to the Corporation as the holding company and its affiliates have with respect to the appropriate Federal banking agency.".

(c) RULE OF CONSTRUCTION.—Nothing in this Act shall be construed to limit or curtail the Corporation's current authority to examine or bring enforcement actions with respect to any insured depository institution or institution-affiliated party.

SEC. 173. ACCESS TO UNITED STATES FINANCIAL MARKET BY FOREIGN INSTITUTIONS.

(a) ESTABLISHMENT OF FOREIGN BANK OFFICES IN THE UNITED STATES.—Section 7(d)(3) of the International Banking Act of 1978 (12 U.S.C. 3105(d)(3)) is amended—

(1) in subparagraph (C), by striking "and" at the end;

(2) in subparagraph (D), by striking the period at the end of and inserting "; and"; and

(3) by adding at the end the following new subparagraph:

"(E) for a foreign bank that presents a risk to the stability of United States financial system, whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk.".

(b) TERMINATION OF FOREIGN BANK OFFICES IN THE UNITED STATES.—Section 7(e)(1) of the International Banking Act of 1978 (12 U.S.C. 3105(e)(1)) is amended—

(1) in subparagraph (A), by striking "or" at the end;

(2) in subparagraph (B), by striking the period at the end of and inserting "; or"; and

(3) by inserting after subparagraph (B), the following new subparagraph:

"(C) for a foreign bank that presents a risk to the stability of the United States financial system, the home country of the foreign bank has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk.".

(c) REGISTRATION OR SUCCESSION TO A UNITED STATES BROKER OR DEALER AND TERMINATION OF SUCH REGISTRATION.—Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended by adding at the end the following new subsections:

"(k) REGISTRATION OR SUCCESSION TO A UNITED STATES BROKER OR DEALER.—In determining whether to permit a foreign person or an affiliate of a foreign person to register as a United States broker or dealer, or succeed to the registration of a United States broker or dealer, the Commission may consider whether, for a foreign person, or an affiliate of a foreign person that presents a risk to the stability of the United States financial system, the home country of the foreign person has adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk.

"(l) TERMINATION OF A UNITED STATES BROKER OR DEALER.—For a foreign person or an affiliate of a foreign person that presents such a risk to the stability of the United States financial system, the Commission may determine to terminate the registration of such foreign person or an affiliate of such foreign person as a broker or dealer in the United States, if the Commission determines that the home country of the foreign person has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk.".

SEC. 174. STUDIES AND REPORTS ON HOLDING COMPANY CAPITAL REQUIREMENTS.

(a) STUDY OF HYBRID CAPITAL INSTRUMENTS.—The Comptroller General of the United States, in consultation with the Board of Governors, the Comptroller of the Currency, and the Corporation, shall conduct a study of the use of hybrid capital instruments as a component of Tier 1 capital for banking institutions and bank holding companies. The study shall consider—

(1) the current use of hybrid capital instruments, such as trust preferred shares, as a component of Tier 1 capital;

(2) the differences between the components of capital permitted for insured depository institutions and those permitted for companies that control insured depository institutions;

(3) the benefits and risks of allowing such instruments to be used to comply with Tier 1 capital requirements;

(4) the economic impact of prohibiting the use of such capital instruments for Tier 1;

(5) a review of the consequences of disqualifying trust preferred instruments, and whether it could lead to the failure or undercapitalization of existing banking organizations;

(6) the international competitive implications prohibiting hybrid capital instruments for Tier 1;

(7) the impact on the cost and availability of credit in the United States from such a prohibition;

(8) the availability of capital for financial institutions with less than $10,000,000,000 in total assets; and

(9) any other relevant factors relating to the safety and soundness of our financial system and potential economic impact of such a prohibition.

(b) STUDY OF FOREIGN BANK INTERMEDIATE HOLDING COMPANY CAPITAL REQUIREMENTS.—The Comptroller General of the United States, in consultation with the Secretary, the Board of Governors, the Comptroller of the Currency, and the Corporation, shall conduct a study of capital requirements applicable to United States intermediate holding companies of foreign banks that are bank holding companies or savings and loan holding companies. The study shall consider—

(1) current Board of Governors policy regarding the treatment of intermediate holding companies;

(2) the principle of national treatment and equality of competitive opportunity for foreign banks operating in the United States;

(3) the extent to which foreign banks are subject on a consolidated basis to home country capital standards comparable to United States capital standards;

(4) potential effects on United States banking organizations operating abroad of changes to United States policy regarding intermediate holding companies;

(5) the impact on the cost and availability of credit in the United States from a change in United States policy regarding intermediate holding companies; and

(6) any other relevant factors relating to the safety and soundness of our financial system and potential economic impact of such a prohibition.

(c) REPORT.—Not later than 18 months after the date of enactment of this Act, the Comptroller General of the United States shall submit reports to the Committee on Banking, Housing, and

Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives summarizing the results of the studies required under subsection (a). The reports shall include specific recommendations for legislative or regulatory action regarding the treatment of hybrid capital instruments, including trust preferred shares, and shall explain the basis for such recommendations.

SEC. 175. INTERNATIONAL POLICY COORDINATION.

(a) BY THE PRESIDENT.—The President, or a designee of the President, may coordinate through all available international policy channels, similar policies as those found in United States law relating to limiting the scope, nature, size, scale, concentration, and interconnectedness of financial companies, in order to protect financial stability and the global economy.

(b) BY THE COUNCIL.—The Chairperson of the Council, in consultation with the other members of the Council, shall regularly consult with the financial regulatory entities and other appropriate organizations of foreign governments or international organizations on matters relating to systemic risk to the international financial system.

(c) BY THE BOARD OF GOVERNORS AND THE SECRETARY.—The Board of Governors and the Secretary shall consult with their foreign counterparts and through appropriate multilateral organizations to encourage comprehensive and robust prudential supervision and regulation for all highly leveraged and interconnected financial companies.

SEC. 176. RULE OF CONSTRUCTION.

No regulation or standard imposed under this title may be construed in a manner that would lessen the stringency of the requirements of any applicable primary financial regulatory agency or any other Federal or State agency that are otherwise applicable. This title, and the rules and regulations or orders prescribed pursuant to this title, do not divest any such agency of any authority derived from any other applicable law.

TITLE II—ORDERLY LIQUIDATION AUTHORITY

SEC. 201. DEFINITIONS.

(a) IN GENERAL.—In this title, the following definitions shall apply:

(1) ADMINISTRATIVE EXPENSES OF THE RECEIVER.—The term "administrative expenses of the receiver" includes—

(A) the actual, necessary costs and expenses incurred by the Corporation as receiver for a covered financial company in liquidating a covered financial company; and

(B) any obligations that the Corporation as receiver for a covered financial company determines are necessary and appropriate to facilitate the smooth and orderly liquidation of the covered financial company.

(2) BANKRUPTCY CODE.—The term "Bankruptcy Code" means title 11, United States Code.

(3) BRIDGE FINANCIAL COMPANY.—The term "bridge financial company" means a new financial company organized by

the Corporation in accordance with section 210(h) for the purpose of resolving a covered financial company.

(4) CLAIM.—The term "claim" means any right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

(5) COMPANY.—The term "company" has the same meaning as in section 2(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(b)), except that such term includes any company described in paragraph (11), the majority of the securities of which are owned by the United States or any State.

(6) COURT.—The term "Court" means the United States District Court for the District of Columbia, unless the context otherwise requires.

(7) COVERED BROKER OR DEALER.—The term "covered broker or dealer" means a covered financial company that is a broker or dealer that—

(A) is registered with the Commission under section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)); and

(B) is a member of SIPC.

(8) COVERED FINANCIAL COMPANY.—The term "covered financial company"—

(A) means a financial company for which a determination has been made under section 203(b); and

(B) does not include an insured depository institution.

(9) COVERED SUBSIDIARY.—The term "covered subsidiary" means a subsidiary of a covered financial company, other than—

(A) an insured depository institution;

(B) an insurance company; or

(C) a covered broker or dealer.

(10) DEFINITIONS RELATING TO COVERED BROKERS AND DEALERS.—The terms "customer", "customer name securities", "customer property", and "net equity" in the context of a covered broker or dealer, have the same meanings as in section 16 of the Securities Investor Protection Act of 1970 (15 U.S.C. 78lll).

(11) FINANCIAL COMPANY.—The term "financial company" means any company that—

(A) is incorporated or organized under any provision of Federal law or the laws of any State;

(B) is—

(i) a bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a));

(ii) a nonbank financial company supervised by the Board of Governors;

(iii) any company that is predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)) other than a company described in clause (i) or (ii); or

(iv) any subsidiary of any company described in any of clauses (i) through (iii) that is predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)) (other than a subsidiary that is an insured depository institution or an insurance company); and

(C) is not a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971, as amended (12 U.S.C. 2001 et seq.), a governmental entity, or a regulated entity, as defined under section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4502(20)).

(12) FUND.—The term "Fund" means the Orderly Liquidation Fund established under section 210(n).

(13) INSURANCE COMPANY.—The term "insurance company" means any entity that is—

(A) engaged in the business of insurance;

(B) subject to regulation by a State insurance regulator; and

(C) covered by a State law that is designed to specifically deal with the rehabilitation, liquidation, or insolvency of an insurance company.

(14) NONBANK FINANCIAL COMPANY.—The term "nonbank financial company" has the same meaning as in section 102(a)(4)(C).

(15) NONBANK FINANCIAL COMPANY SUPERVISED BY THE BOARD OF GOVERNORS.—The term "nonbank financial company supervised by the Board of Governors" has the same meaning as in section 102(a)(4)(D).

(16) SIPC.—The term "SIPC" means the Securities Investor Protection Corporation.

(b) DEFINITIONAL CRITERIA.—For purpose of the definition of the term "financial company" under subsection (a)(11), no company shall be deemed to be predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)), if the consolidated revenues of such company from such activities constitute less than 85 percent of the total consolidated revenues of such company, as the Corporation, in consultation with the Secretary, shall establish by regulation. In determining whether a company is a financial company under this title, the consolidated revenues derived from the ownership or control of a depository institution shall be included.

SEC. 202. JUDICIAL REVIEW.

(a) COMMENCEMENT OF ORDERLY LIQUIDATION.—

(1) PETITION TO DISTRICT COURT.—

(A) DISTRICT COURT REVIEW.—

(i) PETITION TO DISTRICT COURT.—Subsequent to a determination by the Secretary under section 203 that a financial company satisfies the criteria in section 203(b), the Secretary shall notify the Corporation and the covered financial company. If the board of directors (or body performing similar functions) of the covered financial company acquiesces or consents to the appointment of the Corporation as receiver, the Secretary shall appoint the Corporation as receiver. If the board of directors (or body performing similar functions) of the covered financial company does not acquiesce or consent to the appointment of the Corporation as receiver, the Secretary shall petition the United States District Court for the District of Columbia for an order authorizing the Secretary to appoint the Corporation as receiver.

(ii) FORM AND CONTENT OF ORDER.—The Secretary shall present all relevant findings and the recommendation made pursuant to section 203(a) to the Court. The petition shall be filed under seal.

(iii) DETERMINATION.—On a strictly confidential basis, and without any prior public disclosure, the Court, after notice to the covered financial company and a hearing in which the covered financial company may oppose the petition, shall determine whether the determination of the Secretary that the covered financial company is in default or in danger of default and satisfies the definition of a financial company under section 201(a)(11) is arbitrary and capricious.

(iv) ISSUANCE OF ORDER.—If the Court determines that the determination of the Secretary that the covered financial company is in default or in danger of default and satisfies the definition of a financial company under section 201(a)(11)—

(I) is not arbitrary and capricious, the Court shall issue an order immediately authorizing the Secretary to appoint the Corporation as receiver of the covered financial company; or

(II) is arbitrary and capricious, the Court shall immediately provide to the Secretary a written statement of each reason supporting its determination, and afford the Secretary an immediate opportunity to amend and refile the petition under clause (i).

(v) PETITION GRANTED BY OPERATION OF LAW.—If the Court does not make a determination within 24 hours of receipt of the petition—

(I) the petition shall be granted by operation of law;

(II) the Secretary shall appoint the Corporation as receiver; and

(III) liquidation under this title shall automatically and without further notice or action be commenced and the Corporation may immediately take all actions authorized under this title.

(B) EFFECT OF DETERMINATION.—The determination of the Court under subparagraph (A) shall be final, and shall be subject to appeal only in accordance with paragraph (2). The decision shall not be subject to any stay or injunction pending appeal. Upon conclusion of its proceedings under subparagraph (A), the Court shall provide immediately for the record a written statement of each reason supporting the decision of the Court, and shall provide copies thereof to the Secretary and the covered financial company.

(C) CRIMINAL PENALTIES.—A person who recklessly discloses a determination of the Secretary under section 203(b) or a petition of the Secretary under subparagraph (A), or the pendency of court proceedings as provided for under subparagraph (A), shall be fined not more than $250,000, or imprisoned for not more than 5 years, or both.

(2) APPEAL OF DECISIONS OF THE DISTRICT COURT.—

(A) APPEAL TO COURT OF APPEALS.—

(i) IN GENERAL.—Subject to clause (ii), the United States Court of Appeals for the District of Columbia Circuit shall have jurisdiction of an appeal of a final decision of the Court filed by the Secretary or a covered financial company, through its board of directors, notwithstanding section 210(a)(1)(A)(i), not later than 30 days after the date on which the decision of the Court is rendered or deemed rendered under this subsection.

(ii) CONDITION OF JURISDICTION.—The Court of Appeals shall have jurisdiction of an appeal by a covered financial company only if the covered financial company did not acquiesce or consent to the appointment of a receiver by the Secretary under paragraph (1)(A).

(iii) EXPEDITION.—The Court of Appeals shall consider any appeal under this subparagraph on an expedited basis.

(iv) SCOPE OF REVIEW.—For an appeal taken under this subparagraph, review shall be limited to whether the determination of the Secretary that a covered financial company is in default or in danger of default and satisfies the definition of a financial company under section 201(a)(11) is arbitrary and capricious.

(B) APPEAL TO THE SUPREME COURT.—

(i) IN GENERAL.—A petition for a writ of certiorari to review a decision of the Court of Appeals under subparagraph (A) may be filed by the Secretary or the covered financial company, through its board of directors, notwithstanding section 210(a)(1)(A)(i), with the Supreme Court of the United States, not later than 30 days after the date of the final decision of the Court of Appeals, and the Supreme Court shall have discretionary jurisdiction to review such decision.

(ii) WRITTEN STATEMENT.—In the event of a petition under clause (i), the Court of Appeals shall immediately provide for the record a written statement of each reason for its decision.

(iii) EXPEDITION.—The Supreme Court shall consider any petition under this subparagraph on an expedited basis.

(iv) SCOPE OF REVIEW.—Review by the Supreme Court under this subparagraph shall be limited to whether the determination of the Secretary that the covered financial company is in default or in danger of default and satisfies the definition of a financial company under section 201(a)(11) is arbitrary and capricious.

(b) ESTABLISHMENT AND TRANSMITTAL OF RULES AND PROCEDURES.—

(1) IN GENERAL.—Not later than 6 months after the date of enactment of this Act, the Court shall establish such rules and procedures as may be necessary to ensure the orderly conduct of proceedings, including rules and procedures to ensure that the 24-hour deadline is met and that the Secretary shall have an ongoing opportunity to amend and refile petitions under subsection (a)(1).

(2) PUBLICATION OF RULES.—The rules and procedures established under paragraph (1), and any modifications of such rules and procedures, shall be recorded and shall be transmitted to—

(A) the Committee on the Judiciary of the Senate;

(B) the Committee on Banking, Housing, and Urban Affairs of the Senate;

(C) the Committee on the Judiciary of the House of Representatives; and

(D) the Committee on Financial Services of the House of Representatives.

(c) PROVISIONS APPLICABLE TO FINANCIAL COMPANIES.—

(1) BANKRUPTCY CODE.—Except as provided in this subsection, the provisions of the Bankruptcy Code and rules issued thereunder or otherwise applicable insolvency law, and not the provisions of this title, shall apply to financial companies that are not covered financial companies for which the Corporation has been appointed as receiver.

(2) THIS TITLE.—The provisions of this title shall exclusively apply to and govern all matters relating to covered financial companies for which the Corporation is appointed as receiver, and no provisions of the Bankruptcy Code or the rules issued thereunder shall apply in such cases, except as expressly provided in this title.

(d) TIME LIMIT ON RECEIVERSHIP AUTHORITY.—

(1) BASELINE PERIOD.—Any appointment of the Corporation as receiver under this section shall terminate at the end of the 3-year period beginning on the date on which such appointment is made.

(2) EXTENSION OF TIME LIMIT.—The time limit established in paragraph (1) may be extended by the Corporation for up to 1 additional year, if the Chairperson of the Corporation determines and certifies in writing to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives that continuation of the receivership is necessary—

(A) to—

(i) maximize the net present value return from the sale or other disposition of the assets of the covered financial company; or

(ii) minimize the amount of loss realized upon the sale or other disposition of the assets of the covered financial company; and

(B) to protect the stability of the financial system of the United States.

(3) SECOND EXTENSION OF TIME LIMIT.—

(A) IN GENERAL.—The time limit under this subsection, as extended under paragraph (2), may be extended for up to 1 additional year, if the Chairperson of the Corporation, with the concurrence of the Secretary, submits the certifications described in paragraph (2).

(B) ADDITIONAL REPORT REQUIRED.—Not later than 30 days after the date of commencement of the extension under subparagraph (A), the Corporation shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives describing the need for the extension and the specific plan of the Corporation to conclude the receivership before the end of the second extension.

(4) ONGOING LITIGATION.—The time limit under this subsection, as extended under paragraph (3), may be further extended solely for the purpose of completing ongoing litigation in which the Corporation as receiver is a party, provided that the appointment of the Corporation as receiver shall terminate not later than 90 days after the date of completion of such litigation, if—

(A) the Council determines that the Corporation used its best efforts to conclude the receivership in accordance with its plan before the end of the time limit described in paragraph (3);

(B) the Council determines that the completion of longer-term responsibilities in the form of ongoing litigation justifies the need for an extension; and

(C) the Corporation submits a report approved by the Council not later than 30 days after the date of the determinations by the Council under subparagraphs (A) and (B) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, describing—

(i) the ongoing litigation justifying the need for an extension; and

(ii) the specific plan of the Corporation to complete the litigation and conclude the receivership.

(5) REGULATIONS.—The Corporation may issue regulations governing the termination of receiverships under this title.

(6) NO LIABILITY.—The Corporation and the Deposit Insurance Fund shall not be liable for unresolved claims arising from the receivership after the termination of the receivership.

(e) STUDY OF BANKRUPTCY AND ORDERLY LIQUIDATION PROCESS FOR FINANCIAL COMPANIES.—

(1) STUDY.—

(A) IN GENERAL.—The Administrative Office of the United States Courts and the Comptroller General of the United States shall each monitor the activities of the Court, and each such Office shall conduct separate studies regarding the bankruptcy and orderly liquidation process for financial companies under the Bankruptcy Code.

(B) ISSUES TO BE STUDIED.—In conducting the study under subparagraph (A), the Administrative Office of the United States Courts and the Comptroller General of the United States each shall evaluate—

(i) the effectiveness of chapter 7 or chapter 11 of the Bankruptcy Code in facilitating the orderly liquidation or reorganization of financial companies;

(ii) ways to maximize the efficiency and effectiveness of the Court; and

(iii) ways to make the orderly liquidation process under the Bankruptcy Code for financial companies more effective.

(2) REPORTS.—Not later than 1 year after the date of enactment of this Act, in each successive year until the third year, and every fifth year after that date of enactment, the Administrative Office of the United States Courts and the Comptroller General of the United States shall submit to the Committee on Banking, Housing, and Urban Affairs and the Committee on the Judiciary of the Senate and the Committee on Financial Services and the Committee on the Judiciary of the House of Representatives separate reports summarizing the results of the studies conducted under paragraph (1).

(f) STUDY OF INTERNATIONAL COORDINATION RELATING TO BANKRUPTCY PROCESS FOR FINANCIAL COMPANIES.—

(1) STUDY.—

(A) IN GENERAL.—The Comptroller General of the United States shall conduct a study regarding international coordination relating to the orderly liquidation of financial companies under the Bankruptcy Code.

(B) ISSUES TO BE STUDIED.—In conducting the study under subparagraph (A), the Comptroller General of the United States shall evaluate, with respect to the bankruptcy process for financial companies—

(i) the extent to which international coordination currently exists;

(ii) current mechanisms and structures for facilitating international cooperation;

(iii) barriers to effective international coordination; and

(iv) ways to increase and make more effective international coordination.

(2) REPORT.—Not later than 1 year after the date of enactment of this Act, the Comptroller General of the United States shall submit to the Committee on Banking, Housing, and Urban Affairs and the Committee on the Judiciary of the Senate and the Committee on Financial Services and the Committee on the Judiciary of the House of Representatives and the Secretary a report summarizing the results of the study conducted under paragraph (1).

(g) STUDY OF PROMPT CORRECTIVE ACTION IMPLEMENTATION BY THE APPROPRIATE FEDERAL AGENCIES.—

(1) STUDY.—The Comptroller General of the United States shall conduct a study regarding the implementation of prompt corrective action by the appropriate Federal banking agencies.

(2) ISSUES TO BE STUDIED.—In conducting the study under paragraph (1), the Comptroller General shall evaluate—

(A) the effectiveness of implementation of prompt corrective action by the appropriate Federal banking agencies and the resolution of insured depository institutions by the Corporation; and

(B) ways to make prompt corrective action a more effective tool to resolve the insured depository institutions at the least possible long-term cost to the Deposit Insurance Fund.

(3) REPORT TO COUNCIL.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to the Council on the results of the study conducted under this subsection.

(4) COUNCIL REPORT OF ACTION.—Not later than 6 months after the date of receipt of the report from the Comptroller General under paragraph (3), the Council shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on actions taken in response to the report, including any recommendations made to the Federal primary financial regulatory agencies under section 120.

SEC. 203. SYSTEMIC RISK DETERMINATION.

(a) WRITTEN RECOMMENDATION AND DETERMINATION.—

(1) VOTE REQUIRED.—

(A) IN GENERAL.—On their own initiative, or at the request of the Secretary, the Corporation and the Board of Governors shall consider whether to make a written recommendation described in paragraph (2) with respect to whether the Secretary should appoint the Corporation as receiver for a financial company. Such recommendation shall be made upon a vote of not fewer than ⅔ of the members of the Board of Governors then serving and ⅔ of the members of the board of directors of the Corporation then serving.

(B) CASES INVOLVING BROKERS OR DEALERS.—In the case of a broker or dealer, or in which the largest United States subsidiary (as measured by total assets as of the end of the previous calendar quarter) of a financial company is a broker or dealer, the Commission and the Board of Governors, at the request of the Secretary, or on their own initiative, shall consider whether to make the written recommendation described in paragraph (2) with respect to the financial company. Subject to the requirements in paragraph (2), such recommendation shall be made upon a vote of not fewer than ⅔ of the members of the Board of Governors then serving and ⅔ of the members of the Commission then serving, and in consultation with the Corporation.

(C) CASES INVOLVING INSURANCE COMPANIES.—In the case of an insurance company, or in which the largest United States subsidiary (as measured by total assets as of the end of the previous calendar quarter) of a financial company is an insurance company, the Director of the Federal Insurance Office and the Board of Governors, at the request of the Secretary or on their own initiative, shall consider whether to make the written recommendation described in paragraph (2) with respect to the financial company. Subject to the requirements in paragraph (2), such recommendation shall be made upon a vote of not fewer than ⅔ of the Board of Governors then serving and the affirmative approval of the Director of the Federal Insurance Office, and in consultation with the Corporation.

(2) RECOMMENDATION REQUIRED.—Any written recommendation pursuant to paragraph (1) shall contain—

(A) an evaluation of whether the financial company is in default or in danger of default;

(B) a description of the effect that the default of the financial company would have on financial stability in the United States;

(C) a description of the effect that the default of the financial company would have on economic conditions or financial stability for low income, minority, or underserved communities;

(D) a recommendation regarding the nature and the extent of actions to be taken under this title regarding the financial company;

(E) an evaluation of the likelihood of a private sector alternative to prevent the default of the financial company;

(F) an evaluation of why a case under the Bankruptcy Code is not appropriate for the financial company;

(G) an evaluation of the effects on creditors, counterparties, and shareholders of the financial company and other market participants; and

(H) an evaluation of whether the company satisfies the definition of a financial company under section 201.

(b) DETERMINATION BY THE SECRETARY.—Notwithstanding any other provision of Federal or State law, the Secretary shall take action in accordance with section 202(a)(1)(A), if, upon the written recommendation under subsection (a), the Secretary (in consultation with the President) determines that—

(1) the financial company is in default or in danger of default;

(2) the failure of the financial company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States;

(3) no viable private sector alternative is available to prevent the default of the financial company;

(4) any effect on the claims or interests of creditors, counterparties, and shareholders of the financial company and other market participants as a result of actions to be taken under this title is appropriate, given the impact that any action taken under this title would have on financial stability in the United States;

(5) any action under section 204 would avoid or mitigate such adverse effects, taking into consideration the effectiveness of the action in mitigating potential adverse effects on the financial system, the cost to the general fund of the Treasury, and the potential to increase excessive risk taking on the part of creditors, counterparties, and shareholders in the financial company;

(6) a Federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order; and

(7) the company satisfies the definition of a financial company under section 201.

(c) DOCUMENTATION AND REVIEW.—

(1) IN GENERAL.—The Secretary shall—

(A) document any determination under subsection (b);

(B) retain the documentation for review under paragraph (2); and

(C) notify the covered financial company and the Corporation of such determination.

(2) REPORT TO CONGRESS.—Not later than 24 hours after the date of appointment of the Corporation as receiver for a covered financial company, the Secretary shall provide written notice of the recommendations and determinations reached in accordance with subsections (a) and (b) to the Majority Leader and the Minority Leader of the Senate and the Speaker and the Minority Leader of the House of Representatives, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, which shall consist of a summary of the basis for the determination, including, to the extent available at the time of the determination—

(A) the size and financial condition of the covered financial company;

(B) the sources of capital and credit support that were available to the covered financial company;

(C) the operations of the covered financial company that could have had a significant impact on financial stability, markets, or both;

(D) identification of the banks and financial companies which may be able to provide the services offered by the covered financial company;

(E) any potential international ramifications of resolution of the covered financial company under other applicable insolvency law;

(F) an estimate of the potential effect of the resolution of the covered financial company under other applicable insolvency law on the financial stability of the United States;

(G) the potential effect of the appointment of a receiver by the Secretary on consumers;

(H) the potential effect of the appointment of a receiver by the Secretary on the financial system, financial markets, and banks and other financial companies; and

(I) whether resolution of the covered financial company under other applicable insolvency law would cause banks or other financial companies to experience severe liquidity distress.

(3) REPORTS TO CONGRESS AND THE PUBLIC.—

(A) IN GENERAL.—Not later than 60 days after the date of appointment of the Corporation as receiver for a covered financial company, the Corporation shall file a report with the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives—

(i) setting forth information on the financial condition of the covered financial company as of the date of the appointment, including a description of its assets and liabilities;

(ii) describing the plan of, and actions taken by, the Corporation to wind down the covered financial company;

(iii) explaining each instance in which the Corporation waived any applicable requirements of part 366 of title 12, Code of Federal Regulations (or any successor thereto) with respect to conflicts of interest by any person in the private sector who was retained to provide services to the Corporation in connection with such receivership;

(iv) describing the reasons for the provision of any funding to the receivership out of the Fund;

(v) setting forth the expected costs of the orderly liquidation of the covered financial company;

(vi) setting forth the identity of any claimant that is treated in a manner different from other similarly situated claimants under subsection (b)(4), (d)(4), or (h)(5)(E), the amount of any additional payment to such claimant under subsection (d)(4), and the reason for any such action; and

(vii) which report the Corporation shall publish on an online website maintained by the Corporation, subject to maintaining appropriate confidentiality.

(B) AMENDMENTS.—The Corporation shall, on a timely basis, not less frequently than quarterly, amend or revise and resubmit the reports prepared under this paragraph, as necessary.

(C) CONGRESSIONAL TESTIMONY.—The Corporation and the primary financial regulatory agency, if any, of the financial company for which the Corporation was appointed receiver under this title shall appear before Congress, if requested, not later than 30 days after the date on which the Corporation first files the reports required under subparagraph (A).

(4) DEFAULT OR IN DANGER OF DEFAULT.—For purposes of this title, a financial company shall be considered to be in default or in danger of default if, as determined in accordance with subsection (b)—

(A) a case has been, or likely will promptly be, commenced with respect to the financial company under the Bankruptcy Code;

(B) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion;

(C) the assets of the financial company are, or are likely to be, less than its obligations to creditors and others; or

(D) the financial company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.

(5) GAO REVIEW.—The Comptroller General of the United States shall review and report to Congress on any determination under subsection (b), that results in the appointment of the Corporation as receiver, including—

(A) the basis for the determination;

(B) the purpose for which any action was taken pursuant thereto;

(C) the likely effect of the determination and such action on the incentives and conduct of financial companies and their creditors, counterparties, and shareholders; and

(D) the likely disruptive effect of the determination and such action on the reasonable expectations of creditors, counterparties, and shareholders, taking into account the impact any action under this title would have on financial stability in the United States, including whether the rights of such parties will be disrupted.

(d) CORPORATION POLICIES AND PROCEDURES.—As soon as is practicable after the date of enactment of this Act, the Corporation shall establish policies and procedures that are acceptable to the Secretary governing the use of funds available to the Corporation to carry out this title, including the terms and conditions for the provision and use of funds under sections 204(d), 210(h)(2)(G)(iv), and 210(h)(9).

(e) TREATMENT OF INSURANCE COMPANIES AND INSURANCE COMPANY SUBSIDIARIES.—

(1) IN GENERAL.—Notwithstanding subsection (b), if an insurance company is a covered financial company or a subsidiary or affiliate of a covered financial company, the liquidation or rehabilitation of such insurance company, and any subsidiary or affiliate of such company that is not excepted under paragraph (2), shall be conducted as provided under applicable State law.

(2) EXCEPTION FOR SUBSIDIARIES AND AFFILIATES.—The requirement of paragraph (1) shall not apply with respect to any subsidiary or affiliate of an insurance company that is not itself an insurance company.

(3) BACKUP AUTHORITY.—Notwithstanding paragraph (1), with respect to a covered financial company described in paragraph (1), if, after the end of the 60-day period beginning on the date on which a determination is made under section 202(a) with respect to such company, the appropriate regulatory agency has not filed the appropriate judicial action in the appropriate State court to place such company into orderly liquidation under the laws and requirements of the State, the Corporation shall have the authority to stand in the place of the appropriate regulatory agency and file the appropriate judicial action in the appropriate State court to place such company into orderly liquidation under the laws and requirements of the State.

SEC. 204. ORDERLY LIQUIDATION OF COVERED FINANCIAL COMPANIES.

(a) PURPOSE OF ORDERLY LIQUIDATION AUTHORITY.—It is the purpose of this title to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard. The authority provided in this title shall be exercised in the manner that best fulfills such purpose, so that—

(1) creditors and shareholders will bear the losses of the financial company;

(2) management responsible for the condition of the financial company will not be retained; and

(3) the Corporation and other appropriate agencies will take all steps necessary and appropriate to assure that all parties, including management, directors, and third parties, having responsibility for the condition of the financial company

bear losses consistent with their responsibility, including actions for damages, restitution, and recoupment of compensation and other gains not compatible with such responsibility.

(b) CORPORATION AS RECEIVER.—Upon the appointment of the Corporation under section 202, the Corporation shall act as the receiver for the covered financial company, with all of the rights and obligations set forth in this title.

(c) CONSULTATION.—The Corporation, as receiver—

(1) shall consult with the primary financial regulatory agency or agencies of the covered financial company and its covered subsidiaries for purposes of ensuring an orderly liquidation of the covered financial company;

(2) may consult with, or under subsection (a)(1)(B)(v) or (a)(1)(L) of section 210, acquire the services of, any outside experts, as appropriate to inform and aid the Corporation in the orderly liquidation process;

(3) shall consult with the primary financial regulatory agency or agencies of any subsidiaries of the covered financial company that are not covered subsidiaries, and coordinate with such regulators regarding the treatment of such solvent subsidiaries and the separate resolution of any such insolvent subsidiaries under other governmental authority, as appropriate; and

(4) shall consult with the Commission and the Securities Investor Protection Corporation in the case of any covered financial company for which the Corporation has been appointed as receiver that is a broker or dealer registered with the Commission under section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)) and is a member of the Securities Investor Protection Corporation, for the purpose of determining whether to transfer to a bridge financial company organized by the Corporation as receiver, without consent of any customer, customer accounts of the covered financial company.

(d) FUNDING FOR ORDERLY LIQUIDATION.—Upon its appointment as receiver for a covered financial company, and thereafter as the Corporation may, in its discretion, determine to be necessary or appropriate, the Corporation may make available to the receivership, subject to the conditions set forth in section 206 and subject to the plan described in section 210(n)(9), funds for the orderly liquidation of the covered financial company. All funds provided by the Corporation under this subsection shall have a priority of claims under subparagraph (A) or (B) of section 210(b)(1), as applicable, including funds used for—

(1) making loans to, or purchasing any debt obligation of, the covered financial company or any covered subsidiary;

(2) purchasing or guaranteeing against loss the assets of the covered financial company or any covered subsidiary, directly or through an entity established by the Corporation for such purpose;

(3) assuming or guaranteeing the obligations of the covered financial company or any covered subsidiary to 1 or more third parties;

(4) taking a lien on any or all assets of the covered financial company or any covered subsidiary, including a first priority lien on all unencumbered assets of the covered financial company or any covered subsidiary to secure repayment of any transactions conducted under this subsection;

(5) selling or transferring all, or any part, of such acquired assets, liabilities, or obligations of the covered financial company or any covered subsidiary; and

(6) making payments pursuant to subsections (b)(4), (d)(4), and (h)(5)(E) of section 210.

SEC. 205. ORDERLY LIQUIDATION OF COVERED BROKERS AND DEALERS.

(a) APPOINTMENT OF SIPC AS TRUSTEE.—

(1) APPOINTMENT.—Upon the appointment of the Corporation as receiver for any covered broker or dealer, the Corporation shall appoint, without any need for court approval, the Securities Investor Protection Corporation to act as trustee for the liquidation under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) of the covered broker or dealer.

(2) ACTIONS BY SIPC.—

(A) FILING.—Upon appointment of SIPC under paragraph (1), SIPC shall promptly file with any Federal district court of competent jurisdiction specified in section 21 or 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78u, 78aa), an application for a protective decree under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) as to the covered broker or dealer. The Federal district court shall accept and approve the filing, including outside of normal business hours, and shall immediately issue the protective decree as to the covered broker or dealer.

(B) ADMINISTRATION BY SIPC.—Following entry of the protective decree, and except as otherwise provided in this section, the determination of claims and the liquidation of assets retained in the receivership of the covered broker or dealer and not transferred to the bridge financial company shall be administered under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) by SIPC, as trustee for the covered broker or dealer.

(C) DEFINITION OF FILING DATE.—For purposes of the liquidation proceeding, the term "filing date" means the date on which the Corporation is appointed as receiver of the covered broker or dealer.

(D) DETERMINATION OF CLAIMS.—As trustee for the covered broker or dealer, SIPC shall determine and satisfy, consistent with this title and with the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), all claims against the covered broker or dealer arising on or before the filing date.

(b) POWERS AND DUTIES OF SIPC.—

(1) IN GENERAL.—Except as provided in this section, upon its appointment as trustee for the liquidation of a covered broker or dealer, SIPC shall have all of the powers and duties provided by the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), including, without limitation, all rights of action against third parties, and shall conduct such liquidation in accordance with the terms of the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), except that SIPC shall have no powers or duties with respect to assets and liabilities transferred by the Corporation from the covered

broker or dealer to any bridge financial company established in accordance with this title.

(2) LIMITATION OF POWERS.—The exercise by SIPC of powers and functions as trustee under subsection (a) shall not impair or impede the exercise of the powers and duties of the Corporation with regard to—

(A) any action, except as otherwise provided in this title—

(i) to make funds available under section 204(d);

(ii) to organize, establish, operate, or terminate any bridge financial company;

(iii) to transfer assets and liabilities;

(iv) to enforce or repudiate contracts; or

(v) to take any other action relating to such bridge financial company under section 210; or

(B) determining claims under subsection (e).

(3) PROTECTIVE DECREE.—SIPC and the Corporation, in consultation with the Commission, shall jointly determine the terms of the protective decree to be filed by SIPC with any court of competent jurisdiction under section 21 or 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78u, 78aa), as required by subsection (a).

(4) QUALIFIED FINANCIAL CONTRACTS.—Notwithstanding any provision of the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) to the contrary (including section 5(b)(2)(C) of that Act (15 U.S.C. 78eee(b)(2)(C))), the rights and obligations of any party to a qualified financial contract (as that term is defined in section 210(c)(8)) to which a covered broker or dealer for which the Corporation has been appointed receiver is a party shall be governed exclusively by section 210, including the limitations and restrictions contained in section 210(c)(10)(B).

(c) LIMITATION ON COURT ACTION.—Except as otherwise provided in this title, no court may take any action, including any action pursuant to the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) or the Bankruptcy Code, to restrain or affect the exercise of powers or functions of the Corporation as receiver for a covered broker or dealer and any claims against the Corporation as such receiver shall be determined in accordance with subsection (e) and such claims shall be limited to money damages.

(d) ACTIONS BY CORPORATION AS RECEIVER.—

(1) IN GENERAL.—Notwithstanding any other provision of this title, no action taken by the Corporation as receiver with respect to a covered broker or dealer shall—

(A) adversely affect the rights of a customer to customer property or customer name securities;

(B) diminish the amount or timely payment of net equity claims of customers; or

(C) otherwise impair the recoveries provided to a customer under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.).

(2) NET PROCEEDS.—The net proceeds from any transfer, sale, or disposition of assets of the covered broker or dealer, or proceeds thereof by the Corporation as receiver for the covered broker or dealer shall be for the benefit of the estate of the covered broker or dealer, as provided in this title.

(e) CLAIMS AGAINST THE CORPORATION AS RECEIVER.—Any claim against the Corporation as receiver for a covered broker or dealer for assets transferred to a bridge financial company established with respect to such covered broker or dealer—

(1) shall be determined in accordance with section 210(a)(2); and

(2) may be reviewed by the appropriate district or territorial court of the United States in accordance with section 210(a)(5).

(f) SATISFACTION OF CUSTOMER CLAIMS.—

(1) OBLIGATIONS TO CUSTOMERS.—Notwithstanding any other provision of this title, all obligations of a covered broker or dealer or of any bridge financial company established with respect to such covered broker or dealer to a customer relating to, or net equity claims based upon, customer property or customer name securities shall be promptly discharged by SIPC, the Corporation, or the bridge financial company, as applicable, by the delivery of securities or the making of payments to or for the account of such customer, in a manner and in an amount at least as beneficial to the customer as would have been the case had the actual proceeds realized from the liquidation of the covered broker or dealer under this title been distributed in a proceeding under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) without the appointment of the Corporation as receiver and without any transfer of assets or liabilities to a bridge financial company, and with a filing date as of the date on which the Corporation is appointed as receiver.

(2) SATISFACTION OF CLAIMS BY SIPC.—SIPC, as trustee for a covered broker or dealer, shall satisfy customer claims in the manner and amount provided under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), as if the appointment of the Corporation as receiver had not occurred, and with a filing date as of the date on which the Corporation is appointed as receiver. The Corporation shall satisfy customer claims, to the extent that a customer would have received more securities or cash with respect to the allocation of customer property had the covered financial company been subject to a proceeding under the Securities Investor Protection Act (15 U.S.C. 78aaa et seq.) without the appointment of the Corporation as receiver, and with a filing date as of the date on which the Corporation is appointed as receiver.

(g) PRIORITIES.—

(1) CUSTOMER PROPERTY.—As trustee for a covered broker or dealer, SIPC shall allocate customer property and deliver customer name securities in accordance with section 8(c) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78fff–2(c)).

(2) OTHER CLAIMS.—All claims other than those described in paragraph (1) (including any unpaid claim by a customer for the allowed net equity claim of such customer from customer property) shall be paid in accordance with the priorities in section 210(b).

(h) RULEMAKING.—The Commission and the Corporation, after consultation with SIPC, shall jointly issue rules to implement this section.

SEC. 206. MANDATORY TERMS AND CONDITIONS FOR ALL ORDERLY LIQUIDATION ACTIONS.

In taking action under this title, the Corporation shall—

(1) determine that such action is necessary for purposes of the financial stability of the United States, and not for the purpose of preserving the covered financial company;

(2) ensure that the shareholders of a covered financial company do not receive payment until after all other claims and the Fund are fully paid;

(3) ensure that unsecured creditors bear losses in accordance with the priority of claim provisions in section 210;

(4) ensure that management responsible for the failed condition of the covered financial company is removed (if such management has not already been removed at the time at which the Corporation is appointed receiver);

(5) ensure that the members of the board of directors (or body performing similar functions) responsible for the failed condition of the covered financial company are removed, if such members have not already been removed at the time the Corporation is appointed as receiver; and

(6) not take an equity interest in or become a shareholder of any covered financial company or any covered subsidiary.

SEC. 207. DIRECTORS NOT LIABLE FOR ACQUIESCING IN APPOINTMENT OF RECEIVER.

The members of the board of directors (or body performing similar functions) of a covered financial company shall not be liable to the shareholders or creditors thereof for acquiescing in or consenting in good faith to the appointment of the Corporation as receiver for the covered financial company under section 203.

SEC. 208. DISMISSAL AND EXCLUSION OF OTHER ACTIONS.

(a) IN GENERAL.—Effective as of the date of the appointment of the Corporation as receiver for the covered financial company under section 202 or the appointment of SIPC as trustee for a covered broker or dealer under section 205, as applicable, any case or proceeding commenced with respect to the covered financial company under the Bankruptcy Code or the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) shall be dismissed, upon notice to the bankruptcy court (with respect to a case commenced under the Bankruptcy Code), and upon notice to SIPC (with respect to a covered broker or dealer) and no such case or proceeding may be commenced with respect to a covered financial company at any time while the orderly liquidation is pending.

(b) REVESTING OF ASSETS.—Effective as of the date of appointment of the Corporation as receiver, the assets of a covered financial company shall, to the extent they have vested in any entity other than the covered financial company as a result of any case or proceeding commenced with respect to the covered financial company under the Bankruptcy Code, the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), or any similar provision of State liquidation or insolvency law applicable to the covered financial company, revest in the covered financial company.

(c) LIMITATION.—Notwithstanding subsections (a) and (b), any order entered or other relief granted by a bankruptcy court prior to the date of appointment of the Corporation as receiver shall continue with the same validity as if an orderly liquidation had not been commenced.

SEC. 209. RULEMAKING; NON-CONFLICTING LAW.

The Corporation shall, in consultation with the Council, prescribe such rules or regulations as the Corporation considers necessary or appropriate to implement this title, including rules and regulations with respect to the rights, interests, and priorities of creditors, counterparties, security entitlement holders, or other persons with respect to any covered financial company or any assets or other property of or held by such covered financial company, and address the potential for conflicts of interest between or among individual receiverships established under this title or under the Federal Deposit Insurance Act. To the extent possible, the Corporation shall seek to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company.

SEC. 210. POWERS AND DUTIES OF THE CORPORATION.

(a) POWERS AND AUTHORITIES.—

(1) GENERAL POWERS.—

(A) SUCCESSOR TO COVERED FINANCIAL COMPANY.—The Corporation shall, upon appointment as receiver for a covered financial company under this title, succeed to—

(i) all rights, titles, powers, and privileges of the covered financial company and its assets, and of any stockholder, member, officer, or director of such company; and

(ii) title to the books, records, and assets of any previous receiver or other legal custodian of such covered financial company.

(B) OPERATION OF THE COVERED FINANCIAL COMPANY DURING THE PERIOD OF ORDERLY LIQUIDATION.—The Corporation, as receiver for a covered financial company, may—

(i) take over the assets of and operate the covered financial company with all of the powers of the members or shareholders, the directors, and the officers of the covered financial company, and conduct all business of the covered financial company;

(ii) collect all obligations and money owed to the covered financial company;

(iii) perform all functions of the covered financial company, in the name of the covered financial company;

(iv) manage the assets and property of the covered financial company, consistent with maximization of the value of the assets in the context of the orderly liquidation; and

(v) provide by contract for assistance in fulfilling any function, activity, action, or duty of the Corporation as receiver.

(C) FUNCTIONS OF COVERED FINANCIAL COMPANY OFFICERS, DIRECTORS, AND SHAREHOLDERS.—The Corporation may provide for the exercise of any function by any member or stockholder, director, or officer of any covered financial company for which the Corporation has been appointed as receiver under this title.

(D) ADDITIONAL POWERS AS RECEIVER.—The Corporation shall, as receiver for a covered financial company, and subject to all legally enforceable and perfected security interests and all legally enforceable security entitlements in respect of assets held by the covered financial company, liquidate, and wind-up the affairs of a covered financial company, including taking steps to realize upon the assets of the covered financial company, in such manner as the Corporation deems appropriate, including through the sale of assets, the transfer of assets to a bridge financial company established under subsection (h), or the exercise of any other rights or privileges granted to the receiver under this section.

(E) ADDITIONAL POWERS WITH RESPECT TO FAILING SUBSIDIARIES OF A COVERED FINANCIAL COMPANY.—

(i) IN GENERAL.—In any case in which a receiver is appointed for a covered financial company under section 202, the Corporation may appoint itself as receiver of any covered subsidiary of the covered financial company that is organized under Federal law or the laws of any State, if the Corporation and the Secretary jointly determine that—

(I) the covered subsidiary is in default or in danger of default;

(II) such action would avoid or mitigate serious adverse effects on the financial stability or economic conditions of the United States; and

(III) such action would facilitate the orderly liquidation of the covered financial company.

(ii) TREATMENT AS COVERED FINANCIAL COMPANY.—If the Corporation is appointed as receiver of a covered subsidiary of a covered financial company under clause (i), the covered subsidiary shall thereafter be considered a covered financial company under this title, and the Corporation shall thereafter have all the powers and rights with respect to that covered subsidiary as it has with respect to a covered financial company under this title.

(F) ORGANIZATION OF BRIDGE COMPANIES.—The Corporation, as receiver for a covered financial company, may organize a bridge financial company under subsection (h).

(G) MERGER; TRANSFER OF ASSETS AND LIABILITIES.—

(i) IN GENERAL.—Subject to clauses (ii) and (iii), the Corporation, as receiver for a covered financial company, may—

(I) merge the covered financial company with another company; or

(II) transfer any asset or liability of the covered financial company (including any assets and liabilities held by the covered financial company for security entitlement holders, any customer property, or any assets and liabilities associated with any trust or custody business) without obtaining any approval, assignment, or consent with respect to such transfer.

(ii) FEDERAL AGENCY APPROVAL; ANTITRUST REVIEW.—With respect to a transaction described in clause (i)(I) that requires approval by a Federal agency—

(I) the transaction may not be consummated before the 5th calendar day after the date of approval by the Federal agency responsible for such approval;

(II) if, in connection with any such approval, a report on competitive factors is required, the Federal agency responsible for such approval shall promptly notify the Attorney General of the United States of the proposed transaction, and the Attorney General shall provide the required report not later than 10 days after the date of the request; and

(III) if notification under section 7A of the Clayton Act is required with respect to such transaction, then the required waiting period shall end on the 15th day after the date on which the Attorney General and the Federal Trade Commission receive such notification, unless the waiting period is terminated earlier under subsection (b)(2) of such section 7A, or is extended pursuant to subsection (e)(2) of such section 7A.

(iii) SETOFF.—Subject to the other provisions of this title, any transferee of assets from a receiver, including a bridge financial company, shall be subject to such claims or rights as would prevail over the rights of such transferee in such assets under applicable noninsolvency law.

(H) PAYMENT OF VALID OBLIGATIONS.—The Corporation, as receiver for a covered financial company, shall, to the extent that funds are available, pay all valid obligations of the covered financial company that are due and payable at the time of the appointment of the Corporation as receiver, in accordance with the prescriptions and limitations of this title.

(I) APPLICABLE NONINSOLVENCY LAW.—Except as may otherwise be provided in this title, the applicable noninsolvency law shall be determined by the noninsolvency choice of law rules otherwise applicable to the claims, rights, titles, persons, or entities at issue.

(J) SUBPOENA AUTHORITY.—

(i) IN GENERAL.—The Corporation, as receiver for a covered financial company, may, for purposes of carrying out any power, authority, or duty with respect to the covered financial company (including determining any claim against the covered financial company and determining and realizing upon any asset of any person in the course of collecting money due the covered financial company), exercise any power established under section 8(n) of the Federal Deposit Insurance Act, as if the Corporation were the appropriate Federal banking agency for the covered financial company, and the covered financial company were an insured depository institution.

(ii) RULE OF CONSTRUCTION.—This subparagraph may not be construed as limiting any rights that the

Corporation, in any capacity, might otherwise have to exercise any powers described in clause (i) or under any other provision of law.

(K) INCIDENTAL POWERS.—The Corporation, as receiver for a covered financial company, may exercise all powers and authorities specifically granted to receivers under this title, and such incidental powers as shall be necessary to carry out such powers under this title.

(L) UTILIZATION OF PRIVATE SECTOR.—In carrying out its responsibilities in the management and disposition of assets from the covered financial company, the Corporation, as receiver for a covered financial company, may utilize the services of private persons, including real estate and loan portfolio asset management, property management, auction marketing, legal, and brokerage services, if such services are available in the private sector, and the Corporation determines that utilization of such services is practicable, efficient, and cost effective.

(M) SHAREHOLDERS AND CREDITORS OF COVERED FINANCIAL COMPANY.—Notwithstanding any other provision of law, the Corporation, as receiver for a covered financial company, shall succeed by operation of law to the rights, titles, powers, and privileges described in subparagraph (A), and shall terminate all rights and claims that the stockholders and creditors of the covered financial company may have against the assets of the covered financial company or the Corporation arising out of their status as stockholders or creditors, except for their right to payment, resolution, or other satisfaction of their claims, as permitted under this section. The Corporation shall ensure that shareholders and unsecured creditors bear losses, consistent with the priority of claims provisions under this section.

(N) COORDINATION WITH FOREIGN FINANCIAL AUTHORITIES.—The Corporation, as receiver for a covered financial company, shall coordinate, to the maximum extent possible, with the appropriate foreign financial authorities regarding the orderly liquidation of any covered financial company that has assets or operations in a country other than the United States.

(O) RESTRICTION ON TRANSFERS.—

(i) SELECTION OF ACCOUNTS FOR TRANSFER.—If the Corporation establishes one or more bridge financial companies with respect to a covered broker or dealer, the Corporation shall transfer to one of such bridge financial companies, all customer accounts of the covered broker or dealer, and all associated customer name securities and customer property, unless the Corporation, after consulting with the Commission and SIPC, determines that—

(I) the customer accounts, customer name securities, and customer property are likely to be promptly transferred to another broker or dealer that is registered with the Commission under section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 73o(b)) and is a member of SIPC; or

(II) the transfer of the accounts to a bridge financial company would materially interfere with the ability of the Corporation to avoid or mitigate serious adverse effects on financial stability or economic conditions in the United States.

(ii) TRANSFER OF PROPERTY.—SIPC, as trustee for the liquidation of the covered broker or dealer, and the Commission shall provide any and all reasonable assistance necessary to complete such transfers by the Corporation.

(iii) CUSTOMER CONSENT AND COURT APPROVAL NOT REQUIRED.—Neither customer consent nor court approval shall be required to transfer any customer accounts or associated customer name securities or customer property to a bridge financial company in accordance with this section.

(iv) NOTIFICATION OF SIPC AND SHARING OF INFORMATION.—The Corporation shall identify to SIPC the customer accounts and associated customer name securities and customer property transferred to the bridge financial company. The Corporation and SIPC shall cooperate in the sharing of any information necessary for each entity to discharge its obligations under this title and under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) including by providing access to the books and records of the covered financial company and any bridge financial company established in accordance with this title.

(2) DETERMINATION OF CLAIMS.—

(A) IN GENERAL.—The Corporation, as receiver for a covered financial company, shall report on claims, as set forth in section 203(c)(3). Subject to paragraph (4) of this subsection, the Corporation, as receiver for a covered financial company, shall determine claims in accordance with the requirements of this subsection and regulations prescribed under section 209.

(B) NOTICE REQUIREMENTS.—The Corporation, as receiver for a covered financial company, in any case involving the liquidation or winding up of the affairs of a covered financial company, shall—

(i) promptly publish a notice to the creditors of the covered financial company to present their claims, together with proof, to the receiver by a date specified in the notice, which shall be not earlier than 90 days after the date of publication of such notice; and

(ii) republish such notice 1 month and 2 months, respectively, after the date of publication under clause (i).

(C) MAILING REQUIRED.—The Corporation as receiver shall mail a notice similar to the notice published under clause (i) or (ii) of subparagraph (B), at the time of such publication, to any creditor shown on the books and records of the covered financial company—

(i) at the last address of the creditor appearing in such books;

(ii) in any claim filed by the claimant; or

(iii) upon discovery of the name and address of a claimant not appearing on the books and records of the covered financial company, not later than 30 days after the date of the discovery of such name and address.

(3) PROCEDURES FOR RESOLUTION OF CLAIMS.—

(A) DECISION PERIOD.—

(i) IN GENERAL.—Prior to the 180th day after the date on which a claim against a covered financial company is filed with the Corporation as receiver, or such later date as may be agreed as provided in clause (ii), the Corporation shall notify the claimant whether it allows or disallows the claim, in accordance with subparagraphs (B), (C), and (D).

(ii) EXTENSION OF TIME.—By written agreement executed not later than 180 days after the date on which a claim against a covered financial company is filed with the Corporation, the period described in clause (i) may be extended by written agreement between the claimant and the Corporation. Failure to notify the claimant of any disallowance within the time period set forth in clause (i), as it may be extended by agreement under this clause, shall be deemed to be a disallowance of such claim, and the claimant may file or continue an action in court, as provided in paragraph (4).

(iii) MAILING OF NOTICE SUFFICIENT.—The requirements of clause (i) shall be deemed to be satisfied if the notice of any decision with respect to any claim is mailed to the last address of the claimant which appears—

(I) on the books, records, or both of the covered financial company;

(II) in the claim filed by the claimant; or

(III) in documents submitted in proof of the claim.

(iv) CONTENTS OF NOTICE OF DISALLOWANCE.—If the Corporation as receiver disallows any claim filed under clause (i), the notice to the claimant shall contain—

(I) a statement of each reason for the disallowance; and

(II) the procedures required to file or continue an action in court, as provided in paragraph (4).

(B) ALLOWANCE OF PROVEN CLAIM.—The receiver shall allow any claim received by the receiver on or before the date specified in the notice under paragraph (2)(B)(i), which is proved to the satisfaction of the receiver.

(C) DISALLOWANCE OF CLAIMS FILED AFTER END OF FILING PERIOD.—

(i) IN GENERAL.—Except as provided in clause (ii), claims filed after the date specified in the notice published under paragraph (2)(B)(i) shall be disallowed, and such disallowance shall be final.

(ii) CERTAIN EXCEPTIONS.—Clause (i) shall not apply with respect to any claim filed by a claimant after the date specified in the notice published under paragraph (2)(B)(i), and such claim may be considered by the receiver under subparagraph (B), if—

(I) the claimant did not receive notice of the appointment of the receiver in time to file such claim before such date; and

(II) such claim is filed in time to permit payment of such claim.

(D) AUTHORITY TO DISALLOW CLAIMS.—

(i) IN GENERAL.—The Corporation may disallow any portion of any claim by a creditor or claim of a security, preference, setoff, or priority which is not proved to the satisfaction of the Corporation.

(ii) PAYMENTS TO UNDERSECURED CREDITORS.—In the case of a claim against a covered financial company that is secured by any property or other asset of such covered financial company, the receiver—

(I) may treat the portion of such claim which exceeds an amount equal to the fair market value of such property or other asset as an unsecured claim; and

(II) may not make any payment with respect to such unsecured portion of the claim, other than in connection with the disposition of all claims of unsecured creditors of the covered financial company.

(iii) EXCEPTIONS.—No provision of this paragraph shall apply with respect to—

(I) any extension of credit from any Federal reserve bank, or the Corporation, to any covered financial company; or

(II) subject to clause (ii), any legally enforceable and perfected security interest in the assets of the covered financial company securing any such extension of credit.

(E) LEGAL EFFECT OF FILING.—

(i) STATUTE OF LIMITATIONS TOLLED.—For purposes of any applicable statute of limitations, the filing of a claim with the receiver shall constitute a commencement of an action.

(ii) NO PREJUDICE TO OTHER ACTIONS.—Subject to paragraph (8), the filing of a claim with the receiver shall not prejudice any right of the claimant to continue any action which was filed before the date of appointment of the receiver for the covered financial company.

(4) JUDICIAL DETERMINATION OF CLAIMS.—

(A) IN GENERAL.—Subject to subparagraph (B), a claimant may file suit on a claim (or continue an action commenced before the date of appointment of the Corporation as receiver) in the district or territorial court of the United States for the district within which the principal place of business of the covered financial company is located (and such court shall have jurisdiction to hear such claim).

(B) TIMING.—A claim under subparagraph (A) may be filed before the end of the 60-day period beginning on the earlier of—

(i) the end of the period described in paragraph (3)(A)(i) (or, if extended by agreement of the Corporation and the claimant, the period described in paragraph (3)(A)(ii)) with respect to any claim against a covered financial company for which the Corporation is receiver; or

(ii) the date of any notice of disallowance of such claim pursuant to paragraph (3)(A)(i).

(C) STATUTE OF LIMITATIONS.—If any claimant fails to file suit on such claim (or to continue an action on such claim commenced before the date of appointment of the Corporation as receiver) prior to the end of the 60-day period described in subparagraph (B), the claim shall be deemed to be disallowed (other than any portion of such claim which was allowed by the receiver) as of the end of such period, such disallowance shall be final, and the claimant shall have no further rights or remedies with respect to such claim.

(5) EXPEDITED DETERMINATION OF CLAIMS.—

(A) PROCEDURE REQUIRED.—The Corporation shall establish a procedure for expedited relief outside of the claims process established under paragraph (3), for any claimant that alleges—

(i) having a legally valid and enforceable or perfected security interest in property of a covered financial company or control of any legally valid and enforceable security entitlement in respect of any asset held by the covered financial company for which the Corporation has been appointed receiver; and

(ii) that irreparable injury will occur if the claims procedure established under paragraph (3) is followed.

(B) DETERMINATION PERIOD.—Prior to the end of the 90-day period beginning on the date on which a claim is filed in accordance with the procedures established pursuant to subparagraph (A), the Corporation shall—

(i) determine—

(I) whether to allow or disallow such claim, or any portion thereof; or

(II) whether such claim should be determined pursuant to the procedures established pursuant to paragraph (3);

(ii) notify the claimant of the determination; and

(iii) if the claim is disallowed, provide a statement of each reason for the disallowance and the procedure for obtaining a judicial determination.

(C) PERIOD FOR FILING OR RENEWING SUIT.—Any claimant who files a request for expedited relief shall be permitted to file suit (or continue a suit filed before the date of appointment of the Corporation as receiver seeking a determination of the rights of the claimant with respect to such security interest (or such security entitlement) after the earlier of—

(i) the end of the 90-day period beginning on the date of the filing of a request for expedited relief; or

(ii) the date on which the Corporation denies the claim or a portion thereof.

(D) STATUTE OF LIMITATIONS.—If an action described in subparagraph (C) is not filed, or the motion to renew a previously filed suit is not made, before the end of the 30-day period beginning on the date on which such action or motion may be filed in accordance with subparagraph (C), the claim shall be deemed to be disallowed as of the end of such period (other than any portion of such claim which was allowed by the receiver), such disallowance shall be final, and the claimant shall have no further rights or remedies with respect to such claim.

(E) LEGAL EFFECT OF FILING.—

(i) STATUTE OF LIMITATIONS TOLLED.—For purposes of any applicable statute of limitations, the filing of a claim with the receiver shall constitute a commencement of an action.

(ii) NO PREJUDICE TO OTHER ACTIONS.—Subject to paragraph (8), the filing of a claim with the receiver shall not prejudice any right of the claimant to continue any action which was filed before the appointment of the Corporation as receiver for the covered financial company.

(6) AGREEMENTS AGAINST INTEREST OF THE RECEIVER.— No agreement that tends to diminish or defeat the interest of the Corporation as receiver in any asset acquired by the receiver under this section shall be valid against the receiver, unless such agreement—

(A) is in writing;

(B) was executed by an authorized officer or representative of the covered financial company, or confirmed in the ordinary course of business by the covered financial company; and

(C) has been, since the time of its execution, an official record of the company or the party claiming under the agreement provides documentation, acceptable to the receiver, of such agreement and its authorized execution or confirmation by the covered financial company.

(7) PAYMENT OF CLAIMS.—

(A) IN GENERAL.—Subject to subparagraph (B), the Corporation as receiver may, in its discretion and to the extent that funds are available, pay creditor claims, in such manner and amounts as are authorized under this section, which are—

(i) allowed by the receiver;

(ii) approved by the receiver pursuant to a final determination pursuant to paragraph (3) or (5), as applicable; or

(iii) determined by the final judgment of a court of competent jurisdiction.

(B) LIMITATION.—A creditor shall, in no event, receive less than the amount that the creditor is entitled to receive under paragraphs (2) and (3) of subsection (d), as applicable.

(C) PAYMENT OF DIVIDENDS ON CLAIMS.—The Corporation as receiver may, in its sole discretion, and to the extent otherwise permitted by this section, pay dividends on proven claims at any time, and no liability shall attach to the Corporation as receiver, by reason of any such payment or for failure to pay dividends to a claimant whose claim is not proved at the time of any such payment.

(D) RULEMAKING BY THE CORPORATION.—The Corporation may prescribe such rules, including definitions of terms, as the Corporation deems appropriate to establish an interest rate for or to make payments of post-insolvency interest to creditors holding proven claims against the receivership estate of a covered financial company, except that no such interest shall be paid until the Corporation as receiver has satisfied the principal amount of all creditor claims.

(8) SUSPENSION OF LEGAL ACTIONS.—

(A) IN GENERAL.—After the appointment of the Corporation as receiver for a covered financial company, the Corporation may request a stay in any judicial action or proceeding in which such covered financial company is or becomes a party, for a period of not to exceed 90 days.

(B) GRANT OF STAY BY ALL COURTS REQUIRED.—Upon receipt of a request by the Corporation pursuant to subparagraph (A), the court shall grant such stay as to all parties.

(9) ADDITIONAL RIGHTS AND DUTIES.—

(A) PRIOR FINAL ADJUDICATION.—The Corporation shall abide by any final, non-appealable judgment of any court of competent jurisdiction that was rendered before the appointment of the Corporation as receiver.

(B) RIGHTS AND REMEDIES OF RECEIVER.—In the event of any appealable judgment, the Corporation as receiver shall—

(i) have all the rights and remedies available to the covered financial company (before the date of appointment of the Corporation as receiver under section 202) and the Corporation, including removal to Federal court and all appellate rights; and

(ii) not be required to post any bond in order to pursue such remedies.

(C) NO ATTACHMENT OR EXECUTION.—No attachment or execution may be issued by any court upon assets in the possession of the Corporation as receiver for a covered financial company.

(D) LIMITATION ON JUDICIAL REVIEW.—Except as otherwise provided in this title, no court shall have jurisdiction over—

(i) any claim or action for payment from, or any action seeking a determination of rights with respect to, the assets of any covered financial company for which the Corporation has been appointed receiver, including any assets which the Corporation may acquire from itself as such receiver; or

(ii) any claim relating to any act or omission of such covered financial company or the Corporation as receiver.

(E) DISPOSITION OF ASSETS.—In exercising any right, power, privilege, or authority as receiver in connection with any covered financial company for which the Corporation is acting as receiver under this section, the Corporation shall, to the greatest extent practicable, conduct its operations in a manner that—

(i) maximizes the net present value return from the sale or disposition of such assets;

(ii) minimizes the amount of any loss realized in the resolution of cases;

(iii) mitigates the potential for serious adverse effects to the financial system;

(iv) ensures timely and adequate competition and fair and consistent treatment of offerors; and

(v) prohibits discrimination on the basis of race, sex, or ethnic group in the solicitation and consideration of offers.

(10) STATUTE OF LIMITATIONS FOR ACTIONS BROUGHT BY RECEIVER.—

(A) IN GENERAL.—Notwithstanding any provision of any contract, the applicable statute of limitations with regard to any action brought by the Corporation as receiver for a covered financial company shall be—

(i) in the case of any contract claim, the longer of—

(I) the 6-year period beginning on the date on which the claim accrues; or

(II) the period applicable under State law; and

(ii) in the case of any tort claim, the longer of—

(I) the 3-year period beginning on the date on which the claim accrues; or

(II) the period applicable under State law.

(B) DATE ON WHICH A CLAIM ACCRUES.—For purposes of subparagraph (A), the date on which the statute of limitations begins to run on any claim described in subparagraph (A) shall be the later of—

(i) the date of the appointment of the Corporation as receiver under this title; or

(ii) the date on which the cause of action accrues.

(C) REVIVAL OF EXPIRED STATE CAUSES OF ACTION.—

(i) IN GENERAL.—In the case of any tort claim described in clause (ii) for which the applicable statute of limitations under State law has expired not more than 5 years before the date of appointment of the Corporation as receiver for a covered financial company, the Corporation may bring an action as receiver on such claim without regard to the expiration of the statute of limitations.

(ii) CLAIMS DESCRIBED.—A tort claim referred to in clause (i) is a claim arising from fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to the covered financial company.

(11) AVOIDABLE TRANSFERS.—

(A) FRAUDULENT TRANSFERS.—The Corporation, as receiver for any covered financial company, may avoid a transfer of any interest of the covered financial company in property, or any obligation incurred by the covered financial company, that was made or incurred at or within 2 years before the date on which the Corporation was appointed receiver, if—

(i) the covered financial company voluntarily or involuntarily—

(I) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the covered financial company was or became, on or after the date on which such transfer was made or such obligation was incurred, indebted; or

(II) received less than a reasonably equivalent value in exchange for such transferor obligation; and

(ii) the covered financial company voluntarily or involuntarily—

(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the covered financial company was an unreasonably small capital;

(III) intended to incur, or believed that the covered financial company would incur, debts that would be beyond the ability of the covered financial company to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

(B) PREFERENTIAL TRANSFERS.—The Corporation as receiver for any covered financial company may avoid a transfer of an interest of the covered financial company in property—

(i) to or for the benefit of a creditor;

(ii) for or on account of an antecedent debt that was owed by the covered financial company before the transfer was made;

(iii) that was made while the covered financial company was insolvent;

(iv) that was made—

(I) 90 days or less before the date on which the Corporation was appointed receiver; or

(II) more than 90 days, but less than 1 year before the date on which the Corporation was appointed receiver, if such creditor at the time of the transfer was an insider; and

(v) that enables the creditor to receive more than the creditor would receive if—

(I) the covered financial company had been liquidated under chapter 7 of the Bankruptcy Code;

(II) the transfer had not been made; and

(III) the creditor received payment of such debt to the extent provided by the provisions of chapter 7 of the Bankruptcy Code.

(C) POST-RECEIVERSHIP TRANSACTIONS.—The Corporation as receiver for any covered financial company may avoid a transfer of property of the receivership that occurred after the Corporation was appointed receiver that was not authorized under this title by the Corporation as receiver.

(D) RIGHT OF RECOVERY.—To the extent that a transfer is avoided under subparagraph (A), (B), or (C), the Corporation may recover, for the benefit of the covered financial company, the property transferred or, if a court so orders, the value of such property (at the time of such transfer) from—

(i) the initial transferee of such transfer or the person for whose benefit such transfer was made; or

(ii) any immediate or mediate transferee of any such initial transferee.

(E) RIGHTS OF TRANSFEREE OR OBLIGEE.—The Corporation may not recover under subparagraph (D)(ii) from—

(i) any transferee that takes for value, including in satisfaction of or to secure a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(ii) any immediate or mediate good faith transferee of such transferee.

(F) DEFENSES.—Subject to the other provisions of this title—

(i) a transferee or obligee from which the Corporation seeks to recover a transfer or to avoid an obligation under subparagraph (A), (B), (C), or (D) shall have the same defenses available to a transferee or obligee from which a trustee seeks to recover a transfer or avoid an obligation under sections 547, 548, and 549 of the Bankruptcy Code; and

(ii) the authority of the Corporation to recover a transfer or avoid an obligation shall be subject to subsections (b) and (c) of section 546, section 547(c), and section 548(c) of the Bankruptcy Code.

(G) RIGHTS UNDER THIS SECTION.—The rights of the Corporation as receiver under this section shall be superior to any rights of a trustee or any other party (other than a Federal agency) under the Bankruptcy Code.

(H) RULES OF CONSTRUCTION; DEFINITIONS.—For purposes of—

(i) subparagraphs (A) and (B)—

(I) the term "insider" has the same meaning as in section 101(31) of the Bankruptcy Code;

(II) a transfer is made when such transfer is so perfected that a bona fide purchaser from the covered financial company against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the date on which the Corporation is appointed as receiver for the covered financial company, such transfer is made immediately before the date of such appointment; and

(III) the term "value" means property, or satisfaction or securing of a present or antecedent debt of the covered financial company, but does not include an unperformed promise to furnish support to the covered financial company; and

(ii) subparagraph (B)—

(I) the covered financial company is presumed to have been insolvent on and during the 90-day period immediately preceding the date of appointment of the Corporation as receiver; and

(II) the term "insolvent" has the same meaning as in section 101(32) of the Bankruptcy Code.

(12) SETOFF.—

(A) GENERALLY.—Except as otherwise provided in this title, any right of a creditor to offset a mutual debt owed by the creditor to any covered financial company that arose before the Corporation was appointed as receiver for the covered financial company against a claim of such creditor may be asserted if enforceable under applicable noninsolvency law, except to the extent that—

(i) the claim of the creditor against the covered financial company is disallowed;

(ii) the claim was transferred, by an entity other than the covered financial company, to the creditor—

(I) after the Corporation was appointed as receiver of the covered financial company; or

(II)(aa) after the 90-day period preceding the date on which the Corporation was appointed as receiver for the covered financial company; and

(bb) while the covered financial company was insolvent (except for a setoff in connection with a qualified financial contract); or

(iii) the debt owed to the covered financial company was incurred by the covered financial company—

(I) after the 90-day period preceding the date on which the Corporation was appointed as receiver for the covered financial company;

(II) while the covered financial company was insolvent; and

(III) for the purpose of obtaining a right of setoff against the covered financial company (except for a setoff in connection with a qualified financial contract).

(B) INSUFFICIENCY.—

(i) IN GENERAL.—Except with respect to a setoff in connection with a qualified financial contract, if a creditor offsets a mutual debt owed to the covered financial company against a claim of the covered financial company on or within the 90-day period preceding the date on which the Corporation is appointed as receiver for the covered financial company, the Corporation may recover from the creditor the amount so offset, to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of—

(I) the date that is 90 days before the date on which the Corporation is appointed as receiver for the covered financial company; or

(II) the first day on which there is an insufficiency during the 90-day period preceding the date on which the Corporation is appointed as receiver for the covered financial company.

(ii) DEFINITION OF INSUFFICIENCY.—In this subparagraph, the term "insufficiency" means the amount, if any, by which a claim against the covered financial company exceeds a mutual debt owed to the covered financial company by the holder of such claim.

(C) INSOLVENCY.—The term "insolvent" has the same meaning as in section 101(32) of the Bankruptcy Code.

(D) PRESUMPTION OF INSOLVENCY.—For purposes of this paragraph, the covered financial company is presumed to have been insolvent on and during the 90-day period preceding the date of appointment of the Corporation as receiver.

(E) LIMITATION.—Nothing in this paragraph (12) shall be the basis for any right of setoff where no such right exists under applicable noninsolvency law.

(F) PRIORITY CLAIM.—Except as otherwise provided in this title, the Corporation as receiver for the covered financial company may sell or transfer any assets free and clear of the setoff rights of any party, except that such party shall be entitled to a claim, subordinate to the claims payable under subparagraphs (A), (B), (C), and (D) of subsection (b)(1), but senior to all other unsecured liabilities defined in subsection (b)(1)(E), in an amount equal to the value of such setoff rights.

(13) ATTACHMENT OF ASSETS AND OTHER INJUNCTIVE RELIEF.—Subject to paragraph (14), any court of competent jurisdiction may, at the request of the Corporation as receiver for a covered financial company, issue an order in accordance with Rule 65 of the Federal Rules of Civil Procedure, including an order placing the assets of any person designated by the Corporation under the control of the court and appointing a trustee to hold such assets.

(14) STANDARDS.—

(A) SHOWING.—Rule 65 of the Federal Rules of Civil Procedure shall apply with respect to any proceeding under paragraph (13), without regard to the requirement that the applicant show that the injury, loss, or damage is irreparable and immediate.

(B) STATE PROCEEDING.—If, in the case of any proceeding in a State court, the court determines that rules of civil procedure available under the laws of the State provide substantially similar protections of the right of the parties to due process as provided under Rule 65 (as modified with respect to such proceeding by subparagraph (A)), the relief sought by the Corporation pursuant to paragraph (14) may be requested under the laws of such State.

(15) TREATMENT OF CLAIMS ARISING FROM BREACH OF CONTRACTS EXECUTED BY THE CORPORATION AS RECEIVER.—Notwithstanding any other provision of this title, any final and nonappealable judgment for monetary damages entered against the Corporation as receiver for a covered financial company for the breach of an agreement executed or approved by the Corporation after the date of its appointment shall be paid as an administrative expense of the receiver. Nothing in this paragraph shall be construed to limit the power of a receiver

to exercise any rights under contract or law, including to terminate, breach, cancel, or otherwise discontinue such agreement.

(16) ACCOUNTING AND RECORDKEEPING REQUIREMENTS.—

(A) IN GENERAL.—The Corporation as receiver for a covered financial company shall, consistent with the accounting and reporting practices and procedures established by the Corporation, maintain a full accounting of each receivership or other disposition of any covered financial company.

(B) ANNUAL ACCOUNTING OR REPORT.—With respect to each receivership to which the Corporation is appointed, the Corporation shall make an annual accounting or report, as appropriate, available to the Secretary and the Comptroller General of the United States.

(C) AVAILABILITY OF REPORTS.—Any report prepared pursuant to subparagraph (B) and section 203(c)(3) shall be made available to the public by the Corporation.

(D) RECORDKEEPING REQUIREMENT.—

(i) IN GENERAL.—The Corporation shall prescribe such regulations and establish such retention schedules as are necessary to maintain the documents and records of the Corporation generated in exercising the authorities of this title and the records of a covered financial company for which the Corporation is appointed receiver, with due regard for—

(I) the avoidance of duplicative record retention; and

(II) the expected evidentiary needs of the Corporation as receiver for a covered financial company and the public regarding the records of covered financial companies.

(ii) RETENTION OF RECORDS.—Unless otherwise required by applicable Federal law or court order, the Corporation may not, at any time, destroy any records that are subject to clause (i).

(iii) RECORDS DEFINED.—As used in this subparagraph, the terms "records" and "records of a covered financial company" mean any document, book, paper, map, photograph, microfiche, microfilm, computer or electronically-created record generated or maintained by the covered financial company in the course of and necessary to its transaction of business.

(b) PRIORITY OF EXPENSES AND UNSECURED CLAIMS.—

(1) IN GENERAL.—Unsecured claims against a covered financial company, or the Corporation as receiver for such covered financial company under this section, that are proven to the satisfaction of the receiver shall have priority in the following order:

(A) Administrative expenses of the receiver.

(B) Any amounts owed to the United States, unless the United States agrees or consents otherwise.

(C) Wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual (other than an individual described in subparagraph (G)), but only to the extent of $11,725 for each individual (as indexed for inflation, by regulation of the Corporation) earned not later than 180 days before the date of appointment of the Corporation as receiver.

(D) Contributions owed to employee benefit plans arising from services rendered not later than 180 days before the date of appointment of the Corporation as receiver, to the extent of the number of employees covered by each such plan, multiplied by $11,725 (as indexed for inflation, by regulation of the Corporation), less the aggregate amount paid to such employees under subparagraph (C), plus the aggregate amount paid by the receivership on behalf of such employees to any other employee benefit plan.

(E) Any other general or senior liability of the covered financial company (which is not a liability described under subparagraph (F), (G), or (H)).

(F) Any obligation subordinated to general creditors (which is not an obligation described under subparagraph (G) or (H)).

(G) Any wages, salaries, or commissions, including vacation, severance, and sick leave pay earned, owed to senior executives and directors of the covered financial company.

(H) Any obligation to shareholders, members, general partners, limited partners, or other persons, with interests in the equity of the covered financial company arising as a result of their status as shareholders, members, general partners, limited partners, or other persons with interests in the equity of the covered financial company.

(2) POST-RECEIVERSHIP FINANCING PRIORITY.—In the event that the Corporation, as receiver for a covered financial company, is unable to obtain unsecured credit for the covered financial company from commercial sources, the Corporation as receiver may obtain credit or incur debt on the part of the covered financial company, which shall have priority over any or all administrative expenses of the receiver under paragraph (1)(A).

(3) CLAIMS OF THE UNITED STATES.—Unsecured claims of the United States shall, at a minimum, have a higher priority than liabilities of the covered financial company that count as regulatory capital.

(4) CREDITORS SIMILARLY SITUATED.—All claimants of a covered financial company that are similarly situated under paragraph (1) shall be treated in a similar manner, except that the Corporation may take any action (including making payments, subject to subsection (o)(1)(D)(i)) that does not comply with this subsection, if—

(A) the Corporation determines that such action is necessary—

(i) to maximize the value of the assets of the covered financial company;

(ii) to initiate and continue operations essential to implementation of the receivership or any bridge financial company;

(iii) to maximize the present value return from the sale or other disposition of the assets of the covered financial company; or

(iv) to minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company; and

(B) all claimants that are similarly situated under paragraph (1) receive not less than the amount provided in paragraphs (2) and (3) of subsection (d).

(5) SECURED CLAIMS UNAFFECTED.—This section shall not affect secured claims or security entitlements in respect of assets or property held by the covered financial company, except to the extent that the security is insufficient to satisfy the claim, and then only with regard to the difference between the claim and the amount realized from the security.

(6) PRIORITY OF EXPENSES AND UNSECURED CLAIMS IN THE ORDERLY LIQUIDATION OF SIPC MEMBER.—Where the Corporation is appointed as receiver for a covered broker or dealer, unsecured claims against such covered broker or dealer, or the Corporation as receiver for such covered broker or dealer under this section, that are proven to the satisfaction of the receiver under section 205(e), shall have the priority prescribed in paragraph (1), except that—

(A) SIPC shall be entitled to recover administrative expenses incurred in performing its responsibilities under section 205 on an equal basis with the Corporation, in accordance with paragraph (1)(A);

(B) the Corporation shall be entitled to recover any amounts paid to customers or to SIPC pursuant to section 205(f), in accordance with paragraph (1)(B);

(C) SIPC shall be entitled to recover any amounts paid out of the SIPC Fund to meet its obligations under section 205 and under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), which claim shall be subordinate to the claims payable under subparagraphs (A) and (B) of paragraph (1), but senior to all other claims; and

(D) the Corporation may, after paying any proven claims to customers under section 205 and the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), and as provided above, pay dividends on other proven claims, in its discretion, and to the extent that funds are available, in accordance with the priorities set forth in paragraph (1).

(c) PROVISIONS RELATING TO CONTRACTS ENTERED INTO BEFORE APPOINTMENT OF RECEIVER.—

(1) AUTHORITY TO REPUDIATE CONTRACTS.—In addition to any other rights that a receiver may have, the Corporation as receiver for any covered financial company may disaffirm or repudiate any contract or lease—

(A) to which the covered financial company is a party;

(B) the performance of which the Corporation as receiver, in the discretion of the Corporation, determines to be burdensome; and

(C) the disaffirmance or repudiation of which the Corporation as receiver determines, in the discretion of the Corporation, will promote the orderly administration of the affairs of the covered financial company.

(2) TIMING OF REPUDIATION.—The Corporation, as receiver for any covered financial company, shall determine whether

or not to exercise the rights of repudiation under this section within a reasonable period of time.

(3) CLAIMS FOR DAMAGES FOR REPUDIATION.—

(A) IN GENERAL.—Except as provided in paragraphs (4), (5), and (6) and in subparagraphs (C), (D), and (E) of this paragraph, the liability of the Corporation as receiver for a covered financial company for the disaffirmance or repudiation of any contract pursuant to paragraph (1) shall be—

(i) limited to actual direct compensatory damages; and

(ii) determined as of—

(I) the date of the appointment of the Corporation as receiver; or

(II) in the case of any contract or agreement referred to in paragraph (8), the date of the disaffirmance or repudiation of such contract or agreement.

(B) NO LIABILITY FOR OTHER DAMAGES.—For purposes of subparagraph (A), the term "actual direct compensatory damages" does not include—

(i) punitive or exemplary damages;

(ii) damages for lost profits or opportunity; or

(iii) damages for pain and suffering.

(C) MEASURE OF DAMAGES FOR REPUDIATION OF QUALIFIED FINANCIAL CONTRACTS.—In the case of any qualified financial contract or agreement to which paragraph (8) applies, compensatory damages shall be—

(i) deemed to include normal and reasonable costs of cover or other reasonable measures of damages utilized in the industries for such contract and agreement claims; and

(ii) paid in accordance with this paragraph and subsection (d), except as otherwise specifically provided in this subsection.

(D) MEASURE OF DAMAGES FOR REPUDIATION OR DISAFFIRMANCE OF DEBT OBLIGATION.—In the case of any debt for borrowed money or evidenced by a security, actual direct compensatory damages shall be no less than the amount lent plus accrued interest plus any accreted original issue discount as of the date the Corporation was appointed receiver of the covered financial company and, to the extent that an allowed secured claim is secured by property the value of which is greater than the amount of such claim and any accrued interest through the date of repudiation or disaffirmance, such accrued interest pursuant to paragraph (1).

(E) MEASURE OF DAMAGES FOR REPUDIATION OR DISAFFIRMANCE OF CONTINGENT OBLIGATION.—In the case of any contingent obligation of a covered financial company consisting of any obligation under a guarantee, letter of credit, loan commitment, or similar credit obligation, the Corporation may, by rule or regulation, prescribe that actual direct compensatory damages shall be no less than the estimated value of the claim as of the date the Corporation was appointed receiver of the covered financial company, as such value is measured based on the likelihood that such contingent claim would become fixed and the probable magnitude thereof.

(4) LEASES UNDER WHICH THE COVERED FINANCIAL COMPANY IS THE LESSEE.—

(A) IN GENERAL.—If the Corporation as receiver disaffirms or repudiates a lease under which the covered financial company is the lessee, the receiver shall not be liable for any damages (other than damages determined pursuant to subparagraph (B)) for the disaffirmance or repudiation of such lease.

(B) PAYMENTS OF RENT.—Notwithstanding subparagraph (A), the lessor under a lease to which subparagraph (A) would otherwise apply shall—

(i) be entitled to the contractual rent accruing before the later of the date on which—

(I) the notice of disaffirmance or repudiation is mailed; or

(II) the disaffirmance or repudiation becomes effective, unless the lessor is in default or breach of the terms of the lease;

(ii) have no claim for damages under any acceleration clause or other penalty provision in the lease; and

(iii) have a claim for any unpaid rent, subject to all appropriate offsets and defenses, due as of the date of the appointment which shall be paid in accordance with this paragraph and subsection (d).

(5) LEASES UNDER WHICH THE COVERED FINANCIAL COMPANY IS THE LESSOR.—

(A) IN GENERAL.—If the Corporation as receiver for a covered financial company repudiates an unexpired written lease of real property of the covered financial company under which the covered financial company is the lessor and the lessee is not, as of the date of such repudiation, in default, the lessee under such lease may either—

(i) treat the lease as terminated by such repudiation; or

(ii) remain in possession of the leasehold interest for the balance of the term of the lease, unless the lessee defaults under the terms of the lease after the date of such repudiation.

(B) PROVISIONS APPLICABLE TO LESSEE REMAINING IN POSSESSION.—If any lessee under a lease described in subparagraph (A) remains in possession of a leasehold interest pursuant to clause (ii) of subparagraph (A)—

(i) the lessee—

(I) shall continue to pay the contractual rent pursuant to the terms of the lease after the date of the repudiation of such lease; and

(II) may offset against any rent payment which accrues after the date of the repudiation of the lease, any damages which accrue after such date due to the nonperformance of any obligation of the covered financial company under the lease after such date; and

(ii) the Corporation as receiver shall not be liable to the lessee for any damages arising after such date as a result of the repudiation, other than the amount of any offset allowed under clause (i)(II).

(6) CONTRACTS FOR THE SALE OF REAL PROPERTY.—

(A) IN GENERAL.—If the receiver repudiates any contract (which meets the requirements of subsection (a)(6)) for the sale of real property, and the purchaser of such real property under such contract is in possession and is not, as of the date of such repudiation, in default, such purchaser may either—

(i) treat the contract as terminated by such repudiation; or

(ii) remain in possession of such real property.

(B) PROVISIONS APPLICABLE TO PURCHASER REMAINING IN POSSESSION.—If any purchaser of real property under any contract described in subparagraph (A) remains in possession of such property pursuant to clause (ii) of subparagraph (A)—

(i) the purchaser—

(I) shall continue to make all payments due under the contract after the date of the repudiation of the contract; and

(II) may offset against any such payments any damages which accrue after such date due to the nonperformance (after such date) of any obligation of the covered financial company under the contract; and

(ii) the Corporation as receiver shall—

(I) not be liable to the purchaser for any damages arising after such date as a result of the repudiation, other than the amount of any offset allowed under clause (i)(II);

(II) deliver title to the purchaser in accordance with the provisions of the contract; and

(III) have no obligation under the contract other than the performance required under subclause (II).

(C) ASSIGNMENT AND SALE ALLOWED.—

(i) IN GENERAL.—No provision of this paragraph shall be construed as limiting the right of the Corporation as receiver to assign the contract described in subparagraph (A) and sell the property, subject to the contract and the provisions of this paragraph.

(ii) NO LIABILITY AFTER ASSIGNMENT AND SALE.—If an assignment and sale described in clause (i) is consummated, the Corporation as receiver shall have no further liability under the contract described in subparagraph (A) or with respect to the real property which was the subject of such contract.

(7) PROVISIONS APPLICABLE TO SERVICE CONTRACTS.—

(A) SERVICES PERFORMED BEFORE APPOINTMENT.—In the case of any contract for services between any person and any covered financial company for which the Corporation has been appointed receiver, any claim of such person for services performed before the date of appointment shall be—

(i) a claim to be paid in accordance with subsections (a), (b), and (d); and

(ii) deemed to have arisen as of the date on which the receiver was appointed.

(B) SERVICES PERFORMED AFTER APPOINTMENT AND PRIOR TO REPUDIATION.—If, in the case of any contract for services described in subparagraph (A), the Corporation as receiver accepts performance by the other person before making any determination to exercise the right of repudiation of such contract under this section—

(i) the other party shall be paid under the terms of the contract for the services performed; and

(ii) the amount of such payment shall be treated as an administrative expense of the receivership.

(C) ACCEPTANCE OF PERFORMANCE NO BAR TO SUBSEQUENT REPUDIATION.—The acceptance by the Corporation as receiver for services referred to in subparagraph (B) in connection with a contract described in subparagraph (B) shall not affect the right of the Corporation as receiver to repudiate such contract under this section at any time after such performance.

(8) CERTAIN QUALIFIED FINANCIAL CONTRACTS.—

(A) RIGHTS OF PARTIES TO CONTRACTS.—Subject to subsection (a)(8) and paragraphs (9) and (10) of this subsection, and notwithstanding any other provision of this section, any other provision of Federal law, or the law of any State, no person shall be stayed or prohibited from exercising—

(i) any right that such person has to cause the termination, liquidation, or acceleration of any qualified financial contract with a covered financial company which arises upon the date of appointment of the Corporation as receiver for such covered financial company or at any time after such appointment;

(ii) any right under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts described in clause (i); or

(iii) any right to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more contracts or agreements described in clause (i), including any master agreement for such contracts or agreements.

(B) APPLICABILITY OF OTHER PROVISIONS.—Subsection (a)(8) shall apply in the case of any judicial action or proceeding brought against the Corporation as receiver referred to in subparagraph (A), or the subject covered financial company, by any party to a contract or agreement described in subparagraph (A)(i) with such covered financial company.

(C) CERTAIN TRANSFERS NOT AVOIDABLE.—

(i) IN GENERAL.—Notwithstanding subsection (a)(11), (a)(12), or (c)(12), section 5242 of the Revised Statutes of the United States, or any other provision of Federal or State law relating to the avoidance of preferential or fraudulent transfers, the Corporation, whether acting as the Corporation or as receiver for a covered financial company, may not avoid any transfer of money or other property in connection with any qualified financial contract with a covered financial company.

(ii) EXCEPTION FOR CERTAIN TRANSFERS.—Clause (i) shall not apply to any transfer of money or other property in connection with any qualified financial contract with a covered financial company if the transferee had actual intent to hinder, delay, or defraud such company, the creditors of such company, or the Corporation as receiver appointed for such company.

(D) CERTAIN CONTRACTS AND AGREEMENTS DEFINED.—For purposes of this subsection, the following definitions shall apply:

(i) QUALIFIED FINANCIAL CONTRACT.—The term "qualified financial contract" means any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the Corporation determines by regulation, resolution, or order to be a qualified financial contract for purposes of this paragraph.

(ii) SECURITIES CONTRACT.—The term "securities contract"—

(I) means a contract for the purchase, sale, or loan of a security, a certificate of deposit, a mortgage loan, any interest in a mortgage loan, a group or index of securities, certificates of deposit, or mortgage loans or interests therein (including any interest therein or based on the value thereof), or any option on any of the foregoing, including any option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option, and including any repurchase or reverse repurchase transaction on any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such repurchase or reverse repurchase transaction is a "repurchase agreement", as defined in clause (v));

(II) does not include any purchase, sale, or repurchase obligation under a participation in a commercial mortgage loan unless the Corporation determines by regulation, resolution, or order to include any such agreement within the meaning of such term;

(III) means any option entered into on a national securities exchange relating to foreign currencies;

(IV) means the guarantee (including by novation) by or to any securities clearing agency of any settlement of cash, securities, certificates of deposit, mortgage loans or interests therein, group or index of securities, certificates of deposit or mortgage loans or interests therein (including any interest therein or based on the value thereof) or an option on any of the foregoing, including any option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such settlement is in connection with any agreement or transaction referred to in subclauses (I) through (XII) (other than subclause (II)));

(V) means any margin loan;

(VI) means any extension of credit for the clearance or settlement of securities transactions;

(VII) means any loan transaction coupled with a securities collar transaction, any prepaid securities forward transaction, or any total return swap transaction coupled with a securities sale transaction;

(VIII) means any other agreement or transaction that is similar to any agreement or transaction referred to in this clause;

(IX) means any combination of the agreements or transactions referred to in this clause;

(X) means any option to enter into any agreement or transaction referred to in this clause;

(XI) means a master agreement that provides for an agreement or transaction referred to in any of subclauses (I) through (X), other than subclause (II), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a securities contract under this clause, except that the master agreement shall be considered to be a securities contract under this clause only with respect to each agreement or transaction under the master agreement that is referred to in any of subclauses (I) through (X), other than subclause (II); and

(XII) means any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this clause, including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in this clause.

(iii) COMMODITY CONTRACT.—The term "commodity contract" means—

(I) with respect to a futures commission merchant, a contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade;

(II) with respect to a foreign futures commission merchant, a foreign future;

(III) with respect to a leverage transaction merchant, a leverage transaction;

(IV) with respect to a clearing organization, a contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade that is cleared by such clearing organization, or commodity option traded on, or subject to the rules of, a contract market or board of trade that is cleared by such clearing organization;

(V) with respect to a commodity options dealer, a commodity option;

(VI) any other agreement or transaction that is similar to any agreement or transaction referred to in this clause;

(VII) any combination of the agreements or transactions referred to in this clause;

(VIII) any option to enter into any agreement or transaction referred to in this clause;

(IX) a master agreement that provides for an agreement or transaction referred to in any of subclauses (I) through (VIII), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a commodity contract under this clause, except that the master agreement shall be considered to be a commodity contract under this clause only with respect to each agreement or transaction under the master agreement that is referred to in any of subclauses (I) through (VIII); or

(X) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this clause, including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in this clause.

(iv) FORWARD CONTRACT.—The term "forward contract" means—

(I) a contract (other than a commodity contract) for the purchase, sale, or transfer of a commodity or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date that is more than 2 days after the date on which the contract is entered into, including a repurchase or reverse repurchase transaction (whether or not such repurchase or reverse repurchase transaction is a "repurchase agreement", as defined in clause (v)), consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any other similar agreement;

(II) any combination of agreements or transactions referred to in subclauses (I) and (III);

(III) any option to enter into any agreement or transaction referred to in subclause (I) or (II);

(IV) a master agreement that provides for an agreement or transaction referred to in subclause (I), (II), or (III), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a forward contract under this clause, except that the master agreement shall be considered to be a forward contract under this clause only with respect to each agreement or transaction under the master agreement that is referred to in subclause (I), (II), or (III); or

(V) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in subclause (I), (II), (III), or (IV), including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in any such subclause.

(v) REPURCHASE AGREEMENT.—The term "repurchase agreement" (which definition also applies to a reverse repurchase agreement)—

(I) means an agreement, including related terms, which provides for the transfer of one or more certificates of deposit, mortgage related securities (as such term is defined in section 3 of the Securities Exchange Act of 1934), mortgage loans, interests in mortgage-related securities or mortgage loans, eligible bankers' acceptances, qualified foreign government securities (which, for purposes of this clause, means a security that is a direct obligation of, or that is fully guaranteed by, the central government of a member of the Organization for Economic Cooperation and Development, as determined by regulation or order adopted by the Board of Governors), or securities that are direct obligations of, or that are fully guaranteed by, the United States or any agency of the United States against the transfer of funds by the transferee of such certificates of deposit, eligible bankers' acceptances, securities, mortgage loans, or interests with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, eligible bankers' acceptances, securities, mortgage loans, or interests as described above, at a date certain not later than 1 year after such transfers or on demand, against the transfer of funds, or any other similar agreement;

(II) does not include any repurchase obligation under a participation in a commercial mortgage loan, unless the Corporation determines, by regulation, resolution, or order to include any such participation within the meaning of such term;

(III) means any combination of agreements or transactions referred to in subclauses (I) and (IV);

(IV) means any option to enter into any agreement or transaction referred to in subclause (I) or (III);

(V) means a master agreement that provides for an agreement or transaction referred to in subclause (I), (III), or (IV), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a repurchase agreement under this clause, except that the master agreement shall be considered to be a repurchase agreement under this subclause only with respect to each agreement or transaction under the master agreement that is referred to in subclause (I), (III), or (IV); and

(VI) means any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in subclause (I), (III), (IV), or (V), including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in any such subclause.

(vi) SWAP AGREEMENT.—The term "swap agreement" means—

(I) any agreement, including the terms and conditions incorporated by reference in any such agreement, which is an interest rate swap, option, future, or forward agreement, including a rate floor, rate cap, rate collar, cross-currency rate swap, and basis swap; a spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange, precious metals, or other commodity agreement; a currency swap, option, future, or forward agreement; an equity index or equity swap, option, future, or forward agreement; a debt index or debt swap, option, future, or forward agreement; a total return, credit spread or credit swap, option, future, or forward agreement; a commodity index or commodity swap, option, future, or forward agreement; weather swap, option, future, or forward agreement; an emissions swap, option, future, or forward agreement; or an inflation swap, option, future, or forward agreement;

(II) any agreement or transaction that is similar to any other agreement or transaction referred to in this clause and that is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap or other derivatives markets (including terms and conditions incorporated by reference in such agreement) and that is a forward, swap, future, option, or spot transaction on one or more rates, currencies, commodities, equity securities or other equity instruments, debt securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial, or economic consequence, or economic or financial indices or measures of economic or financial risk or value;

(III) any combination of agreements or transactions referred to in this clause;

(IV) any option to enter into any agreement or transaction referred to in this clause;

(V) a master agreement that provides for an agreement or transaction referred to in subclause (I), (II), (III), or (IV), together with all supplements to any such master agreement, without regard to whether the master agreement contains an agreement or transaction that is not a swap agreement under this clause, except that the master agreement shall be considered to be a swap agreement under this clause only with respect to each agreement or transaction under the master agreement that is referred to in subclause (I), (II), (III), or (IV); and

(VI) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in any of subclauses (I) through (V), including any guarantee or reimbursement obligation in connection with any agreement or transaction referred to in any such clause.

(vii) DEFINITIONS RELATING TO DEFAULT.—When used in this paragraph and paragraphs (9) and (10)—

(I) the term "default" means, with respect to a covered financial company, any adjudication or other official decision by any court of competent jurisdiction, or other public authority pursuant to which the Corporation has been appointed receiver; and

(II) the term "in danger of default" means a covered financial company with respect to which the Corporation or appropriate State authority has determined that—

(aa) in the opinion of the Corporation or such authority—

(AA) the covered financial company is not likely to be able to pay its obligations in the normal course of business; and

(BB) there is no reasonable prospect that the covered financial company will be able to pay such obligations without Federal assistance; or

(bb) in the opinion of the Corporation or such authority—

(AA) the covered financial company has incurred or is likely to incur losses that will deplete all or substantially all of its capital; and

(BB) there is no reasonable prospect that the capital will be replenished without Federal assistance.

(viii) TREATMENT OF MASTER AGREEMENT AS ONE AGREEMENT.—Any master agreement for any contract or agreement described in any of clauses (i) through (vi) (or any master agreement for such master agreement or agreements), together with all supplements to such master agreement, shall be treated as a single agreement and a single qualified financial contact. If a master agreement contains provisions relating to agreements or transactions that are not themselves qualified financial contracts, the master agreement shall be deemed to be a qualified financial contract only with respect to those transactions that are themselves qualified financial contracts.

(ix) TRANSFER.—The term "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the equity of redemption of the covered financial company.

(x) PERSON.—The term "person" includes any governmental entity in addition to any entity included in the definition of such term in section 1, title 1, United States Code.

(E) CLARIFICATION.—No provision of law shall be construed as limiting the right or power of the Corporation, or authorizing any court or agency to limit or delay, in any manner, the right or power of the Corporation to transfer any qualified financial contract or to disaffirm or repudiate any such contract in accordance with this subsection.

(F) WALKAWAY CLAUSES NOT EFFECTIVE.—

(i) IN GENERAL.—Notwithstanding the provisions of subparagraph (A) of this paragraph and sections 403 and 404 of the Federal Deposit Insurance Corporation Improvement Act of 1991, no walkaway clause shall be enforceable in a qualified financial contract of a covered financial company in default.

(ii) LIMITED SUSPENSION OF CERTAIN OBLIGATIONS.—In the case of a qualified financial contract referred to in clause (i), any payment or delivery obligations otherwise due from a party pursuant to the qualified financial contract shall be suspended from the time at which the Corporation is appointed as receiver until the earlier of—

(I) the time at which such party receives notice that such contract has been transferred pursuant to paragraph (10)(A); or

(II) 5:00 p.m. (eastern time) on the business day following the date of the appointment of the Corporation as receiver.

(iii) WALKAWAY CLAUSE DEFINED.—For purposes of this subparagraph, the term "walkaway clause" means any provision in a qualified financial contract that suspends, conditions, or extinguishes a payment obligation of a party, in whole or in part, or does not create a payment obligation of a party that would otherwise exist, solely because of the status of such party as a nondefaulting party in connection with the insolvency of a covered financial company that is a party to the contract or the appointment of or the exercise of rights or powers by the Corporation as receiver for such covered financial company, and not as a result of the exercise by a party of any right to offset, setoff, or net obligations that exist under the contract, any other contract between those parties, or applicable law.

(G) CERTAIN OBLIGATIONS TO CLEARING ORGANIZATIONS.—In the event that the Corporation has been appointed as receiver for a covered financial company which is a party to any qualified financial contract cleared by or subject to the rules of a clearing organization (as defined in paragraph (9)(D)), the receiver shall use its best efforts to meet all margin, collateral, and settlement obligations of the covered financial company that arise under qualified financial contracts (other than any margin, collateral, or settlement obligation that is not enforceable against the receiver under paragraph (8)(F)(i) or paragraph (10)(B)), as required by the rules of the clearing organization when due. Notwithstanding any other provision of this title, if the receiver fails to satisfy any such margin, collateral, or settlement obligations under the rules of the clearing organization, the clearing organization shall have the immediate right to exercise, and shall not be stayed from exercising, all of its rights and remedies under its rules and applicable law with respect to any qualified financial contract of the covered financial company, including, without limitation, the right to liquidate all positions and collateral of such covered financial company under the company's qualified financial contracts, and suspend or cease to act for such covered financial company, all in accordance with the rules of the clearing organization.

(H) RECORDKEEPING.—

(i) JOINT RULEMAKING.—The Federal primary financial regulatory agencies shall jointly prescribe regulations requiring that financial companies maintain such records with respect to qualified financial contracts (including market valuations) that the Federal primary financial regulatory agencies determine to be necessary or appropriate in order to assist the Corporation as receiver for a covered financial company in being able to exercise its rights and fulfill its obligations under this paragraph or paragraph (9) or (10).

(ii) TIME FRAME.—The Federal primary financial regulatory agencies shall prescribe joint final or interim final regulations not later than 24 months after the date of enactment of this Act.

(iii) BACK-UP RULEMAKING AUTHORITY.—If the Federal primary financial regulatory agencies do not prescribe joint final or interim final regulations within the time frame in clause (ii), the Chairperson of the Council shall prescribe, in consultation with the Corporation, the regulations required by clause (i).

(iv) CATEGORIZATION AND TIERING.—The joint regulations prescribed under clause (i) shall, as appropriate, differentiate among financial companies by taking into consideration their size, risk, complexity, leverage, frequency and dollar amount of qualified financial contracts, interconnectedness to the financial system, and any other factors deemed appropriate.

(9) TRANSFER OF QUALIFIED FINANCIAL CONTRACTS.—

(A) IN GENERAL.—In making any transfer of assets or liabilities of a covered financial company in default, which includes any qualified financial contract, the Corporation as receiver for such covered financial company shall either—

(i) transfer to one financial institution, other than a financial institution for which a conservator, receiver, trustee in bankruptcy, or other legal custodian has been appointed or which is otherwise the subject of a bankruptcy or insolvency proceeding—

(I) all qualified financial contracts between any person or any affiliate of such person and the covered financial company in default;

(II) all claims of such person or any affiliate of such person against such covered financial company under any such contract (other than any claim which, under the terms of any such contract, is subordinated to the claims of general unsecured creditors of such company);

(III) all claims of such covered financial company against such person or any affiliate of such person under any such contract; and

(IV) all property securing or any other credit enhancement for any contract described in subclause (I) or any claim described in subclause (II) or (III) under any such contract; or

(ii) transfer none of the qualified financial contracts, claims, property or other credit enhancement referred to in clause (i) (with respect to such person and any affiliate of such person).

(B) TRANSFER TO FOREIGN BANK, FINANCIAL INSTITUTION, OR BRANCH OR AGENCY THEREOF.—In transferring any qualified financial contracts and related claims and property under subparagraph (A)(i), the Corporation as receiver for the covered financial company shall not make such transfer to a foreign bank, financial institution organized under the laws of a foreign country, or a branch or agency of a foreign bank or financial institution unless, under the law applicable to such bank, financial institution, branch or agency, to the qualified financial contracts, and to any netting contract, any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts, the contractual rights of the parties to such qualified financial contracts, netting contracts, security agreements or arrangements, or other credit enhancements are enforceable substantially to the same extent as permitted under this section.

(C) TRANSFER OF CONTRACTS SUBJECT TO THE RULES OF A CLEARING ORGANIZATION.—In the event that the Corporation as receiver for a financial institution transfers any qualified financial contract and related claims, property, or credit enhancement pursuant to subparagraph (A)(i) and such contract is cleared by or subject to the rules of a clearing organization, the clearing organization shall not be required to accept the transferee as a member by virtue of the transfer.

(D) DEFINITIONS.—For purposes of this paragraph—

(i) the term "financial institution" means a broker or dealer, a depository institution, a futures commission merchant, a bridge financial company, or any other institution determined by the Corporation, by regulation, to be a financial institution; and

(ii) the term "clearing organization" has the same meaning as in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991.

(10) NOTIFICATION OF TRANSFER.—

(A) IN GENERAL.—

(i) NOTICE.—The Corporation shall provide notice in accordance with clause (ii), if—

(I) the Corporation as receiver for a covered financial company in default or in danger of default transfers any assets or liabilities of the covered financial company; and

(II) the transfer includes any qualified financial contract.

(ii) TIMING.—The Corporation as receiver for a covered financial company shall notify any person who is a party to any contract described in clause (i) of such transfer not later than 5:00 p.m. (eastern time) on the business day following the date of the appointment of the Corporation as receiver.

(B) CERTAIN RIGHTS NOT ENFORCEABLE.—

(i) RECEIVERSHIP.—A person who is a party to a qualified financial contract with a covered financial company may not exercise any right that such person has to terminate, liquidate, or net such contract under paragraph (8)(A) solely by reason of or incidental to the appointment under this section of the Corporation as receiver for the covered financial company (or the insolvency or financial condition of the covered financial company for which the Corporation has been appointed as receiver)—

(I) until 5:00 p.m. (eastern time) on the business day following the date of the appointment; or

(II) after the person has received notice that the contract has been transferred pursuant to paragraph (9)(A).

(ii) NOTICE.—For purposes of this paragraph, the Corporation as receiver for a covered financial company shall be deemed to have notified a person who is a party to a qualified financial contract with such covered financial company, if the Corporation has taken steps reasonably calculated to provide notice to such person by the time specified in subparagraph (A).

(C) TREATMENT OF BRIDGE FINANCIAL COMPANY.—For purposes of paragraph (9), a bridge financial company shall not be considered to be a financial institution for which a conservator, receiver, trustee in bankruptcy, or other legal custodian has been appointed, or which is otherwise the subject of a bankruptcy or insolvency proceeding.

(D) BUSINESS DAY DEFINED.—For purposes of this paragraph, the term "business day" means any day other than any Saturday, Sunday, or any day on which either the

New York Stock Exchange or the Federal Reserve Bank of New York is closed.

(11) DISAFFIRMANCE OR REPUDIATION OF QUALIFIED FINANCIAL CONTRACTS.—In exercising the rights of disaffirmance or repudiation of the Corporation as receiver with respect to any qualified financial contract to which a covered financial company is a party, the Corporation shall either—

(A) disaffirm or repudiate all qualified financial contracts between—

(i) any person or any affiliate of such person; and

(ii) the covered financial company in default; or

(B) disaffirm or repudiate none of the qualified financial contracts referred to in subparagraph (A) (with respect to such person or any affiliate of such person).

(12) CERTAIN SECURITY AND CUSTOMER INTERESTS NOT AVOIDABLE.—No provision of this subsection shall be construed as permitting the avoidance of any—

(A) legally enforceable or perfected security interest in any of the assets of any covered financial company, except in accordance with subsection (a)(11); or

(B) legally enforceable interest in customer property, security entitlements in respect of assets or property held by the covered financial company for any security entitlement holder.

(13) AUTHORITY TO ENFORCE CONTRACTS.—

(A) IN GENERAL.—The Corporation, as receiver for a covered financial company, may enforce any contract, other than a liability insurance contract of a director or officer, a financial institution bond entered into by the covered financial company, notwithstanding any provision of the contract providing for termination, default, acceleration, or exercise of rights upon, or solely by reason of, insolvency, the appointment of or the exercise of rights or powers by the Corporation as receiver, the filing of the petition pursuant to section 202(a)(1), or the issuance of the recommendations or determination, or any actions or events occurring in connection therewith or as a result thereof, pursuant to section 203.

(B) CERTAIN RIGHTS NOT AFFECTED.—No provision of this paragraph may be construed as impairing or affecting any right of the Corporation as receiver to enforce or recover under a liability insurance contract of a director or officer or financial institution bond under other applicable law.

(C) CONSENT REQUIREMENT AND IPSO FACTO CLAUSES.—

(i) IN GENERAL.—Except as otherwise provided by this section, no person may exercise any right or power to terminate, accelerate, or declare a default under any contract to which the covered financial company is a party (and no provision in any such contract providing for such default, termination, or acceleration shall be enforceable), or to obtain possession of or exercise control over any property of the covered financial company or affect any contractual rights of the covered financial company, without the consent of the

Corporation as receiver for the covered financial company during the 90 day period beginning from the appointment of the Corporation as receiver.

(ii) EXCEPTIONS.—No provision of this subparagraph shall apply to a director or officer liability insurance contract or a financial institution bond, to the rights of parties to certain qualified financial contracts pursuant to paragraph (8), or to the rights of parties to netting contracts pursuant to subtitle A of title IV of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4401 et seq.), or shall be construed as permitting the Corporation as receiver to fail to comply with otherwise enforceable provisions of such contract.

(D) CONTRACTS TO EXTEND CREDIT.—Notwithstanding any other provision in this title, if the Corporation as receiver enforces any contract to extend credit to the covered financial company or bridge financial company, any valid and enforceable obligation to repay such debt shall be paid by the Corporation as receiver, as an administrative expense of the receivership.

(14) EXCEPTION FOR FEDERAL RESERVE BANKS AND CORPORATION SECURITY INTEREST.—No provision of this subsection shall apply with respect to—

(A) any extension of credit from any Federal reserve bank or the Corporation to any covered financial company; or

(B) any security interest in the assets of the covered financial company securing any such extension of credit.

(15) SAVINGS CLAUSE.—The meanings of terms used in this subsection are applicable for purposes of this subsection only, and shall not be construed or applied so as to challenge or affect the characterization, definition, or treatment of any similar terms under any other statute, regulation, or rule, including the Gramm-Leach-Bliley Act, the Legal Certainty for Bank Products Act of 2000, the securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), and the Commodity Exchange Act.

(16) ENFORCEMENT OF CONTRACTS GUARANTEED BY THE COVERED FINANCIAL COMPANY.—

(A) IN GENERAL.—The Corporation, as receiver for a covered financial company or as receiver for a subsidiary of a covered financial company (including an insured depository institution) shall have the power to enforce contracts of subsidiaries or affiliates of the covered financial company, the obligations under which are guaranteed or otherwise supported by or linked to the covered financial company, notwithstanding any contractual right to cause the termination, liquidation, or acceleration of such contracts based solely on the insolvency, financial condition, or receivership of the covered financial company, if—

(i) such guaranty or other support and all related assets and liabilities are transferred to and assumed by a bridge financial company or a third party (other than a third party for which a conservator, receiver, trustee in bankruptcy, or other legal custodian has been appointed, or which is otherwise the subject of a bankruptcy or insolvency proceeding) within the same period of time as the Corporation is entitled to transfer the qualified financial contracts of such covered financial company; or

(ii) the Corporation, as receiver, otherwise provides adequate protection with respect to such obligations.

(B) RULE OF CONSTRUCTION.—For purposes of this paragraph, a bridge financial company shall not be considered to be a third party for which a conservator, receiver, trustee in bankruptcy, or other legal custodian has been appointed, or which is otherwise the subject of a bankruptcy or insolvency proceeding.

(d) VALUATION OF CLAIMS IN DEFAULT.—

(1) IN GENERAL.—Notwithstanding any other provision of Federal law or the law of any State, and regardless of the method utilized by the Corporation for a covered financial company, including transactions authorized under subsection (h), this subsection shall govern the rights of the creditors of any such covered financial company.

(2) MAXIMUM LIABILITY.—The maximum liability of the Corporation, acting as receiver for a covered financial company or in any other capacity, to any person having a claim against the Corporation as receiver or the covered financial company for which the Corporation is appointed shall equal the amount that such claimant would have received if—

(A) the Corporation had not been appointed receiver with respect to the covered financial company; and

(B) the covered financial company had been liquidated under chapter 7 of the Bankruptcy Code, or any similar provision of State insolvency law applicable to the covered financial company.

(3) SPECIAL PROVISION FOR ORDERLY LIQUIDATION BY SIPC.—The maximum liability of the Corporation, acting as receiver or in its corporate capacity for any covered broker or dealer to any customer of such covered broker or dealer, with respect to customer property of such customer, shall be—

(A) equal to the amount that such customer would have received with respect to such customer property in a case initiated by SIPC under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.); and

(B) determined as of the close of business on the date on which the Corporation is appointed as receiver.

(4) ADDITIONAL PAYMENTS AUTHORIZED.—

(A) IN GENERAL.—Subject to subsection (o)(1)(D)(i), the Corporation, with the approval of the Secretary, may make additional payments or credit additional amounts to or with respect to or for the account of any claimant or category of claimants of the covered financial company, if the Corporation determines that such payments or credits are necessary or appropriate to minimize losses to the Corporation as receiver from the orderly liquidation of the covered financial company under this section.

(B) LIMITATIONS.—

(i) PROHIBITION.—The Corporation shall not make any payments or credit amounts to any claimant or category of claimants that would result in any claimant receiving more than the face value amount of any claim that is proven to the satisfaction of the Corporation.

(ii) NO OBLIGATION.—Notwithstanding any other provision of Federal or State law, or the Constitution of any State, the Corporation shall not be obligated, as a result of having made any payment under subparagraph (A) or credited any amount described in subparagraph (A) to or with respect to, or for the account, of any claimant or category of claimants, to make payments to any other claimant or category of claimants.

(C) MANNER OF PAYMENT.—The Corporation may make payments or credit amounts under subparagraph (A) directly to the claimants or may make such payments or credit such amounts to a company other than a covered financial company or a bridge financial company established with respect thereto in order to induce such other company to accept liability for such claims.

(e) LIMITATION ON COURT ACTION.—Except as provided in this title, no court may take any action to restrain or affect the exercise of powers or functions of the receiver hereunder, and any remedy against the Corporation or receiver shall be limited to money damages determined in accordance with this title.

(f) LIABILITY OF DIRECTORS AND OFFICERS.—

(1) IN GENERAL.—A director or officer of a covered financial company may be held personally liable for monetary damages in any civil action described in paragraph (2) by, on behalf of, or at the request or direction of the Corporation, which action is prosecuted wholly or partially for the benefit of the Corporation—

(A) acting as receiver for such covered financial company;

(B) acting based upon a suit, claim, or cause of action purchased from, assigned by, or otherwise conveyed by the Corporation as receiver; or

(C) acting based upon a suit, claim, or cause of action purchased from, assigned by, or otherwise conveyed in whole or in part by a covered financial company or its affiliate in connection with assistance provided under this title.

(2) ACTIONS COVERED.—Paragraph (1) shall apply with respect to actions for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State law.

(3) SAVINGS CLAUSE.—Nothing in this subsection shall impair or affect any right of the Corporation under other applicable law.

(g) DAMAGES.—In any proceeding related to any claim against a director, officer, employee, agent, attorney, accountant, or appraiser of a covered financial company, or any other party employed by or providing services to a covered financial company, recoverable damages determined to result from the improvident or otherwise improper use or investment of any assets of the covered financial company shall include principal losses and appropriate interest.

(h) BRIDGE FINANCIAL COMPANIES.—

(1) ORGANIZATION.—

(A) PURPOSE.—The Corporation, as receiver for one or more covered financial companies or in anticipation of being appointed receiver for one or more covered financial companies, may organize one or more bridge financial companies in accordance with this subsection.

(B) AUTHORITIES.—Upon the creation of a bridge financial company under subparagraph (A) with respect to a covered financial company, such bridge financial company may—

(i) assume such liabilities (including liabilities associated with any trust or custody business, but excluding any liabilities that count as regulatory capital) of such covered financial company as the Corporation may, in its discretion, determine to be appropriate;

(ii) purchase such assets (including assets associated with any trust or custody business) of such covered financial company as the Corporation may, in its discretion, determine to be appropriate; and

(iii) perform any other temporary function which the Corporation may, in its discretion, prescribe in accordance with this section.

(2) CHARTER AND ESTABLISHMENT.—

(A) ESTABLISHMENT.—Except as provided in subparagraph (H), where the covered financial company is a covered broker or dealer, the Corporation, as receiver for a covered financial company, may grant a Federal charter to and approve articles of association for one or more bridge financial company or companies, with respect to such covered financial company which shall, by operation of law and immediately upon issuance of its charter and approval of its articles of association, be established and operate in accordance with, and subject to, such charter, articles, and this section.

(B) MANAGEMENT.—Upon its establishment, a bridge financial company shall be under the management of a board of directors appointed by the Corporation.

(C) ARTICLES OF ASSOCIATION.—The articles of association and organization certificate of a bridge financial company shall have such terms as the Corporation may provide, and shall be executed by such representatives as the Corporation may designate.

(D) TERMS OF CHARTER; RIGHTS AND PRIVILEGES.—Subject to and in accordance with the provisions of this subsection, the Corporation shall—

(i) establish the terms of the charter of a bridge financial company and the rights, powers, authorities, and privileges of a bridge financial company granted by the charter or as an incident thereto; and

(ii) provide for, and establish the terms and conditions governing, the management (including the bylaws and the number of directors of the board of directors) and operations of the bridge financial company.

(E) TRANSFER OF RIGHTS AND PRIVILEGES OF COVERED FINANCIAL COMPANY.—

(i) IN GENERAL.—Notwithstanding any other provision of Federal or State law, the Corporation may provide for a bridge financial company to succeed to and assume any rights, powers, authorities, or privileges of the covered financial company with respect to which the bridge financial company was established and, upon such determination by the Corporation, the bridge financial company shall immediately and by operation of law succeed to and assume such rights, powers, authorities, and privileges.

(ii) EFFECTIVE WITHOUT APPROVAL.—Any succession to or assumption by a bridge financial company of rights, powers, authorities, or privileges of a covered financial company under clause (i) or otherwise shall be effective without any further approval under Federal or State law, assignment, or consent with respect thereto.

(F) CORPORATE GOVERNANCE AND ELECTION AND DESIGNATION OF BODY OF LAW.—To the extent permitted by the Corporation and consistent with this section and any rules, regulations, or directives issued by the Corporation under this section, a bridge financial company may elect to follow the corporate governance practices and procedures that are applicable to a corporation incorporated under the general corporation law of the State of Delaware, or the State of incorporation or organization of the covered financial company with respect to which the bridge financial company was established, as such law may be amended from time to time.

(G) CAPITAL.—

(i) CAPITAL NOT REQUIRED.—Notwithstanding any other provision of Federal or State law, a bridge financial company may, if permitted by the Corporation, operate without any capital or surplus, or with such capital or surplus as the Corporation may in its discretion determine to be appropriate.

(ii) NO CONTRIBUTION BY THE CORPORATION REQUIRED.—The Corporation is not required to pay capital into a bridge financial company or to issue any capital stock on behalf of a bridge financial company established under this subsection.

(iii) AUTHORITY.—If the Corporation determines that such action is advisable, the Corporation may cause capital stock or other securities of a bridge financial company established with respect to a covered financial company to be issued and offered for sale in such amounts and on such terms and conditions as the Corporation may, in its discretion, determine.

(iv) OPERATING FUNDS IN LIEU OF CAPITAL AND IMPLEMENTATION PLAN.—Upon the organization of a bridge financial company, and thereafter as the Corporation may, in its discretion, determine to be necessary or advisable, the Corporation may make available to the bridge financial company, subject to the plan described in subsection (n)(9), funds for the operation of the bridge financial company in lieu of capital.

(H) BRIDGE BROKERS OR DEALERS.—

(i) IN GENERAL.—The Corporation, as receiver for a covered broker or dealer, may approve articles of association for one or more bridge financial companies with respect to such covered broker or dealer, which bridge financial company or companies shall, by operation of law and immediately upon approval of its articles of association—

(I) be established and deemed registered with the Commission under the Securities Exchange Act of 1934 and a member of SIPC;

(II) operate in accordance with such articles and this section; and

(III) succeed to any and all registrations and memberships of the covered financial company with or in any self-regulatory organizations.

(ii) OTHER REQUIREMENTS.—Except as provided in clause (i), and notwithstanding any other provision of this section, the bridge financial company shall be subject to the Federal securities laws and all requirements with respect to being a member of a self-regulatory organization, unless exempted from any such requirements by the Commission, as is necessary or appropriate in the public interest or for the protection of investors.

(iii) TREATMENT OF CUSTOMERS.—Except as otherwise provided by this title, any customer of the covered broker or dealer whose account is transferred to a bridge financial company shall have all the rights, privileges, and protections under section 205(f) and under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.), that such customer would have had if the account were not transferred from the covered financial company under this subparagraph.

(iv) OPERATION OF BRIDGE BROKERS OR DEALERS.—Notwithstanding any other provision of this title, the Corporation shall not operate any bridge financial company created by the Corporation under this title with respect to a covered broker or dealer in such a manner as to adversely affect the ability of customers to promptly access their customer property in accordance with applicable law.

(3) INTERESTS IN AND ASSETS AND OBLIGATIONS OF COVERED FINANCIAL COMPANY.—Notwithstanding paragraph (1) or (2) or any other provision of law—

(A) a bridge financial company shall assume, acquire, or succeed to the assets or liabilities of a covered financial company (including the assets or liabilities associated with any trust or custody business) only to the extent that such assets or liabilities are transferred by the Corporation to the bridge financial company in accordance with, and subject to the restrictions set forth in, paragraph (1)(B); and

(B) a bridge financial company shall not assume, acquire, or succeed to any obligation that a covered financial company for which the Corporation has been appointed receiver may have to any shareholder, member, general partner, limited partner, or other person with an interest in the equity of the covered financial company that arises as a result of the status of that person having an equity claim in the covered financial company.

(4) BRIDGE FINANCIAL COMPANY TREATED AS BEING IN DEFAULT FOR CERTAIN PURPOSES.—A bridge financial company shall be treated as a covered financial company in default at such times and for such purposes as the Corporation may, in its discretion, determine.

(5) TRANSFER OF ASSETS AND LIABILITIES.—

(A) AUTHORITY OF CORPORATION.—The Corporation, as receiver for a covered financial company, may transfer any assets and liabilities of a covered financial company (including any assets or liabilities associated with any trust or custody business) to one or more bridge financial companies, in accordance with and subject to the restrictions of paragraph (1).

(B) SUBSEQUENT TRANSFERS.—At any time after the establishment of a bridge financial company with respect to a covered financial company, the Corporation, as receiver, may transfer any assets and liabilities of such covered financial company as the Corporation may, in its discretion, determine to be appropriate in accordance with and subject to the restrictions of paragraph (1).

(C) TREATMENT OF TRUST OR CUSTODY BUSINESS.—For purposes of this paragraph, the trust or custody business, including fiduciary appointments, held by any covered financial company is included among its assets and liabilities.

(D) EFFECTIVE WITHOUT APPROVAL.—The transfer of any assets or liabilities, including those associated with any trust or custody business of a covered financial company, to a bridge financial company shall be effective without any further approval under Federal or State law, assignment, or consent with respect thereto.

(E) EQUITABLE TREATMENT OF SIMILARLY SITUATED CREDITORS.—The Corporation shall treat all creditors of a covered financial company that are similarly situated under subsection (b)(1), in a similar manner in exercising the authority of the Corporation under this subsection to transfer any assets or liabilities of the covered financial company to one or more bridge financial companies established with respect to such covered financial company, except that the Corporation may take any action (including making payments, subject to subsection (o)(1)(D)(i)) that does not comply with this subparagraph, if—

(i) the Corporation determines that such action is necessary—

(I) to maximize the value of the assets of the covered financial company;

(II) to maximize the present value return from the sale or other disposition of the assets of the covered financial company; or

(III) to minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company; and

(ii) all creditors that are similarly situated under subsection (b)(1) receive not less than the amount provided under paragraphs (2) and (3) of subsection (d).

(F) LIMITATION ON TRANSFER OF LIABILITIES.—Notwithstanding any other provision of law, the aggregate amount of liabilities of a covered financial company that are transferred to, or assumed by, a bridge financial company from a covered financial company may not exceed the aggregate amount of the assets of the covered financial company that are transferred to, or purchased by, the bridge financial company from the covered financial company.

(6) STAY OF JUDICIAL ACTION.—Any judicial action to which a bridge financial company becomes a party by virtue of its acquisition of any assets or assumption of any liabilities of a covered financial company shall be stayed from further proceedings for a period of not longer than 45 days (or such longer period as may be agreed to upon the consent of all parties) at the request of the bridge financial company.

(7) AGREEMENTS AGAINST INTEREST OF THE BRIDGE FINANCIAL COMPANY.—No agreement that tends to diminish or defeat the interest of the bridge financial company in any asset of a covered financial company acquired by the bridge financial company shall be valid against the bridge financial company, unless such agreement—

(A) is in writing;

(B) was executed by an authorized officer or representative of the covered financial company or confirmed in the ordinary course of business by the covered financial company; and

(C) has been on the official record of the company, since the time of its execution, or with which, the party claiming under the agreement provides documentation of such agreement and its authorized execution or confirmation by the covered financial company that is acceptable to the receiver.

(8) NO FEDERAL STATUS.—

(A) AGENCY STATUS.—A bridge financial company is not an agency, establishment, or instrumentality of the United States.

(B) EMPLOYEE STATUS.—Representatives for purposes of paragraph (1)(B), directors, officers, employees, or agents of a bridge financial company are not, solely by virtue of service in any such capacity, officers or employees of the United States. Any employee of the Corporation or of any Federal instrumentality who serves at the request of the Corporation as a representative for purposes of paragraph (1)(B), director, officer, employee, or agent of a bridge financial company shall not—

(i) solely by virtue of service in any such capacity lose any existing status as an officer or employee of the United States for purposes of title 5, United States Code, or any other provision of law; or

(ii) receive any salary or benefits for service in any such capacity with respect to a bridge financial company in addition to such salary or benefits as are obtained through employment with the Corporation or such Federal instrumentality.

(9) FUNDING AUTHORIZED.—The Corporation may, subject to the plan described in subsection (n)(9), provide funding to facilitate any transaction described in subparagraph (A), (B), (C), or (D) of paragraph (13) with respect to any bridge financial company, or facilitate the acquisition by a bridge financial company of any assets, or the assumption of any liabilities, of a covered financial company for which the Corporation has been appointed receiver.

(10) EXEMPT TAX STATUS.—Notwithstanding any other provision of Federal or State law, a bridge financial company, its franchise, property, and income shall be exempt from all taxation now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority.

(11) FEDERAL AGENCY APPROVAL; ANTITRUST REVIEW.—If a transaction involving the merger or sale of a bridge financial company requires approval by a Federal agency, the transaction may not be consummated before the 5th calendar day after the date of approval by the Federal agency responsible for such approval with respect thereto. If, in connection with any such approval a report on competitive factors from the Attorney General is required, the Federal agency responsible for such approval shall promptly notify the Attorney General of the proposed transaction and the Attorney General shall provide the required report within 10 days of the request. If a notification is required under section 7A of the Clayton Act with respect to such transaction, the required waiting period shall end on the 15th day after the date on which the Attorney General and the Federal Trade Commission receive such notification, unless the waiting period is terminated earlier under section 7A(b)(2) of the Clayton Act, or extended under section 7A(e)(2) of that Act.

(12) DURATION OF BRIDGE FINANCIAL COMPANY.—Subject to paragraphs (13) and (14), the status of a bridge financial company as such shall terminate at the end of the 2-year period following the date on which it was granted a charter. The Corporation may, in its discretion, extend the status of the bridge financial company as such for no more than 3 additional 1-year periods.

(13) TERMINATION OF BRIDGE FINANCIAL COMPANY STATUS.—The status of any bridge financial company as such shall terminate upon the earliest of—

(A) the date of the merger or consolidation of the bridge financial company with a company that is not a bridge financial company;

(B) at the election of the Corporation, the sale of a majority of the capital stock of the bridge financial company to a company other than the Corporation and other than another bridge financial company;

(C) the sale of 80 percent, or more, of the capital stock of the bridge financial company to a person other than the Corporation and other than another bridge financial company;

(D) at the election of the Corporation, either the assumption of all or substantially all of the liabilities of the bridge financial company by a company that is not a bridge financial company, or the acquisition of all or substantially all of the assets of the bridge financial company by a company that is not a bridge financial company, or other entity as permitted under applicable law; and

(E) the expiration of the period provided in paragraph (12), or the earlier dissolution of the bridge financial company, as provided in paragraph (15).

(14) EFFECT OF TERMINATION EVENTS.—

(A) MERGER OR CONSOLIDATION.—A merger or consolidation, described in paragraph (13)(A) shall be conducted in accordance with, and shall have the effect provided in, the provisions of applicable law. For the purpose of effecting such a merger or consolidation, the bridge financial company shall be treated as a corporation organized under the laws of the State of Delaware (unless the law of another State has been selected by the bridge financial company in accordance with paragraph (2)(F)), and the Corporation shall be treated as the sole shareholder thereof, notwithstanding any other provision of State or Federal law.

(B) CHARTER CONVERSION.—Following the sale of a majority of the capital stock of the bridge financial company, as provided in paragraph (13)(B), the Corporation may amend the charter of the bridge financial company to reflect the termination of the status of the bridge financial company as such, whereupon the company shall have all of the rights, powers, and privileges under its constituent documents and applicable Federal or State law. In connection therewith, the Corporation may take such steps as may be necessary or convenient to reincorporate the bridge financial company under the laws of a State and, notwithstanding any provisions of Federal or State law, such State-chartered corporation shall be deemed to succeed by operation of law to such rights, titles, powers, and interests of the bridge financial company as the Corporation may provide, with the same effect as if the bridge financial company had merged with the State-chartered corporation under provisions of the corporate laws of such State.

(C) SALE OF STOCK.—Following the sale of 80 percent or more of the capital stock of a bridge financial company, as provided in paragraph (13)(C), the company shall have all of the rights, powers, and privileges under its constituent documents and applicable Federal or State law. In connection therewith, the Corporation may take such steps as may be necessary or convenient to reincorporate the bridge financial company under the laws of a State and, notwithstanding any provisions of Federal or State law, the State-chartered corporation shall be deemed to succeed by operation of law to such rights, titles, powers and interests of the bridge financial company as the Corporation may provide, with the same effect as if the bridge financial company had merged with the State-chartered corporation under provisions of the corporate laws of such State.

(D) ASSUMPTION OF LIABILITIES AND SALE OF ASSETS.—Following the assumption of all or substantially all of the liabilities of the bridge financial company, or the sale of all or substantially all of the assets of the bridge financial company, as provided in paragraph (13)(D), at the election of the Corporation, the bridge financial company may retain its status as such for the period provided in paragraph (12) or may be dissolved at the election of the Corporation.

(E) AMENDMENTS TO CHARTER.—Following the consummation of a transaction described in subparagraph (A), (B), (C), or (D) of paragraph (13), the charter of the resulting company shall be amended to reflect the termination of bridge financial company status, if appropriate.

(15) DISSOLUTION OF BRIDGE FINANCIAL COMPANY.—

(A) IN GENERAL.—Notwithstanding any other provision of Federal or State law, if the status of a bridge financial company as such has not previously been terminated by the occurrence of an event specified in subparagraph (A), (B), (C), or (D) of paragraph (13)—

(i) the Corporation may, in its discretion, dissolve the bridge financial company in accordance with this paragraph at any time; and

(ii) the Corporation shall promptly commence dissolution proceedings in accordance with this paragraph upon the expiration of the 2-year period following the date on which the bridge financial company was chartered, or any extension thereof, as provided in paragraph (12).

(B) PROCEDURES.—The Corporation shall remain the receiver for a bridge financial company for the purpose of dissolving the bridge financial company. The Corporation as receiver for a bridge financial company shall wind up the affairs of the bridge financial company in conformity with the provisions of law relating to the liquidation of covered financial companies under this title. With respect to any such bridge financial company, the Corporation as receiver shall have all the rights, powers, and privileges and shall perform the duties related to the exercise of such rights, powers, or privileges granted by law to the Corporation as receiver for a covered financial company under this title and, notwithstanding any other provision of law, in the exercise of such rights, powers, and privileges, the Corporation shall not be subject to the direction or supervision of any State agency or other Federal agency.

(16) AUTHORITY TO OBTAIN CREDIT.—

(A) IN GENERAL.—A bridge financial company may obtain unsecured credit and issue unsecured debt.

(B) INABILITY TO OBTAIN CREDIT.—If a bridge financial company is unable to obtain unsecured credit or issue unsecured debt, the Corporation may authorize the obtaining of credit or the issuance of debt by the bridge financial company—

(i) with priority over any or all of the obligations of the bridge financial company;

(ii) secured by a lien on property of the bridge financial company that is not otherwise subject to a lien; or

(iii) secured by a junior lien on property of the bridge financial company that is subject to a lien.

(C) LIMITATIONS.—

(i) IN GENERAL.—The Corporation, after notice and a hearing, may authorize the obtaining of credit or the issuance of debt by a bridge financial company that is secured by a senior or equal lien on property of the bridge financial company that is subject to a lien, only if—

(I) the bridge financial company is unable to otherwise obtain such credit or issue such debt; and

(II) there is adequate protection of the interest of the holder of the lien on the property with respect to which such senior or equal lien is proposed to be granted.

(ii) HEARING.—The hearing required pursuant to this subparagraph shall be before a court of the United States, which shall have jurisdiction to conduct such hearing and to authorize a bridge financial company to obtain secured credit under clause (i).

(D) BURDEN OF PROOF.—In any hearing under this paragraph, the Corporation has the burden of proof on the issue of adequate protection.

(E) QUALIFIED FINANCIAL CONTRACTS.—No credit or debt obtained or issued by a bridge financial company may contain terms that impair the rights of a counterparty to a qualified financial contract upon a default by the bridge financial company, other than the priority of such counterparty's unsecured claim (after the exercise of rights) relative to the priority of the bridge financial company's obligations in respect of such credit or debt, unless such counterparty consents in writing to any such impairment.

(17) EFFECT ON DEBTS AND LIENS.—The reversal or modification on appeal of an authorization under this subsection to obtain credit or issue debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so issued, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the issuance of such debt, or the granting of such priority or lien, were stayed pending appeal.

(i) SHARING RECORDS.—If the Corporation has been appointed as receiver for a covered financial company, other Federal regulators shall make all records relating to the covered financial company available to the Corporation, which may be used by the Corporation in any manner that the Corporation determines to be appropriate.

(j) EXPEDITED PROCEDURES FOR CERTAIN CLAIMS.—

(1) TIME FOR FILING NOTICE OF APPEAL.—The notice of appeal of any order, whether interlocutory or final, entered in any case brought by the Corporation against a director, officer, employee, agent, attorney, accountant, or appraiser of the covered financial company, or any other person employed by or providing services to a covered financial company, shall be filed not later than 30 days after the date of entry of the order. The hearing of the appeal shall be held not later than 120 days after the date of the notice of appeal. The appeal shall be decided not later than 180 days after the date of the notice of appeal.

(2) SCHEDULING.—The court shall expedite the consideration of any case brought by the Corporation against a director, officer, employee, agent, attorney, accountant, or appraiser of a covered financial company or any other person employed by or providing services to a covered financial company. As far as practicable, the court shall give such case priority on its docket.

(3) JUDICIAL DISCRETION.—The court may modify the schedule and limitations stated in paragraphs (1) and (2) in a particular case, based on a specific finding that the ends of justice that would be served by making such a modification would outweigh the best interest of the public in having the case resolved expeditiously.

(k) FOREIGN INVESTIGATIONS.—The Corporation, as receiver for any covered financial company, and for purposes of carrying out any power, authority, or duty with respect to a covered financial company—

(1) may request the assistance of any foreign financial authority and provide assistance to any foreign financial authority in accordance with section 8(v) of the Federal Deposit Insurance Act, as if the covered financial company were an insured depository institution, the Corporation were the appropriate Federal banking agency for the company, and any foreign financial authority were the foreign banking authority; and

(2) may maintain an office to coordinate foreign investigations or investigations on behalf of foreign financial authorities.

(l) PROHIBITION ON ENTERING SECRECY AGREEMENTS AND PROTECTIVE ORDERS.—The Corporation may not enter into any agreement or approve any protective order which prohibits the Corporation from disclosing the terms of any settlement of an administrative or other action for damages or restitution brought by the Corporation in its capacity as receiver for a covered financial company.

(m) LIQUIDATION OF CERTAIN COVERED FINANCIAL COMPANIES OR BRIDGE FINANCIAL COMPANIES.—

(1) IN GENERAL.—Except as specifically provided in this section, and notwithstanding any other provision of law, the Corporation, in connection with the liquidation of any covered financial company or bridge financial company with respect to which the Corporation has been appointed as receiver, shall—

(A) in the case of any covered financial company or bridge financial company that is a stockbroker, but is not a member of the Securities Investor Protection Corporation, apply the provisions of subchapter III of chapter 7 of the Bankruptcy Code, in respect of the distribution to any customer of all customer name security and customer property and member property, as if such covered financial company or bridge financial company were a debtor for purposes of such subchapter; or

(B) in the case of any covered financial company or bridge financial company that is a commodity broker, apply the provisions of subchapter IV of chapter 7 the Bankruptcy Code, in respect of the distribution to any customer of all customer property and member property, as if such covered financial company or bridge financial company were a debtor for purposes of such subchapter.

(2) DEFINITIONS.—For purposes of this subsection—

(A) the terms "customer", "customer name security", and "customer property and member property" have the same meanings as in sections 741 and 761 of title 11, United States Code; and

(B) the terms "commodity broker" and "stockbroker" have the same meanings as in section 101 of the Bankruptcy Code.

(n) ORDERLY LIQUIDATION FUND.—

(1) ESTABLISHMENT.—There is established in the Treasury of the United States a separate fund to be known as the "Orderly Liquidation Fund", which shall be available to the Corporation to carry out the authorities contained in this title, for the cost of actions authorized by this title, including the orderly liquidation of covered financial companies, payment of administrative expenses, the payment of principal and interest by the Corporation on obligations issued under paragraph (5), and the exercise of the authorities of the Corporation under this title.

(2) PROCEEDS.—Amounts received by the Corporation, including assessments received under subsection (o), proceeds of obligations issued under paragraph (5), interest and other earnings from investments, and repayments to the Corporation by covered financial companies, shall be deposited into the Fund.

(3) MANAGEMENT.—The Corporation shall manage the Fund in accordance with this subsection and the policies and procedures established under section 203(d).

(4) INVESTMENTS.—At the request of the Corporation, the Secretary may invest such portion of amounts held in the Fund that are not, in the judgment of the Corporation, required to meet the current needs of the Corporation, in obligations of the United States having suitable maturities, as determined by the Corporation. The interest on and the proceeds from the sale or redemption of such obligations shall be credited to the Fund.

(5) AUTHORITY TO ISSUE OBLIGATIONS.—

(A) CORPORATION AUTHORIZED TO ISSUE OBLIGATIONS.—Upon appointment by the Secretary of the Corporation as receiver for a covered financial company, the Corporation is authorized to issue obligations to the Secretary.

(B) SECRETARY AUTHORIZED TO PURCHASE OBLIGATIONS.—The Secretary may, under such terms and conditions as the Secretary may require, purchase or agree to purchase any obligations issued under subparagraph (A), and for such purpose, the Secretary is authorized to use as a public debt transaction the proceeds of the sale of any securities issued under chapter 31 of title 31, United States Code, and the purposes for which securities may be issued under chapter 31 of title 31, United States Code, are extended to include such purchases.

(C) INTEREST RATE.—Each purchase of obligations by the Secretary under this paragraph shall be upon such terms and conditions as to yield a return at a rate determined by the Secretary, taking into consideration the current average yield on outstanding marketable obligations of the United States of comparable maturity, plus an interest rate surcharge to be determined by the Secretary, which shall be greater than the difference between—

(i) the current average rate on an index of corporate obligations of comparable maturity; and

(ii) the current average rate on outstanding marketable obligations of the United States of comparable maturity.

(D) SECRETARY AUTHORIZED TO SELL OBLIGATIONS.—The Secretary may sell, upon such terms and conditions as the Secretary shall determine, any of the obligations acquired under this paragraph.

(E) PUBLIC DEBT TRANSACTIONS.—All purchases and sales by the Secretary of such obligations under this paragraph shall be treated as public debt transactions of the United States, and the proceeds from the sale of any obligations acquired by the Secretary under this paragraph shall be deposited into the Treasury of the United States as miscellaneous receipts.

(6) MAXIMUM OBLIGATION LIMITATION.—The Corporation may not, in connection with the orderly liquidation of a covered financial company, issue or incur any obligation, if, after issuing or incurring the obligation, the aggregate amount of such obligations outstanding under this subsection for each covered financial company would exceed—

(A) an amount that is equal to 10 percent of the total consolidated assets of the covered financial company, based on the most recent financial statement available, during the 30-day period immediately following the date of appointment of the Corporation as receiver (or a shorter time period if the Corporation has calculated the amount described under subparagraph (B)); and

(B) the amount that is equal to 90 percent of the fair value of the total consolidated assets of each covered financial company that are available for repayment, after the time period described in subparagraph (A).

(7) RULEMAKING.—The Corporation and the Secretary shall jointly, in consultation with the Council, prescribe regulations governing the calculation of the maximum obligation limitation defined in this paragraph.

(8) RULE OF CONSTRUCTION.—

(A) IN GENERAL.—Nothing in this section shall be construed to affect the authority of the Corporation under subsection (a) or (b) of section 14 or section 15(c)(5) of the Federal Deposit Insurance Act (12 U.S.C. 1824, 1825(c)(5)), the management of the Deposit Insurance Fund by the Corporation, or the resolution of insured depository institutions, provided that—

(i) the authorities of the Corporation contained in this title shall not be used to assist the Deposit Insurance Fund or to assist any financial company under applicable law other than this Act;

(ii) the authorities of the Corporation relating to the Deposit Insurance Fund, or any other responsibilities of the Corporation under applicable law other than this title, shall not be used to assist a covered financial company pursuant to this title; and

(iii) the Deposit Insurance Fund may not be used in any manner to otherwise circumvent the purposes of this title.

(B) VALUATION.—For purposes of determining the amount of obligations under this subsection—

(i) the Corporation shall include as an obligation any contingent liability of the Corporation pursuant to this title; and

(ii) the Corporation shall value any contingent liability at its expected cost to the Corporation.

(9) ORDERLY LIQUIDATION AND REPAYMENT PLANS.—

(A) ORDERLY LIQUIDATION PLAN.—Amounts in the Fund shall be available to the Corporation with regard to a covered financial company for which the Corporation is appointed receiver after the Corporation has developed an orderly liquidation plan that is acceptable to the Secretary with regard to such covered financial company, including the provision and use of funds, including taking any actions specified under section 204(d) and subsection (h)(2)(G)(iv) and (h)(9) of this section, and payments to third parties. The orderly liquidation plan shall take into account actions to avoid or mitigate potential adverse effects on low income, minority, or underserved communities affected by the failure of the covered financial company, and shall provide for coordination with the primary financial regulatory agencies, as appropriate, to ensure that such actions are taken. The Corporation may, at any time, amend any orderly liquidation plan approved by the Secretary with the concurrence of the Secretary.

(B) MANDATORY REPAYMENT PLAN.—

(i) IN GENERAL.—No amount authorized under paragraph (6)(B) may be provided by the Secretary to the Corporation under paragraph (5), unless an agreement is in effect between the Secretary and the Corporation that—

(I) provides a specific plan and schedule to achieve the repayment of the outstanding amount of any borrowing under paragraph (5); and

(II) demonstrates that income to the Corporation from the liquidated assets of the covered financial company and assessments under subsection (o) will be sufficient to amortize the outstanding balance within the period established in the repayment schedule and pay the interest accruing on such balance within the time provided in subsection (o)(1)(B).

(ii) CONSULTATION WITH AND REPORT TO CONGRESS.—The Secretary and the Corporation shall—

(I) consult with the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the terms of any repayment schedule agreement; and

(II) submit a copy of the repayment schedule agreement to the Committees described in subclause (I) before the end of the 30-day period beginning on the date on which any amount is provided by the Secretary to the Corporation under paragraph (5).

(10) IMPLEMENTATION EXPENSES.—

(A) IN GENERAL.—Reasonable implementation expenses of the Corporation incurred after the date of enactment of this Act shall be treated as expenses of the Council.

(B) REQUESTS FOR REIMBURSEMENT.—The Corporation shall periodically submit a request for reimbursement for implementation expenses to the Chairperson of the Council, who shall arrange for prompt reimbursement to the Corporation of reasonable implementation expenses.

(C) DEFINITION.—As used in this paragraph, the term "implementation expenses"—

(i) means costs incurred by the Corporation beginning on the date of enactment of this Act, as part of its efforts to implement this title that do not relate to a particular covered financial company; and

(ii) includes the costs incurred in connection with the development of policies, procedures, rules, and regulations and other planning activities of the Corporation consistent with carrying out this title.

(o) ASSESSMENTS.—

(1) RISK-BASED ASSESSMENTS.—

(A) ELIGIBLE FINANCIAL COMPANIES DEFINED.—For purposes of this subsection, the term "eligible financial company" means any bank holding company with total consolidated assets equal to or greater than $50,000,000,000 and any nonbank financial company supervised by the Board of Governors.

(B) ASSESSMENTS.—The Corporation shall charge one or more risk-based assessments in accordance with the provisions of subparagraph (D), if such assessments are necessary to pay in full the obligations issued by the Corporation to the Secretary under this title within 60 months of the date of issuance of such obligations.

(C) EXTENSIONS AUTHORIZED.—The Corporation may, with the approval of the Secretary, extend the time period under subparagraph (B), if the Corporation determines that an extension is necessary to avoid a serious adverse effect on the financial system of the United States.

(D) APPLICATION OF ASSESSMENTS.—To meet the requirements of subparagraph (B), the Corporation shall—

(i) impose assessments, as soon as practicable, on any claimant that received additional payments or amounts from the Corporation pursuant to subsection (b)(4), (d)(4), or (h)(5)(E), except for payments or amounts necessary to initiate and continue operations essential to implementation of the receivership or any bridge financial company, to recover on a cumulative basis, the entire difference between—

(I) the aggregate value the claimant received from the Corporation on a claim pursuant to this title (including pursuant to subsection (b)(4), (d)(4), and (h)(5)(E)), as of the date on which such value was received; and

(II) the value the claimant was entitled to receive from the Corporation on such claim solely from the proceeds of the liquidation of the covered financial company under this title; and

(ii) if the amounts to be recovered on a cumulative basis under clause (i) are insufficient to meet the requirements of subparagraph (B), after taking into account the considerations set forth in paragraph (4), impose assessments on—

(I) eligible financial companies; and

(II) financial companies with total consolidated assets equal to or greater than $50,000,000,000 that are not eligible financial companies.

(E) PROVISION OF FINANCING.—Payments or amounts necessary to initiate and continue operations essential to implementation of the receivership or any bridge financial company described in subparagraph (D)(i) shall not include the provision of financing, as defined by rule of the Corporation, to third parties.

(2) GRADUATED ASSESSMENT RATE.—The Corporation shall impose assessments on a graduated basis, with financial companies having greater assets and risk being assessed at a higher rate.

(3) NOTIFICATION AND PAYMENT.—The Corporation shall notify each financial company of that company's assessment under this subsection. Any financial company subject to assessment under this subsection shall pay such assessment in accordance with the regulations prescribed pursuant to paragraph (6).

(4) RISK-BASED ASSESSMENT CONSIDERATIONS.—In imposing assessments under paragraph (1)(D)(ii), the Corporation shall use a risk matrix. The Council shall make a recommendation to the Corporation on the risk matrix to be used in imposing such assessments, and the Corporation shall take into account any such recommendation in the establishment of the risk matrix to be used to impose such assessments. In recommending or establishing such risk matrix, the Council and the Corporation, respectively, shall take into account—

(A) economic conditions generally affecting financial companies so as to allow assessments to increase during more favorable economic conditions and to decrease during less favorable economic conditions;

(B) any assessments imposed on a financial company or an affiliate of a financial company that—

(i) is an insured depository institution, assessed pursuant to section 7 or 13(c)(4)(G) of the Federal Deposit Insurance Act;

(ii) is a member of the Securities Investor Protection Corporation, assessed pursuant to section 4 of the Securities Investor Protection Act of 1970 (15 U.S.C. 78ddd);

(iii) is an insured credit union, assessed pursuant to section 202(c)(1)(A)(i) of the Federal Credit Union Act (12 U.S.C. 1782(c)(1)(A)(i)); or

(iv) is an insurance company, assessed pursuant to applicable State law to cover (or reimburse payments made to cover) the costs of the rehabilitation, liquidation, or other State insolvency proceeding with respect to 1 or more insurance companies;

(C) the risks presented by the financial company to the financial system and the extent to which the financial company has benefitted, or likely would benefit, from the orderly liquidation of a financial company under this title, including—

(i) the amount, different categories, and concentrations of assets of the financial company and its affiliates, including both on-balance sheet and off-balance sheet assets;

(ii) the activities of the financial company and its affiliates;

(iii) the relevant market share of the financial company and its affiliates;

(iv) the extent to which the financial company is leveraged;

(v) the potential exposure to sudden calls on liquidity precipitated by economic distress;

(vi) the amount, maturity, volatility, and stability of the company's financial obligations to, and relationship with, other financial companies;

(vii) the amount, maturity, volatility, and stability of the liabilities of the company, including the degree of reliance on short-term funding, taking into consideration existing systems for measuring a company's risk-based capital;

(viii) the stability and variety of the company's sources of funding;

(ix) the company's importance as a source of credit for households, businesses, and State and local governments and as a source of liquidity for the financial system;

(x) the extent to which assets are simply managed and not owned by the financial company and the extent to which ownership of assets under management is diffuse; and

(xi) the amount, different categories, and concentrations of liabilities, both insured and uninsured, contingent and noncontingent, including both on-balance sheet and off-balance sheet liabilities, of the financial company and its affiliates;

(D) any risks presented by the financial company during the 10-year period immediately prior to the appointment of the Corporation as receiver for the covered financial company that contributed to the failure of the covered financial company; and

(E) such other risk-related factors as the Corporation, or the Council, as applicable, may determine to be appropriate.

(5) COLLECTION OF INFORMATION.—The Corporation may impose on covered financial companies such collection of information requirements as the Corporation deems necessary to carry out this subsection after the appointment of the Corporation as receiver under this title.

(6) RULEMAKING.—

(A) IN GENERAL.—The Corporation shall prescribe regulations to carry out this subsection. The Corporation shall consult with the Secretary in the development and finalization of such regulations.

(B) EQUITABLE TREATMENT.—The regulations prescribed under subparagraph (A) shall take into account the differences in risks posed to the financial stability of the United States by financial companies, the differences in the liability structures of financial companies, and the different bases for other assessments that such financial companies may be required to pay, to ensure that assessed financial companies are treated equitably and that assessments under this subsection reflect such differences.

(p) UNENFORCEABILITY OF CERTAIN AGREEMENTS.—

(1) IN GENERAL.—No provision described in paragraph (2) shall be enforceable against or impose any liability on any person, as such enforcement or liability shall be contrary to public policy.

(2) PROHIBITED PROVISIONS.—A provision described in this paragraph is any term contained in any existing or future standstill, confidentiality, or other agreement that, directly or indirectly—

(A) affects, restricts, or limits the ability of any person to offer to acquire or acquire;

(B) prohibits any person from offering to acquire or acquiring; or

(C) prohibits any person from using any previously disclosed information in connection with any such offer to acquire or acquisition of,

all or part of any covered financial company, including any liabilities, assets, or interest therein, in connection with any transaction in which the Corporation exercises its authority under this title.

(q) OTHER EXEMPTIONS.—

(1) IN GENERAL.—When acting as a receiver under this title—

(A) the Corporation, including its franchise, its capital, reserves and surplus, and its income, shall be exempt from all taxation imposed by any State, county, municipality, or local taxing authority, except that any real property of the Corporation shall be subject to State, territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed, except that, notwithstanding the failure of any person to challenge an assessment under State law of the value of such property, such value, and the tax thereon, shall be determined as of the period for which such tax is imposed;

(B) no property of the Corporation shall be subject to levy, attachment, garnishment, foreclosure, or sale without the consent of the Corporation, nor shall any involuntary lien attach to the property of the Corporation; and

(C) the Corporation shall not be liable for any amounts in the nature of penalties or fines, including those arising from the failure of any person to pay any real property, personal property, probate, or recording tax or any recording or filing fees when due; and

(D) the Corporation shall be exempt from all prosecution by the United States or any State, county, municipality, or local authority for any criminal offense arising under Federal, State, county, municipal, or local law, which was allegedly committed by the covered financial company, or persons acting on behalf of the covered financial company, prior to the appointment of the Corporation as receiver.

(2) LIMITATION.—Paragraph (1) shall not apply with respect to any tax imposed (or other amount arising) under the Internal Revenue Code of 1986.

(r) CERTAIN SALES OF ASSETS PROHIBITED.—

(1) PERSONS WHO ENGAGED IN IMPROPER CONDUCT WITH, OR CAUSED LOSSES TO, COVERED FINANCIAL COMPANIES.—The Corporation shall prescribe regulations which, at a minimum, shall prohibit the sale of assets of a covered financial company by the Corporation to—

(A) any person who—

(i) has defaulted, or was a member of a partnership or an officer or director of a corporation that has defaulted, on 1 or more obligations, the aggregate amount of which exceeds $1,000,000, to such covered financial company;

(ii) has been found to have engaged in fraudulent activity in connection with any obligation referred to in clause (i); and

(iii) proposes to purchase any such asset in whole or in part through the use of the proceeds of a loan or advance of credit from the Corporation or from any covered financial company;

(B) any person who participated, as an officer or director of such covered financial company or of any affiliate of such company, in a material way in any transaction that resulted in a substantial loss to such covered financial company; or

(C) any person who has demonstrated a pattern or practice of defalcation regarding obligations to such covered financial company.

(2) CONVICTED DEBTORS.—Except as provided in paragraph (3), a person may not purchase any asset of such institution from the receiver, if that person—

(A) has been convicted of an offense under section 215, 656, 657, 1005, 1006, 1007, 1008, 1014, 1032, 1341, 1343, or 1344 of title 18, United States Code, or of conspiring to commit such an offense, affecting any covered financial company; and

(B) is in default on any loan or other extension of credit from such covered financial company which, if not paid, will cause substantial loss to the Fund or the Corporation.

(3) SETTLEMENT OF CLAIMS.—Paragraphs (1) and (2) shall not apply to the sale or transfer by the Corporation of any asset of any covered financial company to any person, if the sale or transfer of the asset resolves or settles, or is part of the resolution or settlement, of 1 or more claims that have been, or could have been, asserted by the Corporation against the person.

(4) DEFINITION OF DEFAULT.—For purposes of this subsection, the term "default" means a failure to comply with

the terms of a loan or other obligation to such an extent that the property securing the obligation is foreclosed upon.

(s) RECOUPMENT OF COMPENSATION FROM SENIOR EXECUTIVES AND DIRECTORS.—

(1) IN GENERAL.—The Corporation, as receiver of a covered financial company, may recover from any current or former senior executive or director substantially responsible for the failed condition of the covered financial company any compensation received during the 2-year period preceding the date on which the Corporation was appointed as the receiver of the covered financial company, except that, in the case of fraud, no time limit shall apply.

(2) COST CONSIDERATIONS.—In seeking to recover any such compensation, the Corporation shall weigh the financial and deterrent benefits of such recovery against the cost of executing the recovery.

(3) RULEMAKING.—The Corporation shall promulgate regulations to implement the requirements of this subsection, including defining the term "compensation" to mean any financial remuneration, including salary, bonuses, incentives, benefits, severance, deferred compensation, or golden parachute benefits, and any profits realized from the sale of the securities of the covered financial company.

SEC. 211. MISCELLANEOUS PROVISIONS.

(a) CLARIFICATION OF PROHIBITION REGARDING CONCEALMENT OF ASSETS FROM RECEIVER OR LIQUIDATING AGENT.—Section 1032(1) of title 18, United States Code, is amended by inserting "the Federal Deposit Insurance Corporation acting as receiver for a covered financial company, in accordance with title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act," before "or the National Credit".

(b) CONFORMING AMENDMENT.—Section 1032 of title 18, United States Code, is amended in the section heading, by striking "**of financial institution**".

(c) FEDERAL DEPOSIT INSURANCE CORPORATION IMPROVEMENT ACT OF 1991.—Section 403(a) of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4403(a)) is amended by inserting "section 210(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4617(d))," after "section 11(e) of the Federal Deposit Insurance Act,".

(d) FDIC INSPECTOR GENERAL REVIEWS.—

(1) SCOPE.—The Inspector General of the Corporation shall conduct, supervise, and coordinate audits and investigations of the liquidation of any covered financial company by the Corporation as receiver under this title, including collecting and summarizing—

(A) a description of actions taken by the Corporation as receiver;

(B) a description of any material sales, transfers, mergers, obligations, purchases, and other material transactions entered into by the Corporation;

(C) an evaluation of the adequacy of the policies and procedures of the Corporation under section 203(d) and orderly liquidation plan under section 210(n)(14);

(D) an evaluation of the utilization by the Corporation of the private sector in carrying out its functions, including the adequacy of any conflict-of-interest reviews; and

(E) an evaluation of the overall performance of the Corporation in liquidating the covered financial company, including administrative costs, timeliness of liquidation process, and impact on the financial system.

(2) FREQUENCY.—Not later than 6 months after the date of appointment of the Corporation as receiver under this title and every 6 months thereafter, the Inspector General of the Corporation shall conduct the audit and investigation described in paragraph (1).

(3) REPORTS AND TESTIMONY.—The Inspector General of the Corporation shall include in the semiannual reports required by section 5(a) of the Inspector General Act of 1978 (5 U.S.C. App.), a summary of the findings and evaluations under paragraph (1), and shall appear before the appropriate committees of Congress, if requested, to present each such report.

(4) FUNDING.—

(A) INITIAL FUNDING.—The expenses of the Inspector General of the Corporation in carrying out this subsection shall be considered administrative expenses of the receivership.

(B) ADDITIONAL FUNDING.—If the maximum amount available to the Corporation as receiver under this title is insufficient to enable the Inspector General of the Corporation to carry out the duties under this subsection, the Corporation shall pay such additional amounts from assessments imposed under section 210.

(5) TERMINATION OF RESPONSIBILITIES.—The duties and responsibilities of the Inspector General of the Corporation under this subsection shall terminate 1 year after the date of termination of the receivership under this title.

(e) TREASURY INSPECTOR GENERAL REVIEWS.—

(1) SCOPE.—The Inspector General of the Department of the Treasury shall conduct, supervise, and coordinate audits and investigations of actions taken by the Secretary related to the liquidation of any covered financial company under this title, including collecting and summarizing—

(A) a description of actions taken by the Secretary under this title;

(B) an analysis of the approval by the Secretary of the policies and procedures of the Corporation under section 203 and acceptance of the orderly liquidation plan of the Corporation under section 210; and

(C) an assessment of the terms and conditions underlying the purchase by the Secretary of obligations of the Corporation under section 210.

(2) FREQUENCY.—Not later than 6 months after the date of appointment of the Corporation as receiver under this title and every 6 months thereafter, the Inspector General of the Department of the Treasury shall conduct the audit and investigation described in paragraph (1).

(3) REPORTS AND TESTIMONY.—The Inspector General of the Department of the Treasury shall include in the semiannual reports required by section 5(a) of the Inspector General Act

of 1978 (5 U.S.C. App.), a summary of the findings and assessments under paragraph (1), and shall appear before the appropriate committees of Congress, if requested, to present each such report.

(4) TERMINATION OF RESPONSIBILITIES.—The duties and responsibilities of the Inspector General of the Department of the Treasury under this subsection shall terminate 1 year after the date on which the obligations purchased by the Secretary from the Corporation under section 210 are fully redeemed.

(f) PRIMARY FINANCIAL REGULATORY AGENCY INSPECTOR GENERAL REVIEWS.—

(1) SCOPE.—Upon the appointment of the Corporation as receiver for a covered financial company supervised by a Federal primary financial regulatory agency or the Board of Governors under section 165, the Inspector General of the agency or the Board of Governors shall make a written report reviewing the supervision by the agency or the Board of Governors of the covered financial company, which shall—

(A) evaluate the effectiveness of the agency or the Board of Governors in carrying out its supervisory responsibilities with respect to the covered financial company;

(B) identify any acts or omissions on the part of agency or Board of Governors officials that contributed to the covered financial company being in default or in danger of default;

(C) identify any actions that could have been taken by the agency or the Board of Governors that would have prevented the company from being in default or in danger of default; and

(D) recommend appropriate administrative or legislative action.

(2) REPORTS AND TESTIMONY.—Not later than 1 year after the date of appointment of the Corporation as receiver under this title, the Inspector General of the Federal primary financial regulatory agency or the Board of Governors shall provide the report required by paragraph (1) to such agency or the Board of Governors, and along with such agency or the Board of Governors, as applicable, shall appear before the appropriate committees of Congress, if requested, to present the report required by paragraph (1). Not later than 90 days after the date of receipt of the report required by paragraph (1), such agency or the Board of Governors, as applicable, shall provide a written report to Congress describing any actions taken in response to the recommendations in the report, and if no such actions were taken, describing the reasons why no actions were taken.

SEC. 212. PROHIBITION OF CIRCUMVENTION AND PREVENTION OF CONFLICTS OF INTEREST.

(a) NO OTHER FUNDING.—Funds for the orderly liquidation of any covered financial company under this title shall only be provided as specified under this title.

(b) LIMIT ON GOVERNMENTAL ACTIONS.—No governmental entity may take any action to circumvent the purposes of this title.

(c) CONFLICT OF INTEREST.—In the event that the Corporation is appointed receiver for more than 1 covered financial company or is appointed receiver for a covered financial company and receiver for any insured depository institution that is an affiliate of such covered financial company, the Corporation shall take appropriate action, as necessary to avoid any conflicts of interest that may arise in connection with multiple receiverships.

SEC. 213. BAN ON CERTAIN ACTIVITIES BY SENIOR EXECUTIVES AND DIRECTORS.

(a) PROHIBITION AUTHORITY.—The Board of Governors or, if the covered financial company was not supervised by the Board of Governors, the Corporation, may exercise the authority provided by this section.

(b) AUTHORITY TO ISSUE ORDER.—The appropriate agency described in subsection (a) may take any action authorized by subsection (c), if the agency determines that—

(1) a senior executive or a director of the covered financial company, prior to the appointment of the Corporation as receiver, has, directly or indirectly—

(A) violated—

(i) any law or regulation;

(ii) any cease-and-desist order which has become final;

(iii) any condition imposed in writing by a Federal agency in connection with any action on any application, notice, or request by such company or senior executive; or

(iv) any written agreement between such company and such agency;

(B) engaged or participated in any unsafe or unsound practice in connection with any financial company; or

(C) committed or engaged in any act, omission, or practice which constitutes a breach of the fiduciary duty of such senior executive or director;

(2) by reason of the violation, practice, or breach described in any subparagraph of paragraph (1), such senior executive or director has received financial gain or other benefit by reason of such violation, practice, or breach and such violation, practice, or breach contributed to the failure of the company; and

(3) such violation, practice, or breach—

(A) involves personal dishonesty on the part of such senior executive or director; or

(B) demonstrates willful or continuing disregard by such senior executive or director for the safety or soundness of such company.

(c) AUTHORIZED ACTIONS.—

(1) IN GENERAL.—The appropriate agency for a financial company, as described in subsection (a), may serve upon a senior executive or director described in subsection (b) a written notice of the intention of the agency to prohibit any further participation by such person, in any manner, in the conduct of the affairs of any financial company for a period of time determined by the appropriate agency to be commensurate with such violation, practice, or breach, provided such period shall be not less than 2 years.

(2) PROCEDURES.—The due process requirements and other procedures under section 8(e) of the Federal Deposit Insurance Act (12 U.S.C. 1818(e)) shall apply to actions under this section as if the covered financial company were an insured depository institution and the senior executive or director were an institution-affiliated party, as those terms are defined in that Act.

(d) REGULATIONS.—The Corporation and the Board of Governors, in consultation with the Council, shall jointly prescribe rules or regulations to administer and carry out this section, including rules, regulations, or guidelines to further define the term senior executive for the purposes of this section.

SEC. 214. PROHIBITION ON TAXPAYER FUNDING.

(a) LIQUIDATION REQUIRED.—All financial companies put into receivership under this title shall be liquidated. No taxpayer funds shall be used to prevent the liquidation of any financial company under this title.

(b) RECOVERY OF FUNDS.—All funds expended in the liquidation of a financial company under this title shall be recovered from the disposition of assets of such financial company, or shall be the responsibility of the financial sector, through assessments.

(c) NO LOSSES TO TAXPAYERS.—Taxpayers shall bear no losses from the exercise of any authority under this title.

SEC. 215. STUDY ON SECURED CREDITOR HAIRCUTS.

(a) STUDY REQUIRED.—The Council shall conduct a study evaluating the importance of maximizing United States taxpayer protections and promoting market discipline with respect to the treatment of fully secured creditors in the utilization of the orderly liquidation authority authorized by this Act. In carrying out such study, the Council shall—

(1) not be prejudicial to current or past laws or regulations with respect to secured creditor treatment in a resolution process;

(2) study the similarities and differences between the resolution mechanisms authorized by the Bankruptcy Code, the Federal Deposit Insurance Corporation Improvement Act of 1991, and the orderly liquidation authority authorized by this Act;

(3) determine how various secured creditors are treated in such resolution mechanisms and examine how a haircut (of various degrees) on secured creditors could improve market discipline and protect taxpayers;

(4) compare the benefits and dynamics of prudent lending practices by depository institutions in secured loans for consumers and small businesses to the lending practices of secured creditors to large, interconnected financial firms;

(5) consider whether credit differs according to different types of collateral and different terms and timing of the extension of credit; amd

(6) include an examination of stakeholders who were unsecured or under-collateralized and seek collateral when a firm is failing, and the impact that such behavior has on financial stability and an orderly resolution that protects taxpayers if the firm fails.

(b) REPORT.—Not later than the end of the 1-year period beginning on the date of enactment of this Act, the Council shall issue a report to the Congress containing all findings and conclusions made by the Council in carrying out the study required under subsection (a).

SEC. 216. STUDY ON BANKRUPTCY PROCESS FOR FINANCIAL AND NONBANK FINANCIAL INSTITUTIONS.

(a) STUDY.—

(1) IN GENERAL.—Upon enactment of this Act, the Board of Governors, in consultation with the Administrative Office of the United States Courts, shall conduct a study regarding the resolution of financial companies under the Bankruptcy Code, under chapter 7 or 11 thereof .

(2) ISSUES TO BE STUDIED.—Issues to be studied under this section include—

(A) the effectiveness of chapter 7 and chapter 11 of the Bankruptcy Code in facilitating the orderly resolution or reorganization of systemic financial companies;

(B) whether a special financial resolution court or panel of special masters or judges should be established to oversee cases involving financial companies to provide for the resolution of such companies under the Bankruptcy Code, in a manner that minimizes adverse impacts on financial markets without creating moral hazard;

(C) whether amendments to the Bankruptcy Code should be adopted to enhance the ability of the Code to resolve financial companies in a manner that minimizes adverse impacts on financial markets without creating moral hazard;

(D) whether amendments should be made to the Bankruptcy Code, the Federal Deposit Insurance Act, and other insolvency laws to address the manner in which qualified financial contracts of financial companies are treated; and

(E) the implications, challenges, and benefits to creating a new chapter or subchapter of the Bankruptcy Code to deal with financial companies.

(b) REPORTS TO CONGRESS.—Not later than 1 year after the date of enactment of this Act, and in each successive year until the fifth year after the date of enactment of this Act, the Administrative Office of the United States courts shall submit to the Committees on Banking, Housing, and Urban Affairs and the Judiciary of the Senate and the Committees on Financial Services and the Judiciary of the House of Representatives a report summarizing the results of the study conducted under subsection (a).

SEC. 217. STUDY ON INTERNATIONAL COORDINATION RELATING TO BANKRUPTCY PROCESS FOR NONBANK FINANCIAL INSTITUTIONS.

(a) STUDY.—

(1) IN GENERAL.—The Board of Governors, in consultation with the Administrative Office of the United States Courts, shall conduct a study regarding international coordination relating to the resolution of systemic financial companies under the United States Bankruptcy Code and applicable foreign law.

(2) ISSUES TO BE STUDIED.—With respect to the bankruptcy process for financial companies, issues to be studied under this section include—

(A) the extent to which international coordination currently exists;

(B) current mechanisms and structures for facilitating international cooperation;

(C) barriers to effective international coordination; and

(D) ways to increase and make more effective international coordination of the resolution of financial companies, so as to minimize the impact on the financial system without creating moral hazard.

(b) REPORT TO CONGRESS.—Not later than 1 year after the date of enactment of this Act, the Administrative office of the United States Courts shall submit to the Committees on Banking, Housing, and Urban Affairs and the Judiciary of the Senate and the Committees on Financial Services and the Judiciary of the House of Representatives a report summarizing the results of the study conducted under subsection (a).

TITLE III—TRANSFER OF POWERS TO THE COMPTROLLER OF THE CURRENCY, THE CORPORATION, AND THE BOARD OF GOVERNORS

SEC. 300. SHORT TITLE.

This title may be cited as the "Enhancing Financial Institution Safety and Soundness Act of 2010".

SEC. 301. PURPOSES.

The purposes of this title are—

(1) to provide for the safe and sound operation of the banking system of the United States;

(2) to preserve and protect the dual system of Federal and State-chartered depository institutions;

(3) to ensure the fair and appropriate supervision of each depository institution, regardless of the size or type of charter of the depository institution; and

(4) to streamline and rationalize the supervision of depository institutions and the holding companies of depository institutions.

SEC. 302. DEFINITION.

In this title, the term "transferred employee" means, as the context requires, an employee transferred to the Office of the Comptroller of the Currency or the Corporation under section 322.

Subtitle A—Transfer of Powers and Duties

SEC. 311. TRANSFER DATE.

(a) TRANSFER DATE.—Except as provided in subsection (b), the term "transfer date" means the date that is 1 year after the date of enactment of this Act.

(b) EXTENSION PERMITTED.—

(1) NOTICE REQUIRED.—The Secretary, in consultation with the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Chairman of the Board of Governors, and the Chairperson of the Corporation, may extend the period under subsection (a) and designate a transfer date that is

not later than 18 months after the date of enactment of this Act, if the Secretary transmits to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives—

(A) a written determination that commencement of the orderly process to implement this title is not feasible by the date that is 1 year after the date of enactment of this Act;

(B) an explanation of why an extension is necessary to commence the process of orderly implementation of this title;

(C) the transfer date designated under this subsection; and

(D) a description of the steps that will be taken to initiate the process of an orderly and timely implementation of this title within the extended time period.

(2) PUBLICATION OF NOTICE.—Not later than 270 days after the date of enactment of this Act, the Secretary shall publish in the Federal Register notice of any transfer date designated under paragraph (1).

SEC. 312. POWERS AND DUTIES TRANSFERRED.

(a) EFFECTIVE DATE.—This section, and the amendments made by this section, shall take effect on the transfer date.

(b) FUNCTIONS OF THE OFFICE OF THRIFT SUPERVISION.—

(1) SAVINGS AND LOAN HOLDING COMPANY FUNCTIONS TRANSFERRED.—

(A) TRANSFER OF FUNCTIONS.—There are transferred to the Board of Governors all functions of the Office of Thrift Supervision and the Director of the Office of Thrift Supervision (including the authority to issue orders) relating to—

(i) the supervision of—

(I) any savings and loan holding company; and

(II) any subsidiary (other than a depository institution) of a savings and loan holding company; and

(ii) all rulemaking authority of the Office of Thrift Supervision and the Director of the Office of Thrift Supervision relating to savings and loan holding companies.

(B) POWERS, AUTHORITIES, RIGHTS, AND DUTIES.—The Board of Governors shall succeed to all powers, authorities, rights, and duties that were vested in the Office of Thrift Supervision and the Director of the Office of Thrift Supervision on the day before the transfer date relating to the functions and authority transferred under subparagraph (A).

(2) ALL OTHER FUNCTIONS TRANSFERRED.—

(A) BOARD OF GOVERNORS.—All rulemaking authority of the Office of Thrift Supervision and the Director of the Office of Thrift Supervision under section 11 of the Home Owners' Loan Act (12 U.S.C. 1468) relating to transactions with affiliates and extensions of credit to executive officers, directors, and principal shareholders and under section 5(q) of such Act relating to tying arrangements is transferred to the Board of Governors.

(B) COMPTROLLER OF THE CURRENCY.—Except as provided in paragraph (1) and subparagraph (A)—

(i) there are transferred to the Office of the Comptroller of the Currency and the Comptroller of the Currency—

(I) all functions of the Office of Thrift Supervision and the Director of the Office of Thrift Supervision, respectively, relating to Federal savings associations; and

(II) all rulemaking authority of the Office of Thrift Supervision and the Director of the Office of Thrift Supervision, respectively, relating to savings associations; and

(ii) the Office of the Comptroller of the Currency and the Comptroller of the Currency shall succeed to all powers, authorities, rights, and duties that were vested in the Office of Thrift Supervision and the Director of the Office of Thrift Supervision, respectively, on the day before the transfer date relating to the functions and authority transferred under clause (i).

(C) CORPORATION.—Except as provided in paragraph (1) and subparagraphs (A) and (B)—

(i) all functions of the Office of Thrift Supervision and the Director of the Office of Thrift Supervision relating to State savings associations are transferred to the Corporation; and

(ii) the Corporation shall succeed to all powers, authorities, rights, and duties that were vested in the Office of Thrift Supervision and the Director of the Office of Thrift Supervision on the day before the transfer date relating to the functions transferred under clause (i).

(c) CONFORMING AMENDMENTS.—Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813) is amended—

(1) in subsection (q), by striking paragraphs (1) through (4) and inserting the following:

"(1) the Office of the Comptroller of the Currency, in the case of—

"(A) any national banking association;

"(B) any Federal branch or agency of a foreign bank; and

"(C) any Federal savings association;

"(2) the Federal Deposit Insurance Corporation, in the case of—

"(A) any State nonmember insured bank;

"(B) any foreign bank having an insured branch; and

"(C) any State savings association;

"(3) the Board of Governors of the Federal Reserve System, in the case of—

"(A) any State member bank;

"(B) any branch or agency of a foreign bank with respect to any provision of the Federal Reserve Act which is made applicable under the International Banking Act of 1978;

"(C) any foreign bank which does not operate an insured branch;

"(D) any agency or commercial lending company other than a Federal agency;

"(E) supervisory or regulatory proceedings arising from the authority given to the Board of Governors under section 7(c)(1) of the International Banking Act of 1978, including such proceedings under the Financial Institutions Supervisory Act of 1966;

"(F) any bank holding company and any subsidiary (other than a depository institution) of a bank holding company; and

"(G) any savings and loan holding company and any subsidiary (other than a depository institution) of a savings and loan holding company."; and

(2) in paragraphs (1) and (3) of subsection (u), by striking "(other than a bank holding company" and inserting "(other than a bank holding company or savings and loan holding company".

(d) CONSUMER PROTECTION.—Nothing in this section may be construed to limit or otherwise affect the transfer of powers under title X.

SEC. 313. ABOLISHMENT.

Effective 90 days after the transfer date, the Office of Thrift Supervision and the position of Director of the Office of Thrift Supervision are abolished.

SEC. 314. AMENDMENTS TO THE REVISED STATUTES.

(a) AMENDMENT TO SECTION 324.—Section 324 of the Revised Statutes of the United States (12 U.S.C. 1) is amended to read as follows:

"SEC. 324. COMPTROLLER OF THE CURRENCY.

"(a) OFFICE OF THE COMPTROLLER OF THE CURRENCY ESTABLISHED.—There is established in the Department of the Treasury a bureau to be known as the 'Office of the Comptroller of the Currency' which is charged with assuring the safety and soundness of, and compliance with laws and regulations, fair access to financial services, and fair treatment of customers by, the institutions and other persons subject to its jurisdiction.

"(b) COMPTROLLER OF THE CURRENCY.—

"(1) IN GENERAL.—The chief officer of the Office of the Comptroller of the Currency shall be known as the Comptroller of the Currency. The Comptroller of the Currency shall perform the duties of the Comptroller of the Currency under the general direction of the Secretary of the Treasury. The Secretary of the Treasury may not delay or prevent the issuance of any rule or the promulgation of any regulation by the Comptroller of the Currency, and may not intervene in any matter or proceeding before the Comptroller of the Currency (including agency enforcement actions), unless otherwise specifically provided by law.

"(2) ADDITIONAL AUTHORITY.—The Comptroller of the Currency shall have the same authority with respect to functions transferred to the Comptroller of the Currency under the Enhancing Financial Institution Safety and Soundness Act of 2010 as was vested in the Director of the Office of Thrift Supervision on the transfer date, as defined in section 311 of that Act.".

(b) SUPERVISION OF FEDERAL SAVINGS ASSOCIATIONS.—Chapter 9 of title VII of the Revised Statutes of the United States (12 U.S.C. 1 et seq.) is amended by inserting after section 327A (12 U.S.C. 4a) the following:

"SEC. 327B. DEPUTY COMPTROLLER FOR THE SUPERVISION AND EXAMINATION OF FEDERAL SAVINGS ASSOCIATIONS.

"The Comptroller of the Currency shall designate a Deputy Comptroller, who shall be responsible for the supervision and examination of Federal savings associations.".

(c) AMENDMENT TO SECTION 329.—Section 329 of the Revised Statutes of the United States (12 U.S.C. 11) is amended by inserting before the period at the end the following: "or any Federal savings association".

(d) EFFECTIVE DATE.—This section, and the amendments made by this section, shall take effect on the transfer date.

SEC. 315. FEDERAL INFORMATION POLICY.

Section 3502(5) of title 44, United States Code, is amended by inserting "Office of the Comptroller of the Currency," after "the Securities and Exchange Commission,".

SEC. 316. SAVINGS PROVISIONS.

(a) OFFICE OF THRIFT SUPERVISION.—

(1) EXISTING RIGHTS, DUTIES, AND OBLIGATIONS NOT AFFECTED.—Sections 312(b) and 313 shall not affect the validity of any right, duty, or obligation of the United States, the Director of the Office of Thrift Supervision, the Office of Thrift Supervision, or any other person, that existed on the day before the transfer date.

(2) CONTINUATION OF SUITS.—This title shall not abate any action or proceeding commenced by or against the Director of the Office of Thrift Supervision or the Office of Thrift Supervision before the transfer date, except that—

(A) for any action or proceeding arising out of a function of the Office of Thrift Supervision or the Director of the Office of Thrift Supervision transferred to the Board of Governors by this title, the Board of Governors shall be substituted for the Office of Thrift Supervision or the Director of the Office of Thrift Supervision as a party to the action or proceeding on and after the transfer date;

(B) for any action or proceeding arising out of a function of the Office of Thrift Supervision or the Director of the Office of Thrift Supervision transferred to the Office of the Comptroller of the Currency or the Comptroller of the Currency by this title, the Office of the Comptroller of the Currency or the Comptroller of the Currency shall be substituted for the Office of Thrift Supervision or the Director of the Office of Thrift Supervision, as the case may be, as a party to the action or proceeding on and after the transfer date; and

(C) for any action or proceeding arising out of a function of the Office of Thrift Supervision or the Director of the Office of Thrift Supervision transferred to the Corporation by this title, the Corporation shall be substituted for the Office of Thrift Supervision or the Director of the Office of Thrift Supervision as a party to the action or proceeding on and after the transfer date.

(b) CONTINUATION OF EXISTING OTS ORDERS, RESOLUTIONS, DETERMINATIONS, AGREEMENTS, REGULATIONS, ETC.—All orders, resolutions, determinations, agreements, and regulations, interpretative rules, other interpretations, guidelines, procedures, and other advisory materials, that have been issued, made, prescribed, or allowed to become effective by the Office of Thrift Supervision or the Director of the Office of Thrift Supervision, or by a court of competent jurisdiction, in the performance of functions that are transferred by this title and that are in effect on the day before the transfer date, shall continue in effect according to the terms of such orders, resolutions, determinations, agreements, and regulations, interpretative rules, other interpretations, guidelines, procedures, and other advisory materials, and shall be enforceable by or against—

(1) the Board of Governors, in the case of a function of the Office of Thrift Supervision or the Director of the Office of Thrift Supervision transferred to the Board of Governors, until modified, terminated, set aside, or superseded in accordance with applicable law by the Board of Governors, by any court of competent jurisdiction, or by operation of law;

(2) the Office of the Comptroller of the Currency or the Comptroller of the Currency, in the case of a function of the Office of Thrift Supervision or the Director of the Office of Thrift Supervision transferred to the Office of the Comptroller of the Currency or the Comptroller of the Currency, respectively, until modified, terminated, set aside, or superseded in accordance with applicable law by the Office of the Comptroller of the Currency or the Comptroller of the Currency, by any court of competent jurisdiction, or by operation of law; and

(3) the Corporation, in the case of a function of the Office of Thrift Supervision or the Director of the Office of Thrift Supervision transferred to the Corporation, until modified, terminated, set aside, or superseded in accordance with applicable law by the Corporation, by any court of competent jurisdiction, or by operation of law.

(c) IDENTIFICATION OF REGULATIONS CONTINUED.—

(1) BY THE BOARD OF GOVERNORS.—Not later than the transfer date, the Board of Governors shall—

(A) identify the regulations continued under subsection (b) that will be enforced by the Board of Governors; and

(B) publish a list of the regulations identified under subparagraph (A) in the Federal Register.

(2) BY OFFICE OF THE COMPTROLLER OF THE CURRENCY.—Not later than the transfer date, the Office of the Comptroller of the Currency shall—

(A) after consultation with the Corporation, identify the regulations continued under subsection (b) that will be enforced by the Office of the Comptroller of the Currency; and

(B) publish a list of the regulations identified under subparagraph (A) in the Federal Register.

(3) BY THE CORPORATION.—Not later than the transfer date, the Corporation shall—

(A) after consultation with the Office of the Comptroller of the Currency, identify the regulations continued under subsection (b) that will be enforced by the Corporation; and

(B) publish a list of the regulations identified under subparagraph (A) in the Federal Register.

(d) STATUS OF REGULATIONS PROPOSED OR NOT YET EFFECTIVE.—

(1) PROPOSED REGULATIONS.—Any proposed regulation of the Office of Thrift Supervision, which the Office of Thrift Supervision in performing functions transferred by this title, has proposed before the transfer date but has not published as a final regulation before such date, shall be deemed to be a proposed regulation of the Office of the Comptroller of the Currency or the Board of Governors, as appropriate, according to the terms of the proposed regulation.

(2) REGULATIONS NOT YET EFFECTIVE.—Any interim or final regulation of the Office of Thrift Supervision, which the Office of Thrift Supervision, in performing functions transferred by this title, has published before the transfer date but which has not become effective before that date, shall become effective as a regulation of the Office of the Comptroller of the Currency or the Board of Governors, as appropriate, according to the terms of the interim or final regulation, unless modified, terminated, set aside, or superseded in accordance with applicable law by the Office of the Comptroller of the Currency or the Board of Governors, as appropriate, by any court of competent jurisdiction, or by operation of law.

SEC. 317. REFERENCES IN FEDERAL LAW TO FEDERAL BANKING AGENCIES.

On and after the transfer date, any reference in Federal law to the Director of the Office of Thrift Supervision or the Office of Thrift Supervision, in connection with any function of the Director of the Office of Thrift Supervision or the Office of Thrift Supervision transferred under section 312(b) or any other provision of this subtitle, shall be deemed to be a reference to the Comptroller of the Currency, the Office of the Comptroller of the Currency, the Chairperson of the Corporation, the Corporation, the Chairman of the Board of Governors, or the Board of Governors, as appropriate and consistent with the amendments made in subtitle E.

SEC. 318. FUNDING.

(a) COMPENSATION OF EXAMINERS.—Section 5240 of the Revised Statutes of the United States (12 U.S.C. 481 et seq.) is amended—

(1) in the second undesignated paragraph (12 U.S.C. 481), in the fourth sentence, by striking "without regard to the provisions of other laws applicable to officers or employees of the United States" and inserting the following: "set and adjusted subject to chapter 71 of title 5, United States Code, and without regard to the provisions of other laws applicable to officers or employees of the United States"; and

(2) in the third undesignated paragraph (12 U.S.C. 482), in the first sentence, by striking "shall fix" and inserting "shall, subject to chapter 71 of title 5, United States Code, fix".

(b) FUNDING OF OFFICE OF THE COMPTROLLER OF THE CURRENCY.—Chapter 4 of title LXII of the Revised Statutes is amended by inserting after section 5240 (12 U.S.C. 481, 482) the following:

"SEC. 5240A. The Comptroller of the Currency may collect an assessment, fee, or other charge from any entity described in section 3(q)(1) of the Federal Deposit Insurance Act (12 U.S.C.

1813(q)(1)), as the Comptroller determines is necessary or appropriate to carry out the responsibilities of the Office of the Comptroller of the Currency. In establishing the amount of an assessment, fee, or charge collected from an entity under this section, the Comptroller of the Currency may take into account the nature and scope of the activities of the entity, the amount and type of assets that the entity holds, the financial and managerial condition of the entity, and any other factor, as the Comptroller of the Currency determines is appropriate. Funds derived from any assessment, fee, or charge collected or payment made pursuant to this section may be deposited by the Comptroller of the Currency in accordance with the provisions of section 5234. Such funds shall not be construed to be Government funds or appropriated monies, and shall not be subject to apportionment for purposes of chapter 15 of title 31, United States Code, or any other provision of law. The authority of the Comptroller of the Currency under this section shall be in addition to the authority under section 5240.

"The Comptroller of the Currency shall have sole authority to determine the manner in which the obligations of the Office of the Comptroller of the Currency shall be incurred and its disbursements and expenses allowed and paid, in accordance with this section, except as provided in chapter 71 of title 5, United States Code (with respect to compensation).".

(c) FUNDING OF BOARD OF GOVERNORS.—Section 11 of the Federal Reserve Act (12 U.S.C. 248) is amended by adding at the end the following:

"(s) ASSESSMENTS, FEES, AND OTHER CHARGES FOR CERTAIN COMPANIES.—

"(1) IN GENERAL.—The Board shall collect a total amount of assessments, fees, or other charges from the companies described in paragraph (2) that is equal to the total expenses the Board estimates are necessary or appropriate to carry out the supervisory and regulatory responsibilities of the Board with respect to such companies.

"(2) COMPANIES.—The companies described in this paragraph are—

"(A) all bank holding companies having total consolidated assets of $50,000,000,000 or more;

"(B) all savings and loan holding companies having total consolidated assets of $50,000,000,000 or more; and

"(C) all nonbank financial companies supervised by the Board under section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.".

(d) CORPORATION EXAMINATION FEES.—Section 10(e) of the Federal Deposit Insurance Act (12 U.S.C. 1820(e)) is amended by striking paragraph (1) and inserting the following:

"(1) REGULAR AND SPECIAL EXAMINATIONS OF DEPOSITORY INSTITUTIONS.—The cost of conducting any regular examination or special examination of any depository institution under subsection (b)(2), (b)(3), or (d) or of any entity described in section 3(q)(2) may be assessed by the Corporation against the institution or entity to meet the expenses of the Corporation in carrying out such examinations.".

(e) EFFECTIVE DATE.—This section, and the amendments made by this section, shall take effect on the transfer date.

SEC. 319. CONTRACTING AND LEASING AUTHORITY.

Notwithstanding the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 251 et seq.) or any other provision of law (except the full and open competition requirements of the Competition in Contracting Act), the Office of the Comptroller of the Currency may—

(1) enter into and perform contracts, execute instruments, and acquire real property (or property interest) as the Comptroller deems necessary to carry out the duties and responsibilities of the Office of the Comptroller of the Currency; and

(2) hold, maintain, sell, lease, or otherwise dispose of the property (or property interest) acquired under paragraph (1).

Subtitle B—Transitional Provisions

SEC. 321. INTERIM USE OF FUNDS, PERSONNEL, AND PROPERTY OF THE OFFICE OF THRIFT SUPERVISION.

(a) IN GENERAL.—Before the transfer date, the Office of the Comptroller of the Currency, the Corporation, and the Board of Governors shall—

(1) consult and cooperate with the Office of Thrift Supervision to facilitate the orderly transfer of functions to the Office of the Comptroller of the Currency, the Corporation, and the Board of Governors in accordance with this title;

(2) determine jointly, from time to time—

(A) the amount of funds necessary to pay any expenses associated with the transfer of functions (including expenses for personnel, property, and administrative services) during the period beginning on the date of enactment of this Act and ending on the transfer date;

(B) which personnel are appropriate to facilitate the orderly transfer of functions by this title; and

(C) what property and administrative services are necessary to support the Office of the Comptroller of the Currency, the Corporation, and the Board of Governors during the period beginning on the date of enactment of this Act and ending on the transfer date; and

(3) take such actions as may be necessary to provide for the orderly implementation of this title.

(b) AGENCY CONSULTATION.—When requested jointly by the Office of the Comptroller of the Currency, the Corporation, and the Board of Governors to do so before the transfer date, the Office of Thrift Supervision shall—

(1) pay to the Office of the Comptroller of the Currency, the Corporation, or the Board of Governors, as applicable, from funds obtained by the Office of Thrift Supervision through assessments, fees, or other charges that the Office of Thrift Supervision is authorized by law to impose, such amounts as the Office of the Comptroller of the Currency, the Corporation, and the Board of Governors jointly determine to be necessary under subsection (a);

(2) detail to the Office of the Comptroller of the Currency, the Corporation, or the Board of Governors, as applicable, such personnel as the Office of the Comptroller of the Currency, the Corporation, and the Board of Governors jointly determine to be appropriate under subsection (a); and

(3) make available to the Office of the Comptroller of the Currency, the Corporation, or the Board of Governors, as applicable, such property and provide to the Office of the Comptroller of the Currency, the Corporation, or the Board of Governors, as applicable, such administrative services as the Office of the Comptroller of the Currency, the Corporation, and the Board of Governors jointly determine to be necessary under subsection (a).

(c) NOTICE REQUIRED.—The Office of the Comptroller of the Currency, the Corporation, and the Board of Governors shall jointly give the Office of Thrift Supervision reasonable prior notice of any request that the Office of the Comptroller of the Currency, the Corporation, and the Board of Governors jointly intend to make under subsection (b).

SEC. 322. TRANSFER OF EMPLOYEES.

(a) IN GENERAL.—

(1) OFFICE OF THRIFT SUPERVISION EMPLOYEES.—

(A) IN GENERAL.—Except as provided in section 1064, all employees of the Office of Thrift Supervision shall be transferred to the Office of the Comptroller of the Currency or the Corporation for employment in accordance with this section.

(B) ALLOCATING EMPLOYEES FOR TRANSFER TO RECEIVING AGENCIES.—The Director of the Office of Thrift Supervision, the Comptroller of the Currency, and the Chairperson of the Corporation shall—

(i) jointly determine the number of employees of the Office of Thrift Supervision necessary to perform or support the functions that are transferred to the Office of the Comptroller of the Currency or the Corporation by this title; and

(ii) consistent with the determination under clause (i), jointly identify employees of the Office of Thrift Supervision for transfer to the Office of the Comptroller of the Currency or the Corporation.

(2) EMPLOYEES TRANSFERRED; SERVICE PERIODS CREDITED.—For purposes of this section, periods of service with a Federal home loan bank, a joint office of Federal home loan banks, or a Federal reserve bank shall be credited as periods of service with a Federal agency.

(3) APPOINTMENT AUTHORITY FOR EXCEPTED SERVICE TRANSFERRED.—

(A) IN GENERAL.—Except as provided in subparagraph (B), any appointment authority of the Office of Thrift Supervision under Federal law that relates to the functions transferred under section 312, including the regulations of the Office of Personnel Management, for filling the positions of employees in the excepted service shall be transferred to the Comptroller of the Currency or the Chairperson of the Corporation, as appropriate.

(B) DECLINING TRANSFERS ALLOWED.—The Comptroller of the Currency or the Chairperson of the Corporation may decline to accept a transfer of authority under subparagraph (A) (and the employees appointed under that authority) to the extent that such authority relates to positions excepted from the competitive service because of their confidential, policy-making, policy-determining, or policy-advocating character.

(4) ADDITIONAL APPOINTMENT AUTHORITY.—Notwithstanding any other provision of law, the Office of the Comptroller of the Currency and the Corporation may appoint transferred employees to positions in the Office of the Comptroller of the Currency or the Corporation, respectively.

(b) TIMING OF TRANSFERS AND POSITION ASSIGNMENTS.—Each employee to be transferred under subsection (a)(1) shall—

(1) be transferred not later than 90 days after the transfer date; and

(2) receive notice of the position assignment of the employee not later than 120 days after the effective date of the transfer of the employee.

(c) TRANSFER OF FUNCTIONS.—

(1) IN GENERAL.—Notwithstanding any other provision of law, the transfer of employees under this subtitle shall be deemed a transfer of functions for the purpose of section 3503 of title 5, United States Code.

(2) PRIORITY.—If any provision of this subtitle conflicts with any protection provided to a transferred employee under section 3503 of title 5, United States Code, the provisions of this subtitle shall control.

(d) EMPLOYEE STATUS AND ELIGIBILITY.—The transfer of functions and employees under this subtitle, and the abolishment of the Office of Thrift Supervision under section 313, shall not affect the status of the transferred employees as employees of an agency of the United States under any provision of law.

(e) EQUAL STATUS AND TENURE POSITIONS.—

(1) STATUS AND TENURE.—Each transferred employee from the Office of Thrift Supervision shall be placed in a position at the Office of the Comptroller of the Currency or the Corporation with the same status and tenure as the transferred employee held on the day before the date on which the employee was transferred.

(2) FUNCTIONS.—To the extent practicable, each transferred employee shall be placed in a position at the Office of the Comptroller of the Currency or the Corporation, as applicable, responsible for the same functions and duties as the transferred employee had on the day before the date on which the employee was transferred, in accordance with the expertise and preferences of the transferred employee.

(f) NO ADDITIONAL CERTIFICATION REQUIREMENTS.—An examiner who is a transferred employee shall not be subject to any additional certification requirements before being placed in a comparable position at the Office of the Comptroller of the Currency or the Corporation, if the examiner carries out examinations of the same type of institutions as an employee of the Office of the Comptroller of the Currency or the Corporation as the employee was responsible for carrying out before the date on which the employee was transferred.

(g) PERSONNEL ACTIONS LIMITED.—

(1) PROTECTION.—

(A) IN GENERAL.—Except as provided in paragraph (2), each affected employee shall not, during the 30-month period beginning on the transfer date, be involuntarily separated, or involuntarily reassigned outside his or her locality pay area.

(B) AFFECTED EMPLOYEES.—For purposes of this paragraph, the term "affected employee" means—

(i) an employee transferred from the Office of Thrift Supervision holding a permanent position on the day before the transfer date; and

(ii) an employee of the Office of the Comptroller of the Currency or the Corporation holding a permanent position on the day before the transfer date.

(2) EXCEPTIONS.—Paragraph (1) does not limit the right of the Office of the Comptroller of the Currency or the Corporation to—

(A) separate an employee for cause or for unacceptable performance;

(B) terminate an appointment to a position excepted from the competitive service because of its confidential policy-making, policy-determining, or policy-advocating character; or

(C) reassign an employee outside such employee's locality pay area when the Office of the Comptroller of the Currency or the Corporation determines that the reassignment is necessary for the efficient operation of the agency.

(h) PAY.—

(1) 30-MONTH PROTECTION.—Except as provided in paragraph (2), during the 30-month period beginning on the date on which the employee was transferred under this subtitle, a transferred employee shall be paid at a rate that is not less than the basic rate of pay, including any geographic differential, that the transferred employee received during the pay period immediately preceding the date on which the employee was transferred. Notwithstanding the preceding sentence, if the employee was receiving a higher rate of basic pay on a temporary basis (because of a temporary assignment, temporary promotion, or other temporary action) immediately before the transfer, the Agency may reduce the rate of basic pay on the date the rate would have been reduced but for the transfer, and the protected rate for the remainder of the 30-month period will be the reduced rate that would have applied but for the transfer.

(2) EXCEPTIONS.—The Comptroller of the Currency or the Corporation may reduce the rate of basic pay of a transferred employee—

(A) for cause, including for unacceptable performance; or

(B) with the consent of the transferred employee.

(3) PROTECTION ONLY WHILE EMPLOYED.—This subsection shall apply to a transferred employee only during the period that the transferred employee remains employed by Office of the Comptroller of the Currency or the Corporation.

(4) PAY INCREASES PERMITTED.—Nothing in this subsection shall limit the authority of the Comptroller of the Currency or the Chairperson of the Corporation to increase the pay of a transferred employee.

(i) BENEFITS.—

(1) RETIREMENT BENEFITS FOR TRANSFERRED EMPLOYEES.—

(A) IN GENERAL.—

(i) CONTINUATION OF EXISTING RETIREMENT PLAN.—Each transferred employee shall remain enrolled in the retirement plan of the transferred employee, for as long as the transferred employee is employed by the Office of the Comptroller of the Currency or the Corporation.

(ii) EMPLOYER'S CONTRIBUTION.—The Comptroller of the Currency or the Chairperson of the Corporation, as appropriate, shall pay any employer contributions to the existing retirement plan of each transferred employee, as required under each such existing retirement plan.

(B) DEFINITION.—In this paragraph, the term "existing retirement plan" means, with respect to a transferred employee, the retirement plan (including the Financial Institutions Retirement Fund), and any associated thrift savings plan, of the agency from which the employee was transferred in which the employee was enrolled on the day before the date on which the employee was transferred.

(2) BENEFITS OTHER THAN RETIREMENT BENEFITS.—

(A) DURING FIRST YEAR.—

(i) EXISTING PLANS CONTINUE.—During the 1-year period following the transfer date, each transferred employee may retain membership in any employee benefit program (other than a retirement benefit program) of the agency from which the employee was transferred under this title, including any dental, vision, long term care, or life insurance program to which the employee belonged on the day before the transfer date.

(ii) EMPLOYER'S CONTRIBUTION.—The Office of the Comptroller of the Currency or the Corporation, as appropriate, shall pay any employer cost required to extend coverage in the benefit program to the transferred employee as required under that program or negotiated agreements.

(B) DENTAL, VISION, OR LIFE INSURANCE AFTER FIRST YEAR.—If, after the 1-year period beginning on the transfer date, the Office of the Comptroller of the Currency or the Corporation determines that the Office of the Comptroller of the Currency or the Corporation, as the case may be, will not continue to participate in any dental, vision, or life insurance program of an agency from which an employee was transferred, a transferred employee who is a member of the program may, before the decision takes effect and without regard to any regularly scheduled open season, elect to enroll in—

(i) the enhanced dental benefits program established under chapter 89A of title 5, United States Code;

(ii) the enhanced vision benefits established under chapter 89B of title 5, United States Code; and

(iii) the Federal Employees' Group Life Insurance Program established under chapter 87 of title 5, United States Code, without regard to any requirement of insurability.

(C) LONG TERM CARE INSURANCE AFTER 1ST YEAR.—If, after the 1-year period beginning on the transfer date, the Office of the Comptroller of the Currency or the Corporation determines that the Office of the Comptroller of the Currency or the Corporation, as appropriate, will not continue to participate in any long term care insurance program of an agency from which an employee transferred, a transferred employee who is a member of such a program may, before the decision takes effect, elect to apply for coverage under the Federal Long Term Care Insurance Program established under chapter 90 of title 5, United States Code, under the underwriting requirements applicable to a new active workforce member, as described in part 875 of title 5, Code of Federal Regulations (or any successor thereto).

(D) CONTRIBUTION OF TRANSFERRED EMPLOYEE.—

(i) IN GENERAL.—Subject to clause (ii), a transferred employee who is enrolled in a plan under the Federal Employees Health Benefits Program shall pay any employee contribution required under the plan.

(ii) COST DIFFERENTIAL.—The Office of the Comptroller of the Currency or the Corporation, as applicable, shall pay any difference in cost between the employee contribution required under the plan provided to transferred employees by the agency from which the employee transferred on the date of enactment of this Act and the plan provided by the Office of the Comptroller of the Currency or the Corporation, as the case may be, under this section.

(iii) FUNDS TRANSFER.—The Office of the Comptroller of the Currency or the Corporation, as the case may be, shall transfer to the Employees Health Benefits Fund established under section 8909 of title 5, United States Code, an amount determined by the Director of the Office of Personnel Management, after consultation with the Comptroller of the Currency or the Chairperson of the Corporation, as the case may be, and the Office of Management and Budget, to be necessary to reimburse the Fund for the cost to the Fund of providing any benefits under this subparagraph that are not otherwise paid for by a transferred employee under clause (i).

(E) SPECIAL PROVISIONS TO ENSURE CONTINUATION OF LIFE INSURANCE BENEFITS.—

(i) IN GENERAL.—An annuitant, as defined in section 8901 of title 5, United States Code, who is enrolled in a life insurance plan administered by an agency from which employees are transferred under this title on the day before the transfer date shall be eligible for coverage by a life insurance plan under sections 8706(b), 8714a, 8714b, or 8714c of title 5, United States Code, or by a life insurance plan established by the Office of the Comptroller of the Currency or the Corporation, as applicable, without regard to any regularly scheduled open season or any requirement of insurability.

(ii) CONTRIBUTION OF TRANSFERRED EMPLOYEE.—

(I) IN GENERAL.—Subject to subclause (II), a transferred employee enrolled in a life insurance plan under this subparagraph shall pay any employee contribution required by the plan.

(II) COST DIFFERENTIAL.—The Office of the Comptroller of the Currency or the Corporation, as the case may be, shall pay any difference in cost between the benefits provided by the agency from which the employee transferred on the date of enactment of this Act and the benefits provided under this section.

(III) FUNDS TRANSFER.—The Office of the Comptroller of the Currency or the Corporation, as the case may be, shall transfer to the Federal Employees' Group Life Insurance Fund established under section 8714 of title 5, United States Code, an amount determined by the Director of the Office of Personnel Management, after consultation with the Comptroller of the Currency or the Chairperson of the Corporation, as the case may be, and the Office of Management and Budget, to be necessary to reimburse the Federal Employees' Group Life Insurance Fund for the cost to the Federal Employees' Group Life Insurance Fund of providing benefits under this subparagraph not otherwise paid for by a transferred employee under subclause (I).

(IV) CREDIT FOR TIME ENROLLED IN OTHER PLANS.—For any transferred employee, enrollment in a life insurance plan administered by the agency from which the employee transferred, immediately before enrollment in a life insurance plan under chapter 87 of title 5, United States Code, shall be considered as enrollment in a life insurance plan under that chapter for purposes of section 8706(b)(1)(A) of title 5, United States Code.

(j) INCORPORATION INTO AGENCY PAY SYSTEM.—Not later than 30 months after the transfer date, the Comptroller of the Currency and the Chairperson of the Corporation shall place each transferred employee into the established pay system and structure of the appropriate employing agency.

(k) EQUITABLE TREATMENT.—In administering the provisions of this section, the Comptroller of the Currency and the Chairperson of the Corporation—

(1) may not take any action that would unfairly disadvantage a transferred employee relative to any other employee of the Office of the Comptroller of the Currency or the Corporation on the basis of prior employment by the Office of Thrift Supervision;

(2) may take such action as is appropriate in an individual case to ensure that a transferred employee receives equitable treatment, with respect to the status, tenure, pay, benefits (other than benefits under programs administered by the Office of Personnel Management), and accrued leave or vacation time for prior periods of service with any Federal agency of the transferred employee;

(3) shall, jointly with the Director of the Office of Thrift Supervision, develop and adopt procedures and safeguards designed to ensure that the requirements of this subsection are met; and

(4) shall conduct a study detailing the position assignments of all employees transferred pursuant to subsection (a), describing the procedures and safeguards adopted pursuant to paragraph (3), and demonstrating that the requirements of this subsection have been met; and shall, not later than 365 days after the transfer date, submit a copy of such study to Congress.

(l) REORGANIZATION.—

(1) IN GENERAL.—If the Comptroller of the Currency or the Chairperson of the Corporation determines, during the 2-year period beginning 1 year after the transfer date, that a reorganization of the staff of the Office of the Comptroller of the Currency or the Corporation, respectively, is required, the reorganization shall be deemed a "major reorganization" for purposes of affording affected employees retirement under section 8336(d)(2) or 8414(b)(1)(B) of title 5, United States Code.

(2) SERVICE CREDIT.—For purposes of this subsection, periods of service with a Federal home loan bank or a joint office of Federal home loan banks shall be credited as periods of service with a Federal agency.

SEC. 323. PROPERTY TRANSFERRED.

(a) PROPERTY DEFINED.—For purposes of this section, the term "property" includes all real property (including leaseholds) and all personal property, including computers, furniture, fixtures, equipment, books, accounts, records, reports, files, memoranda, paper, reports of examination, work papers, and correspondence related to such reports, and any other information or materials.

(b) PROPERTY OF THE OFFICE OF THRIFT SUPERVISION.—

(1) IN GENERAL.—No later than 90 days after the transfer date, all property of the Office of Thrift Supervision (other than property described under paragraph (b)(2)) that the Comptroller of the Currency and the Chairperson of the Corporation jointly determine is used, on the day before the transfer date, to perform or support the functions of the Office of Thrift Supervision transferred to the Office of the Comptroller of the Currency or the Corporation under this title, shall be transferred to the Office of the Comptroller of the Currency or the Corporation in a manner consistent with the transfer of employees under this subtitle.

(2) PERSONAL PROPERTY.—All books, accounts, records, reports, files, memoranda, papers, documents, reports of examination, work papers, and correspondence of the Office of Thrift Supervision that the Comptroller of the Currency, the Chairperson of the Corporation, and the Chairman of the Board of Governors jointly determine is used, on the day before the transfer date, to perform or support the functions of the Office of Thrift Supervision transferred to the Board of Governors under this title shall be transferred to the Board of Governors in a manner consistent with the purposes of this title.

(c) CONTRACTS RELATED TO PROPERTY TRANSFERRED.—Each contract, agreement, lease, license, permit, and similar arrangement relating to property transferred to the Office of the Comptroller of the Currency or the Corporation by this section shall be transferred to the Office of the Comptroller of the Currency or the Corporation, as appropriate, together with the property to which it relates.

(d) PRESERVATION OF PROPERTY.—Property identified for transfer under this section shall not be altered, destroyed, or deleted before transfer under this section.

SEC. 324. FUNDS TRANSFERRED.

The funds that, on the day before the transfer date, the Director of the Office of Thrift Supervision (in consultation with the Comptroller of the Currency, the Chairperson of the Corporation, and the Chairman of the Board of Governors) determines are not necessary to dispose of the affairs of the Office of Thrift Supervision under section 325 and are available to the Office of Thrift Supervision to pay the expenses of the Office of Thrift Supervision—

(1) relating to the functions of the Office of Thrift Supervision transferred under section 312(b)(2)(B), shall be transferred to the Office of the Comptroller of the Currency on the transfer date;

(2) relating to the functions of the Office of Thrift Supervision transferred under section 312(b)(2)(C), shall be transferred to the Corporation on the transfer date; and

(3) relating to the functions of the Office of Thrift Supervision transferred under section 312(b)(1)(A), shall be transferred to the Board of Governors on the transfer date.

SEC. 325. DISPOSITION OF AFFAIRS.

(a) AUTHORITY OF DIRECTOR.—During the 90-day period beginning on the transfer date, the Director of the Office of Thrift Supervision—

(1) shall, solely for the purpose of winding up the affairs of the Office of Thrift Supervision relating to any function transferred to the Office of the Comptroller of the Currency, the Corporation, or the Board of Governors under this title—

(A) manage the employees of the Office of Thrift Supervision who have not yet been transferred and provide for the payment of the compensation and benefits of the employees that accrue before the date on which the employees are transferred under this title; and

(B) manage any property of the Office of Thrift Supervision, until the date on which the property is transferred under section 323; and

(2) may take any other action necessary to wind up the affairs of the Office of Thrift Supervision.

(b) STATUS OF DIRECTOR.—

(1) IN GENERAL.—Notwithstanding the transfer of functions under this subtitle, during the 90-day period beginning on the transfer date, the Director of the Office of Thrift Supervision shall retain and may exercise any authority vested in the Director of the Office of Thrift Supervision on the day before the transfer date, only to the extent necessary—

(A) to wind up the Office of Thrift Supervision; and

(B) to carry out the transfer under this subtitle during such 90-day period.

(2) OTHER PROVISIONS.—For purposes of paragraph (1), the Director of the Office of Thrift Supervision shall, during the 90-day period beginning on the transfer date, continue to be—

(A) treated as an officer of the United States; and

(B) entitled to receive compensation at the same annual rate of basic pay that the Director of the Office of Thrift Supervision received on the day before the transfer date.

SEC. 326. CONTINUATION OF SERVICES.

Any agency, department, or other instrumentality of the United States, and any successor to any such agency, department, or instrumentality, that was, before the transfer date, providing support services to the Office of Thrift Supervision in connection with functions transferred to the Office of the Comptroller of the Currency, the Corporation or the Board of Governors under this title, shall—

(1) continue to provide such services, subject to reimbursement by the Office of the Comptroller of the Currency, the Corporation, or the Board of Governors, until the transfer of functions under this title is complete; and

(2) consult with the Comptroller of the Currency, the Chairperson of the Corporation, or the Chairman of the Board of Governors, as appropriate, to coordinate and facilitate a prompt and orderly transition.

SEC. 327. IMPLEMENTATION PLAN AND REPORTS.

(a) PLAN SUBMISSION.—Within 180 days of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Board of Governors, the Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, shall jointly submit a plan to the Committee on Banking, Housing, and Urban Affairs of the Senate, the Committee on Financial Services of the House of Representatives, and the Inspectors General of the Department of the Treasury, the Corporation, and the Board of Governors detailing the steps the Board of Governors, the Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision will take to implement the provisions of sections 301 through 326, and the provisions of the amendments made by such sections.

(b) INSPECTORS GENERAL REVIEW OF THE PLAN.—Within 60 days of receiving the plan required under subsection (a), the Inspectors General of the Department of the Treasury, the Corporation, and the Board of Governors shall jointly provide a written report to the Board of Governors, the Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision and shall submit a copy to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives detailing whether the plan conforms with the provisions of sections 301 through 326, and the provisions of the amendments made by such sections, including—

(1) whether the plan sufficiently takes into consideration the orderly transfer of personnel;

(2) whether the plan describes procedures and safeguards to ensure that the Office of Thrift Supervision employees are not unfairly disadvantaged relative to employees of the Office of the Comptroller of the Currency and the Corporation;

(3) whether the plan sufficiently takes into consideration the orderly transfer of authority and responsibilities;

(4) whether the plan sufficiently takes into consideration the effective transfer of funds;

(5) whether the plan sufficiently takes in consideration the orderly transfer of property; and

(6) any additional recommendations for an orderly and effective process.

(c) IMPLEMENTATION REPORTS.—Not later than 6 months after the date on which the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives receives the report required under subsection (b), and every 6 months thereafter until all aspects of the plan have been implemented, the Inspectors General of the Department of the Treasury, the Corporation, and the Board of Governors shall jointly provide a written report on the status of the implementation of the plan to the Board of Governors, the Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision and shall submit a copy to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

Subtitle C—Federal Deposit Insurance Corporation

SEC. 331. DEPOSIT INSURANCE REFORMS.

(a) SIZE DISTINCTIONS.—Section 7(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(2)) is amended—

(1) by striking subparagraph (D); and

(2) by redesignating subparagraph (C) as subparagraph (D).

(b) ASSESSMENT BASE.—The Corporation shall amend the regulations issued by the Corporation under section 7(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(2)) to define the term "assessment base" with respect to an insured depository institution for purposes of that section 7(b)(2), as an amount equal to—

(1) the average consolidated total assets of the insured depository institution during the assessment period; minus

(2) the sum of—

(A) the average tangible equity of the insured depository institution during the assessment period; and

(B) in the case of an insured depository institution that is a custodial bank (as defined by the Corporation, based on factors including the percentage of total revenues generated by custodial businesses and the level of assets under custody) or a banker's bank (as that term is used in section 5136 of the Revised Statutes (12 U.S.C. 24)), an amount that the Corporation determines is necessary to establish assessments consistent with the definition under section 7(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(1)) for a custodial bank or a banker's bank.

SEC. 332. ELIMINATION OF PROCYCLICAL ASSESSMENTS.

Section 7(e) of the Federal Deposit Insurance Act is amended—

(1) in paragraph (2)—

(A) by amending subparagraph (B) to read as follows:

"(B) LIMITATION.—The Board of Directors may, in its sole discretion, suspend or limit the declaration of payment of dividends under subparagraph (A).";

(B) by amending subparagraph (C) to read as follows:

"(C) NOTICE AND OPPORTUNITY FOR COMMENT.—The Corporation shall prescribe, by regulation, after notice and opportunity for comment, the method for the declaration, calculation, distribution, and payment of dividends under this paragraph"; and

(C) by striking subparagraphs (D) through (G); and

(2) in paragraph (4)(A) by striking "paragraphs (2)(D) and" and inserting "paragraphs (2) and".

SEC. 333. ENHANCED ACCESS TO INFORMATION FOR DEPOSIT INSURANCE PURPOSES.

(a) Section 7(a)(2)(B) of the Federal Deposit Insurance Act is amended by striking "agreement" and inserting "consultation".

(b) Section 7(b)(1)(E) of the Federal Deposit Insurance Act is amended—

(1) in clause (i), by striking "such as" and inserting "including"; and

(2) in clause (iii), by striking "Corporation" and inserting "Corporation, except as provided in section 7(a)(2)(B)".

SEC. 334. TRANSITION RESERVE RATIO REQUIREMENTS TO REFLECT NEW ASSESSMENT BASE.

(a) Section 7(b)(3)(B) of the Federal Deposit Insurance Act is amended to read as follows:

"(B) MINIMUM RESERVE RATIO.—The reserve ratio designated by the Board of Directors for any year may not be less than 1.35 percent of estimated insured deposits, or the comparable percentage of the assessment base set forth in paragraph (2)(C).".

(b) Section 3(y)(3) of the Federal Deposit Insurance Act is amended by inserting ", or such comparable percentage of the assessment base set forth in section 7(b)(2)(C)" before the period.

(c) For a period of not less than 5 years after the date of the enactment of this title, the Federal Deposit Insurance Corporation shall make available to the public the reserve ratio and the designated reserve ratio using both estimated insured deposits and the assessment base under section 7(b)(2)(C) of the Federal Deposit Insurance Act.

(d) RESERVE RATIO.—Notwithstanding the timing requirements of section 7(b)(3)(E)(ii) of the Federal Deposit Insurance Act, the Corporation shall take such steps as may be necessary for the reserve ratio of the Deposit Insurance Fund to reach 1.35 percent of estimated insured deposits by September 30, 2020.

(e) OFFSET.—In setting the assessments necessary to meet the requirements of subsection (d), the Corporation shall offset the effect of subsection (d) on insured depository institutions with total consolidated assets of less than $10,000,000,000.

SEC. 335. PERMANENT INCREASE IN DEPOSIT AND SHARE INSURANCE.

(a) PERMANENT INCREASE IN DEPOSIT INSURANCE.—Section 11(a)(1)(E) of the Federal Deposit Insurance Act (12 U.S.C. 1821(a)(1)(E)) is amended—

(1) by striking "$100,000" and inserting "$250,000"; and

(2) by adding at the end the following new sentences: "Notwithstanding any other provision of law, the increase in the standard maximum deposit insurance amount to $250,000 shall apply to depositors in any institution for which the Corporation was appointed as receiver or conservator on or after January 1, 2008, and before October 3, 2008. The Corporation shall take such actions as are necessary to carry out the requirements of this section with respect to such depositors, without regard to any time limitations under this Act. In implementing this and the preceding 2 sentences, any payment on a deposit claim made by the Corporation as receiver or conservator to a depositor above the standard maximum deposit insurance amount in effect at the time of the appointment of the Corporation as receiver or conservator shall be deemed to be part of the net amount due to the depositor under subparagraph (B)."

(b) PERMANENT INCREASE IN SHARE INSURANCE.—Section 207(k)(5) of the Federal Credit Union Act (12 U.S.C. 1787(k)(5)) is amended by striking "$100,000" and inserting "$250,000".

SEC. 336. MANAGEMENT OF THE FEDERAL DEPOSIT INSURANCE CORPORATION.

(a) IN GENERAL.—Section 2 of the Federal Deposit Insurance Act (12 U.S.C. 1812) is amended—

(1) in subsection (a)(1)(B), by striking "Director of the Office of Thrift Supervision" and inserting "Director of the Consumer Financial Protection Bureau";

(2) by amending subsection (d)(2) to read as follows:

"(2) ACTING OFFICIALS MAY SERVE.—In the event of a vacancy in the office of the Comptroller of the Currency or the office of Director of the Consumer Financial Protection Bureau and pending the appointment of a successor, or during the absence or disability of the Comptroller of the Currency or the Director of the Consumer Financial Protection Bureau, the acting Comptroller of the Currency or the acting Director of the Consumer Financial Protection Bureau, as the case may be, shall be a member of the Board of Directors in the place of the Comptroller or Director."; and

(3) in subsection (f)(2), by striking "Office of Thrift Supervision" and inserting "Consumer Financial Protection Bureau".

(b) EFFECTIVE DATE.—This section, and the amendments made by this section, shall take effect on the transfer date.

Subtitle D—Other Matters

SEC. 341. BRANCHING.

Notwithstanding the Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.), the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.), or any other provision of Federal or State law, a savings association that becomes a bank may—

(1) continue to operate any branch or agency that the savings association operated immediately before the savings association became a bank; and

(2) establish, acquire, and operate additional branches and agencies at any location within any State in which the savings association operated a branch immediately before the savings association became a bank, if the law of the State in which the branch is located, or is to be located, would permit establishment of the branch if the bank were a State bank chartered by such State.

SEC. 342. OFFICE OF MINORITY AND WOMEN INCLUSION.

(a) OFFICE OF MINORITY AND WOMEN INCLUSION.—

(1) ESTABLISHMENT.—

(A) IN GENERAL.—Except as provided in subparagraph (B), not later than 6 months after the date of enactment of this Act, each agency shall establish an Office of Minority and Women Inclusion that shall be responsible for all matters of the agency relating to diversity in management, employment, and business activities.

(B) BUREAU.—The Bureau shall establish an Office of Minority and Women Inclusion not later than 6 months after the designated transfer date established under section 1062.

(2) TRANSFER OF RESPONSIBILITIES.—Each agency that, on the day before the date of enactment of this Act, assigned the responsibilities described in paragraph (1) (or comparable responsibilities) to another office of the agency shall ensure that such responsibilities are transferred to the Office.

(3) DUTIES WITH RESPECT TO CIVIL RIGHTS LAWS.—The responsibilities described in paragraph (1) do not include enforcement of statutes, regulations, or executive orders pertaining to civil rights, except each Director shall coordinate with the agency administrator, or the designee of the agency administrator, regarding the design and implementation of any remedies resulting from violations of such statutes, regulations, or executive orders.

(b) DIRECTOR.—

(1) IN GENERAL.—The Director of each Office shall be appointed by, and shall report to, the agency administrator. The position of Director shall be a career reserved position in the Senior Executive Service, as that position is defined in section 3132 of title 5, United States Code, or an equivalent designation.

(2) DUTIES.—Each Director shall develop standards for—

(A) equal employment opportunity and the racial, ethnic, and gender diversity of the workforce and senior management of the agency;

(B) increased participation of minority-owned and women-owned businesses in the programs and contracts of the agency, including standards for coordinating technical assistance to such businesses; and

(C) assessing the diversity policies and practices of entities regulated by the agency.

(3) OTHER DUTIES.—Each Director shall advise the agency administrator on the impact of the policies and regulations of the agency on minority-owned and women-owned businesses.

(4) RULE OF CONSTRUCTION.—Nothing in paragraph (2)(C) may be construed to mandate any requirement on or otherwise affect the lending policies and practices of any regulated entity, or to require any specific action based on the findings of the assessment.

(c) INCLUSION IN ALL LEVELS OF BUSINESS ACTIVITIES.—

(1) IN GENERAL.—The Director of each Office shall develop and implement standards and procedures to ensure, to the maximum extent possible, the fair inclusion and utilization of minorities, women, and minority-owned and women-owned businesses in all business and activities of the agency at all levels, including in procurement, insurance, and all types of contracts.

(2) CONTRACTS.—The procedures established by each agency for review and evaluation of contract proposals and for hiring service providers shall include, to the extent consistent with applicable law, a component that gives consideration to the diversity of the applicant. Such procedure shall include a written statement, in a form and with such content as the Director shall prescribe, that a contractor shall ensure, to the maximum extent possible, the fair inclusion of women and minorities in the workforce of the contractor and, as applicable, subcontractors.

(3) TERMINATION.—

(A) DETERMINATION.—The standards and procedures developed and implemented under this subsection shall include a procedure for the Director to make a determination whether an agency contractor, and, as applicable, a subcontractor has failed to make a good faith effort to include minorities and women in their workforce.

(B) EFFECT OF DETERMINATION.—

(i) RECOMMENDATION TO AGENCY ADMINISTRATOR.—Upon a determination described in subparagraph (A), the Director shall make a recommendation to the agency administrator that the contract be terminated.

(ii) ACTION BY AGENCY ADMINISTRATOR.—Upon receipt of a recommendation under clause (i), the agency administrator may—

(I) terminate the contract;

(II) make a referral to the Office of Federal Contract Compliance Programs of the Department of Labor; or

(III) take other appropriate action.

(d) APPLICABILITY.—This section shall apply to all contracts of an agency for services of any kind, including the services of financial institutions, investment banking firms, mortgage banking firms, asset management firms, brokers, dealers, financial services entities, underwriters, accountants, investment consultants, and providers of legal services. The contracts referred to in this subsection include all contracts for all business and activities of an agency, at all levels, including contracts for the issuance or guarantee of any debt, equity, or security, the sale of assets, the management of the assets of the agency, the making of equity investments by the agency, and the implementation by the agency of programs to address economic recovery.

(e) REPORTS.—Each Office shall submit to Congress an annual report regarding the actions taken by the agency and the Office pursuant to this section, which shall include—

(1) a statement of the total amounts paid by the agency to contractors since the previous report;

(2) the percentage of the amounts described in paragraph (1) that were paid to contractors described in subsection (c)(1);

(3) the successes achieved and challenges faced by the agency in operating minority and women outreach programs;

(4) the challenges the agency may face in hiring qualified minority and women employees and contracting with qualified minority-owned and women-owned businesses; and

(5) any other information, findings, conclusions, and recommendations for legislative or agency action, as the Director determines appropriate.

(f) DIVERSITY IN AGENCY WORKFORCE.—Each agency shall take affirmative steps to seek diversity in the workforce of the agency at all levels of the agency in a manner consistent with applicable law. Such steps shall include—

(1) recruiting at historically black colleges and universities, Hispanic-serving institutions, women's colleges, and colleges that typically serve majority minority populations;

(2) sponsoring and recruiting at job fairs in urban communities;

(3) placing employment advertisements in newspapers and magazines oriented toward minorities and women;

(4) partnering with organizations that are focused on developing opportunities for minorities and women to place talented young minorities and women in industry internships, summer employment, and full-time positions;

(5) where feasible, partnering with inner-city high schools, girls' high schools, and high schools with majority minority populations to establish or enhance financial literacy programs and provide mentoring; and

(6) any other mass media communications that the Office determines necessary.

(g) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

(1) AGENCY.—The term "agency" means—

(A) the Departmental Offices of the Department of the Treasury;

(B) the Corporation;

(C) the Federal Housing Finance Agency;

(D) each of the Federal reserve banks;

(E) the Board;

(F) the National Credit Union Administration;

(G) the Office of the Comptroller of the Currency;

(H) the Commission; and

(I) the Bureau.

(2) AGENCY ADMINISTRATOR.—The term "agency administrator" means the head of an agency.

(3) MINORITY.—The term "minority" has the same meaning as in section 1204(c) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 1811 note).

(4) MINORITY-OWNED BUSINESS.—The term "minority-owned business" has the same meaning as in section 21A(r)(4)(A)

of the Federal Home Loan Bank Act (12 U.S.C. 1441a(r)(4)(A)), as in effect on the day before the transfer date.

(5) OFFICE.—The term "Office" means the Office of Minority and Women Inclusion established by an agency under subsection (a).

(6) WOMEN-OWNED BUSINESS.—The term "women-owned business" has the meaning given the term "women's business" in section 21A(r)(4)(B) of the Federal Home Loan Bank Act (12 U.S.C. 1441a(r)(4)(B)), as in effect on the day before the transfer date.

SEC. 343. INSURANCE OF TRANSACTION ACCOUNTS.

(a) BANKS AND SAVINGS ASSOCIATIONS.—

(1) AMENDMENTS.—Section 11(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1821(a)(1)) is amended—

(A) in subparagraph (B)—

(i) by striking "The net amount" and inserting the following:

"(i) IN GENERAL.—Subject to clause (ii), the net amount"; and

(ii) by adding at the end the following new clauses:

"(ii) INSURANCE FOR NONINTEREST-BEARING TRANSACTION ACCOUNTS.—Notwithstanding clause (i), the Corporation shall fully insure the net amount that any depositor at an insured depository institution maintains in a noninterest-bearing transaction account. Such amount shall not be taken into account when computing the net amount due to such depositor under clause (i).

"(iii) NONINTEREST-BEARING TRANSACTION ACCOUNT DEFINED.—For purposes of this subparagraph, the term 'noninterest-bearing transaction account' means a deposit or account maintained at an insured depository institution—

"(I) with respect to which interest is neither accrued nor paid;

"(II) on which the depositor or account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone or other electronic media transfers, or other similar items for the purpose of making payments or transfers to third parties or others; and

"(III) on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal."; and

(B) in subparagraph (C), by striking "subparagraph (B)" and inserting "subparagraph (B)(i)".

(2) EFFECTIVE DATE.—The amendments made by paragraph (1) shall take effect on December 31, 2010.

(3) PROSPECTIVE REPEAL.—Effective January 1, 2013, section 11(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1821(a)(1)), as amended by paragraph (1), is amended—

(A) in subparagraph (B)—

(i) by striking "DEPOSIT.—" and all that follows through "clause (ii), the net amount" and insert "DEPOSIT.—The net amount"; and

(ii) by striking clauses (ii) and (iii); and

(B) in subparagraph (C), by striking "subparagraph (B)(i)" and inserting "subparagraph (B)".

(b) CREDIT UNIONS.—

(1) AMENDMENTS.—Section 207(k)(1) of the Federal Credit Union Act (12 U.S.C. 1787(k)(1)) is amended—

(A) in subparagraph (A)—

(i) by striking "Subject to the provisions of paragraph (2), the net amount" and inserting the following:

"(i) NET AMOUNT OF INSURANCE PAYABLE.—Subject to clause (ii) and the provisions of paragraph (2), the net amount"; and

(ii) by adding at the end the following new clauses:

"(ii) INSURANCE FOR NONINTEREST-BEARING TRANSACTION ACCOUNTS.—Notwithstanding clause (i), the Board shall fully insure the net amount that any member or depositor at an insured credit union maintains in a noninterest-bearing transaction account. Such amount shall not be taken into account when computing the net amount due to such member or depositor under clause (i).

"(iii) NONINTEREST-BEARING TRANSACTION ACCOUNT DEFINED.—For purposes of this subparagraph, the term 'noninterest-bearing transaction account' means an account or deposit maintained at an insured credit union—

"(I) with respect to which interest is neither accrued nor paid;

"(II) on which the account holder or depositor is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone or other electronic media transfers, or other similar items for the purpose of making payments or transfers to third parties or others; and

"(III) on which the insured credit union does not reserve the right to require advance notice of an intended withdrawal."; and

(B) in subparagraph (B), by striking "subparagraph (A)" and inserting "subparagraph (A)(i)".

(2) EFFECTIVE DATE.—The amendments made by paragraph (1) shall take effect upon the date of the enactment of this Act

(3) PROSPECTIVE REPEAL.—Effective January 1, 2013, section 207(k)(1) of the Federal Credit Union Act (12 U.S.C. 1787(k)(1)), as amended by paragraph (1), is amended—

(A) in subparagraph (A)—

(i) by striking "(i) NET AMOUNT OF INSURANCE PAYABLE.—" and all that follows through "paragraph (2), the net amount" and inserting "Subject to the provisions of paragraph (2), the net amount"; and

(ii) by striking clauses (ii) and (iii); and

(B) in subparagraph (B), by striking "subparagraph (A)(i)" and inserting "subparagraph (A)".

Subtitle E—Technical and Conforming Amendments

SEC. 351. EFFECTIVE DATE.

Except as provided in section 364(a), the amendments made by this subtitle shall take effect on the transfer date.

SEC. 352. BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT OF 1985.

Section 256(h) of the Balanced Budget and Emergency Deficit Control Act of 1985 (2 U.S.C. 906(h)) is amended—

(1) in paragraph (4), by striking subparagraphs (C) and (G); and

(2) by redesignating subparagraphs (D), (E), (F), and (H) as subparagraphs (C), (D), (E), and (F), respectively.

SEC. 353. BANK ENTERPRISE ACT OF 1991.

Section 232(a) of the Bank Enterprise Act of 1991 (12 U.S.C. 1834(a)) is amended—

(1) in the subsection heading, by striking "BY FEDERAL RESERVE BOARD";

(2) in paragraph (1)—

(A) by striking "The Board of Governors of the Federal Reserve System," and inserting "The Comptroller of the Currency"; and

(B) by striking "section 7(b)(2)(H)" and inserting "section 7(b)(2)(E)";

(3) in paragraph (2)(A), by striking "Board" and inserting "Comptroller"; and

(4) in paragraph (3)—

(A) by redesignating subparagraphs (A) through (C) as subparagraphs (B) through (D), respectively; and

(B) by inserting before subparagraph (B) the following:

"(A) COMPTROLLER.—The term 'Comptroller' means the Comptroller of the Currency.".

SEC. 354. BANK HOLDING COMPANY ACT OF 1956.

The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended—

(1) in section 2(j)(3) (12 U.S.C. 1841(j)(3)), strike "Director of the Office of Thrift Supervision" and inserting "appropriate Federal banking agency";

(2) in section 4 (12 U.S.C. 1843)—

(A) in subsection (i)—

(i) in paragraph (4)—

(I) in subparagraph (A)—

(aa) in the subparagraph heading, by striking "TO DIRECTOR"; and

(bb) by striking "Board" and all that follows through the end of the subparagraph and inserting "Board shall solicit comments and recommendations from—

"(i) the Comptroller of the Currency, with respect to the acquisition of a Federal savings association; and "(ii) the Federal Deposit Insurance Corporation, with respect to the acquisition of a State savings association.".

(II) in subparagraph (B), by striking "Director" each place that term appears and inserting "Comptroller of the Currency or the Federal Deposit Insurance Corporation, as applicable,";

(ii) in paragraph (5)—

(I) in subparagraph (B), by striking "Director with" and inserting "Comptroller of the Currency or the Federal Deposit Insurance Corporation, as applicable, with"; and

(II) by striking "Director" each place that term appears and inserting "Comptroller of the Currency or the Federal Deposit Insurance Corporation";

(iii) in paragraph (6), by striking "Director" and inserting "Comptroller of the Currency or the Federal Deposit Insurance Corporation, as applicable,"; and

(iv) by striking paragraph (7); and

(3) in section 5(f) (12 U.S.C. 1844(f))—

(A) by striking "subpena" each place that term appears and inserting "subpoena";

(B) by striking "subpenas" each place that term appears and inserting "subpoenas"; and

(C) by striking "subpenaed" and inserting "subpoenaed".

SEC. 355. BANK HOLDING COMPANY ACT AMENDMENTS OF 1970.

Section 106(b)(1) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(1)) is amended in the undesignated matter following subparagraph (E) by inserting "issue such regulations as are necessary to carry out this section, and, in consultation with the Comptroller of the Currency and the Federal Deposit Insurance Company, may" after "The Board may".

SEC. 356. BANK PROTECTION ACT OF 1968.

The Bank Protection Act of 1968 (12 U.S.C. 1881 et seq.) is amended—

(1) in section 2 (12 U.S.C. 1881), by striking "the term" and all that follows through the end of the section and inserting "the term 'Federal supervisory agency' means the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).";

(2) in section 3 (12 U.S.C. 1882), by striking "and loan" each place that term appears; and

(3) in section 5 (12 U.S.C. 1884), by striking "and loan".

SEC. 357. BANK SERVICE COMPANY ACT.

The Bank Service Company Act (12 U.S.C. 1861 et seq.) is amended—

(1) in section 1(b)(4) (12 U.S.C. 1861(b)(4))—

(A) by inserting after "an insured bank," the following: "a savings association,";

(B) by striking "Director of the Office of Thrift Supervision" and inserting "appropriate Federal banking agency"; and

(C) by striking ", the Federal Savings and Loan Insurance Corporation,";

(2) in section 1(b)(5), by striking "term 'insured depository institution' has the same meaning as in section 3(c)" and inserting "terms 'depository institution' and 'savings association' have the same meanings as in section 3"; and

(3) in section 7(c)(2) (12 U.S.C. 1867(c)(2)), by inserting "each" after "notify".

SEC. 358. COMMUNITY REINVESTMENT ACT OF 1977.

The Community Reinvestment Act of 1977 (12 U.S.C. 2901 et seq.) is amended—

(1) in section 803 (12 U.S.C. 2902)—

(A) in paragraph (1)—

(i) in subparagraph (A), by inserting "and Federal savings associations (the deposits of which are insured by the Federal Deposit Insurance Corporation)" after "banks";

(ii) in subparagraph (B), by striking "and bank holding companies" and inserting ", bank holding companies, and savings and loan holding companies"; and

(iii) in subparagraph (C), by striking "; and" and inserting ", and State savings associations (the deposits of which are insured by the Federal Deposit Insurance Corporation)."; and

(B) by striking paragraph (2) (relating to the Office of Thrift Supervision), as added by section 744(q) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Public Law 101–73; 103 Stat. 440); and

(2) in section 806 (12 U.S.C. 2905), by inserting ", except that the Comptroller of the Currency shall prescribe regulations applicable to savings associations and the Board of Governors shall prescribe regulations applicable to insured State member banks, bank holding companies and savings and loan holding companies," after "supervisory agency".

SEC. 359. CRIME CONTROL ACT OF 1990.

The Crime Control Act of 1990 is amended—

(1) in section 2539(c)(2) (28 U.S.C. 509 note)—

(A) by striking subparagraphs (C) and (D); and

(B) by redesignating subparagraphs (E) through (H) as subparagraphs (C) through (G), respectively; and

(2) in section 2554(b)(2) (Public Law 101–647; 104 Stat. 4890)—

(A) in subparagraph (A), by striking ", the Director of the Office of Thrift Supervision," and inserting "the Comptroller of the Currency"; and

(B) in subparagraph (B), by striking ", the Director" and all that follows through "Trust Corporation" and inserting "or the Federal Deposit Insurance Corporation".

SEC. 360. DEPOSITORY INSTITUTION MANAGEMENT INTERLOCKS ACT.

The Depository Institution Management Interlocks Act (12 U.S.C. 3201 et seq.) is amended—

(1) in section 207 (12 U.S.C. 3206)—

(A) in paragraph (1), by inserting before the comma at the end the following: "and Federal savings associations (the deposits of which are insured by the Federal Deposit Insurance Corporation)";

(B) in paragraph (2), by striking ", and bank holding companies" and inserting ", bank holding companies, and savings and loan holding companies";

(C) in paragraph (3), by striking "Corporation," and inserting "Corporation and State savings associations (the deposits of which are insured by the Federal Deposit Insurance Corporation),";

(D) by striking paragraph (4);

(E) by redesignating paragraphs (5) and (6) as paragraphs (4) and (5), respectively; and

(F) in paragraph (5), as so redesignated, by striking "through (5)" and inserting "through (4)";

(2) in section 209 (12 U.S.C. 3207)—

(A) in paragraph (1), by inserting before the comma at the end the following: "and Federal savings associations (the deposits of which are insured by the Federal Deposit Insurance Corporation)";

(B) in paragraph (2), by striking ", and bank holding companies" and inserting ", bank holding companies, and savings and loan holding companies";

(C) in paragraph (3), by striking "Corporation," and inserting "Corporation and State savings associations (the deposits of which are insured by the Federal Deposit Insurance Corporation),";

(D) by striking paragraph (4); and

(E) by redesignating paragraph (5) as paragraph (4); and

(3) in section 210(a) (12 U.S.C. 3208(a))—

(A) by striking "his" and inserting "the"; and

(B) by inserting "of the Attorney General" after "enforcement functions".

SEC. 361. EMERGENCY HOMEOWNERS' RELIEF ACT.

Section 110 of the Emergency Homeowners' Relief Act (12 U.S.C. 2709) is amended in the second sentence, by striking "Home Loan Bank Board, the Federal Savings and Loan Insurance Corporation" and inserting "Housing Finance Agency".

SEC. 362. FEDERAL CREDIT UNION ACT.

The Federal Credit Union Act (12 U.S.C. 1751 et seq.) is amended—

(1) in section 107(8) (12 U.S.C. 1757(8)), by striking "or the Federal Savings and Loan Insurance Corporation";

(2) in section 205 (12 U.S.C. 1785)—

(A) in subsection (b)(2)(G)(i), by striking "the Office of Thrift Supervision and"; and

(B) in subsection (i)(1), by striking "or the Federal Savings and Loan Insurance Corporation"; and

(3) in section 206(g)(7) (12 U.S.C. 1786(g)(7))—

(A) in subparagraph (A)—

(i) in clause (ii), by striking "(b)(8)" and inserting "(b)(9)";

(ii) in clause (v)—

(I) by striking "depository" and inserting "financial"; and

(II) by adding "and" at the end;

(iii) in clause (vi)—

(I) by striking “Board” and inserting “Agency”; and

(II) by striking “; and” and inserting a period; and

(iv) by striking clause (vii); and

(B) in subparagraph (D)—

(i) in clause (iii), by adding “and” at the end;

(ii) in clause (iv)—

(I) by striking “Board” and inserting “Agency”; and

(II) by striking “and” at the end; and

(iii) by striking clause (v).

SEC. 363. FEDERAL DEPOSIT INSURANCE ACT.

The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended—

(1) in section 3 (12 U.S.C. 1813)—

(A) in subsection (b)(1)(C), by striking “Director of the Office of Thrift Supervision” and inserting “Comptroller of the Currency”;

(B) in subsection (l)(5), in the matter preceding subparagraph (A), by striking “Director of the Office of Thrift Supervision,”; and

(C) in subsection (z), by striking “the Director of the Office of Thrift Supervision,”;

(2) in section 7 (12 U.S.C. 1817)—

(A) in subsection (a)—

(i) in paragraph (2)—

(I) in subparagraph (A)—

(aa) in the first sentence, by striking “the Director of the Office of Thrift Supervision,”;

(bb) in the second sentence—

(AA) by striking “the Director of the Office of Thrift Supervision,” and inserting “to”; and

(BB) by inserting “to” before “any Federal home”; and

(cc) by striking “Finance Board” each place that term appears and inserting “Finance Agency”; and

(II) in subparagraph (B), by striking “the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Director of the Office of Thrift Supervision,” and inserting “the Comptroller of the Currency and the Board of Governors of the Federal Reserve System,”;

(ii) in paragraph (3), in the first sentence, by striking “Comptroller of the Currency, the Chairman of the Board of Governors of the Federal Reserve System, and the Director of the Office of Thrift Supervision.” and inserting “Comptroller of the Currency, and the Chairman of the Board of Governors of the Federal Reserve System.”;

(iii) in paragraph (6), by striking “section 232(a)(3)(C)” and inserting “section 232(a)(3)(D)”; and

(iv) in paragraph (7), by striking ", the Director of the Office of Thrift Supervision,"; and

(B) in subsection (n)—

(i) in the heading, by striking "DIRECTOR OF THE OFFICE OF THRIFT SUPERVISION" and inserting "COMPTROLLER OF THE CURRENCY";

(ii) in the first sentence—

(I) by striking "the Director of the Office of Thrift Supervision" and inserting "the Comptroller of the Currency"; and

(II) by inserting "Federal" before "savings associations";

(iii) in the third sentence, by striking ", the Financing Corporation, and the Resolution Funding Corporation"; and

(iv) by striking "the Director" each place that term appears and inserting "the Comptroller";

(3) in section 8 (12 U.S.C. 1818)—

(A) in subsection (a)(8)(B)(ii), in the last sentence, by striking "Director of the Office of Thrift Supervision" each place that term appears and inserting "Comptroller of the Currency";

(B) in subsection (b)(3)—

(i) by inserting "any savings and loan holding company and any subsidiary (other than a depository institution) of a savings and loan holding company (as such terms are defined in section 10 of Home Owners' Loan Act)), any noninsured State member bank" after "Bank Holding Company Act of 1956,"; and

(ii) by inserting "or against a savings and loan holding company or any subsidiary thereof (other than a depository institution or a subsidiary of such depository institution)" before the period at the end;

(C) by striking paragraph (9) of subsection (b) and inserting the following new paragraph:

"(9) [Repealed]".

(D) in subsection (e)(7)—

(i) in subparagraph (A)—

(I) in clause (v), by inserting "and" after the semicolon;

(II) in clause (vi)—

(aa) by striking "Board" and inserting "Agency"; and

(bb) by striking "; and" and inserting a period; and

(III) by striking clause (vii); and

(ii) in subparagraph (D)—

(I) in clause (iii), by inserting "and" after the semicolon;

(II) in clause (iv)—

(aa) by striking "Board" and inserting "Agency"; and

(bb) by striking "; and" and inserting a period; and

(III) by striking clause (v);

(E) in subsection (j)—

(i) in paragraph (2), by striking ", or as a savings association under subsection (b)(9) of this section";

(ii) in paragraph (3), by inserting "or" after the semicolon;

(iii) in paragraph (4), by striking "; or" and inserting a comma; and

(iv) by striking paragraph (5);

(F) in subsection (o), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency"; and

(G) in subsection (w)(3)(A), by striking "and the Office of Thrift Supervision";

(4) in section 10 (12 U.S.C. 1820)—

(A) in subsection (d)(5), by striking "or the Resolution Trust Corporation" each place that term appears; and

(B) in subsection (k)(5)(B)—

(i) in clause (ii), by inserting "and" after the semicolon;

(ii) in clause (iii), by striking "; and" and inserting a period; and

(iii) by striking clause (iv);

(5) in section 11 (12 U.S.C. 1821)—

(A) in subsection (c)—

(i) in paragraph (2)(A)(ii), by striking "(other than section 21A of the Federal Home Loan Bank Act)";

(ii) in paragraph (4), by striking "Except as otherwise provided in section 21A of the Federal Home Loan Bank Act and notwithstanding" and inserting "Notwithstanding";

(iii) in paragraph (6)—

(I) in the heading, by striking "DIRECTOR OF THE OFFICE OF THRIFT SUPERVISION" and inserting "COMPTROLLER OF THE CURRENCY";

(II) in subparagraph (A)—

(aa) by striking "or the Resolution Trust Corporation"; and

(bb) by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency"; and

(III) by amending subparagraph (B) to read as follows:

"(B) RECEIVER.—The Corporation may, at the discretion of the Comptroller of the Currency, be appointed receiver and the Corporation may accept any such appointment.";

(iv) in paragraph (12)(A), by striking "or the Resolution Trust Corporation";

(B) in subsection (d)—

(i) in paragraph (17)(A), by striking "or the Director of the Office of Thrift Supervision"; and

(ii) in paragraph (18)(B), by striking "or the Director of the Office of Thrift Supervision";

(C) in subsection (m)—

(i) in paragraph (9), by striking "or the Director of the Office of Thrift Supervision, as appropriate";

(ii) in paragraph (16), by striking "or the Director of the Office of Thrift Supervision, as appropriate" each place that term appears; and

(iii) in paragraph (18), by striking "or the Director of the Office of Thrift Supervision, as appropriate" each place that term appears;

(D) in subsection (n)—

(i) in paragraph (1)(A)—

(I) by striking ", or the Director of the Office of Thrift Supervision, with respect to" and inserting "or"; and

(II) by striking "applicable,," and inserting "applicable,";

(ii) in paragraph (2)(A), by striking "or the Director of the Office of Thrift Supervision";

(iii) in paragraph (4)(D), by striking "and the Director of the Office of Thrift Supervision, as appropriate,";

(iv) in paragraph (4)(G), by striking "and the Director of the Office of Thrift Supervision, as appropriate,"; and

(v) in paragraph (12)(B)—

(I) by inserting "as" after "shall appoint the Corporation";

(II) by striking "or the Director of the Office of Thrift Supervision, as appropriate," each place such term appears;

(E) in subsection (p)—

(i) in paragraph (2)(B), by striking "the Corporation, the FSLIC Resolution Fund, or the Resolution Trust Corporation," and inserting "or the Corporation,"; and

(ii) in paragraph (3)(B), by striking ", the FSLIC Resolution Fund, the Resolution Trust Corporation,"; and

(F) in subsection (r), by striking "and the Resolution Trust Corporation";

(6) in section 13(k)(1)(A)(iv) (12 U.S.C. 1823(k)(1)(A)(iv)), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency";

(7) in section 18 (12 U.S.C. 1828)—

(A) in subsection (c)(2)—

(i) in subparagraph (A), by inserting "or a Federal savings association" before the semicolon;

(ii) in subparagraph (B), by adding "and" at the end;

(iii) in subparagraph (C), by striking "(except" and all that follows through "; and" and inserting "or a State savings association."; and

(iv) by striking subparagraph (D);

(B) in subsection (g)(1), by striking "the Director of the Office of Thrift Supervision"and inserting "the Comptroller of the Currency";

(C) in subsection (i)(2)(C), by striking "Director of the Office of Thrift Supervision" and inserting "Corporation"; and

(D) in subsection (m)—

(i) in paragraph (1)—

(I) in subparagraph (A), by striking "and the Director of the Office of Thrift Supervision" and inserting "or the Comptroller of the Currency, as appropriate,"; and

(II) in subparagraph (B), by striking "and orders of the Director of the Office of Thrift Supervision" and inserting "of the Comptroller of the Currency and orders of the Corporation and the Comptroller of the Currency";

(ii) in paragraph (2)—

(I) in subparagraph (A), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency, as appropriate,"; and

(II) in subparagraph (B)—

(aa) in the matter before clause (i), by striking "Director of the Office of Thrift Supervision" and inserting "Corporation or the Comptroller of the Currency, as appropriate,"; and

(bb) in the matter following clause (ii)—

(AA) in the first sentence, by striking "Director of the Office of Thrift Supervision" and inserting "Office of the Comptroller of the Currency, as appropriate,"; and

(BB) by striking the second sentence and inserting the following: "The Corporation or the Comptroller of the Currency, as appropriate, may take any other corrective measures with respect to the subsidiary, including the authority to require the subsidiary to terminate the activities or operations posing such risks, as the Corporation or the Comptroller of the Currency, respectively, may deem appropriate."; and

(iii) in paragraph (3)—

(I) in subparagraph (A), in the second sentence—

(aa) by inserting ", in the case of a Federal savings association," before "consult with"; and

(bb) by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency"; and

(II) in subparagraph (B)—

(aa) in the subparagraph heading, by striking "DIRECTOR" and inserting "COMPTROLLER OF THE CURRENCY";

(bb) by striking "Office of Thrift Supervision" and inserting "Comptroller of the Currency";

(cc) by inserting a comma after "soundness"; and

(dd) by inserting "as to Federal savings associations" after "compliance";

(8) in section 19(e) (12 U.S.C. 1829(e))—

(A) in paragraph (1), by striking "Director of the Office of Thrift Supervision" and inserting "Board of Governors of the Federal Reserve System"; and

(B) in paragraph (2), by striking "Director of the Office of Thrift Supervision" and inserting "Board of Governors of the Federal Reserve System";

(9) in section 28 (12 U.S.C. 1831e)—

(A) in subsection (e)—

(i) in paragraph (2)—

(I) in subparagraph (A)(ii), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency or the Corporation, as appropriate";

(II) in subparagraph (C), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency or the Corporation, as appropriate,"; and

(III) in subparagraph (F), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency or the Corporation, as appropriate"; and

(ii) in paragraph (3)—

(I) in subparagraph (A), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency or the Corporation, as appropriate"; and

(II) in subparagraph (B), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency or the Corporation, as appropriate,"; and

(B) in subsection (h)(2), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency, of the Corporation,"; and

(10) in section 33(e) (12 U.S.C. 1831j(e)), by striking "Federal Housing Finance Board, the Comptroller of the Currency, and the Director of the Office of Thrift Supervision" and inserting "Federal Housing Finance Agency and the Comptroller of the Currency".

SEC. 364. FEDERAL HOME LOAN BANK ACT.

(a) REPEAL OF SECTION 18(c).—Effective 90 days after the transfer date, section 18(c) of the Federal Home Loan Bank Act (12 U.S.C. 1438(c)) is repealed.

(b) REPEAL OF SECTION 21A.—Section 21A of the Federal Home Loan Bank Act (12 U.S.C. 1441a) is repealed.

SEC. 365. FEDERAL HOUSING ENTERPRISES FINANCIAL SAFETY AND SOUNDNESS ACT OF 1992.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4501 et seq.) is amended—

(1) in section 1315(b) (12 U.S.C. 4515(b)), by striking "the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision." and inserting "and the Federal Deposit Insurance Corporation."; and

(2) in section 1317(c) (12 U.S.C. 4517(c)), by striking "the Federal Deposit Insurance Corporation, or the Director of the Office of Thrift Supervision" and inserting "or the Federal Deposit Insurance Corporation".

SEC. 366. FEDERAL RESERVE ACT.

The Federal Reserve Act (12 U.S.C. 221 et seq.) is amended—

(1) in section 11(a)(2) (12 U.S.C. 248(a)(2))—

(A) by inserting "State savings associations that are insured depository institutions (as defined in section 3 of the Federal Deposit Insurance Act)," after "case of insured";

(B) by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency";

(C) by inserting "Federal" before "savings association which"; and

(D) by striking "savings and loan association" and inserting "savings association"; and

(2) in section 19(b) (12 U.S.C. 461(b))—

(A) in paragraph (1)(F), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency"; and

(B) in paragraph (4)(B), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency".

SEC. 367. FINANCIAL INSTITUTIONS REFORM, RECOVERY, AND ENFORCEMENT ACT OF 1989.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 is amended—

(1) in section 203 (12 U.S.C. 1812 note), by striking subsection (b);

(2) in section 302(1) (12 U.S.C. 1467a note), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency";

(3) in section 305(12 U.S.C. 1464 note), by striking subsection (b);

(4) in section 308 (12 U.S.C. 1463 note)—

(A) in subsection (a), by striking "Director of the Office of Thrift Supervision" and inserting "Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Chairman of the National Credit Union Administration,"; and

(B) by adding at the end the following new subsection:

"(c) REPORTS.—The Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Chairman of the National Credit Union Administration, and the Chairperson of Board of Directors of the Federal Deposit Insurance Corporation shall each submit an annual report to the Congress containing a description of actions taken to carry out this section.";

(5) in section 402 (12 U.S.C. 1437 note)—

(A) in subsection (a), by striking "Director of the Office of Thrift Supervision" and inserting "Comptroller of the Currency";

(B) by striking subsection (b);

(C) in subsection (e)—

(i) in paragraph (1), by striking "Office of Thrift Supervision" and inserting "Comptroller of the Currency"; and

(ii) in each of paragraphs (2), (3), and (4), by striking "Director of the Office of Thrift Supervision" each place that term appears and inserting "Comptroller of the Currency"; and

(D) by striking "Federal Housing Finance Board" each place that term appears and inserting "Federal Housing Finance Agency";

(6) in section 1103(a) (12 U.S.C. 3332(a)), by striking "and the Resolution Trust Corporation";

(7) in section 1205(b) (12 U.S.C. 1818 note)—

(A) in paragraph (1)—

(i) by striking subparagraph (B); and

(ii) by redesignating subparagraphs (C) through (F) as subparagraphs (B) through (E), respectively; and

(B) in paragraph (2), by striking "paragraph (1)(F)" and inserting "paragraph (1)(E)";

(8) in section 1206 (12 U.S.C. 1833b)—

(A) by striking "Board, the Oversight Board of the Resolution Trust Corporation" and inserting "Agency, and"; and

(B) by striking ", and the Office of Thrift Supervision";

(9) in section 1216 (12 U.S.C. 1833e)—

(A) in subsection (a)—

(i) in paragraph (3), by adding "and" at the end;

(ii) in paragraph (4), by striking the semicolon at the end and inserting a period;

(iii) by striking paragraphs (2), (5), and (6); and

(iv) by redesignating paragraphs (3) and (4), as paragraphs (2) and (3), respectively;

(B) in subsection (c)—

(i) by striking "the Director of the Office of Thrift Supervision," and inserting "and"; and

(ii) by striking "the Thrift Depositor Protection Oversight Board of the Resolution Trust Corporation, and the Resolution Trust Corporation"; and

(C) in subsection (d)—

(i) by striking paragraphs (3), (5), and (6); and

(ii) by redesignating paragraphs (4), (7), and (8) as paragraphs (3), (4), and (5), respectively.

SEC. 368. FLOOD DISASTER PROTECTION ACT OF 1973.

Section 3(a)(5) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4003(a)(5)) is amended by striking ", the Office of Thrift Supervision".

SEC. 369. HOME OWNERS' LOAN ACT.

The Home Owners' Loan Act (12 U.S.C. 1461 et seq.) is amended—

(1) in section 1 (12 U.S.C. 1461), by striking the table of contents;

(2) in section 2 (12 U.S.C. 1462), as amended by this Act—

(A) by striking paragraphs (1) and (3);

(B) by redesignating paragraph (2) as paragraph (1);

(C) by redesignating paragraphs (4) through (9) as paragraphs (2) through (7), respectively; and

(D) by adding at the end the following:

"(8) BOARD.—The term 'Board', other than in the context of the Board of Directors of the Corporation, means the Board of Governors of the Federal Reserve System.

"(9) COMPTROLLER.—The term 'Comptroller' means the Comptroller of the Currency.";

(3) in section 3 (12 U.S.C. 1462a)—

(A) by striking the section heading and inserting the following:

"SEC. 3. ADMINISTRATIVE PROVISIONS.";

(B) by striking subsections (a), (b), (c), (d), (g), (h), (i), and (j);

(C) by redesignating subsections (e) and (f) as subsections (a) and (b), respectively;

(D) in subsection (a), as so redesignated—

(i) in the heading by striking "OF THE DIRECTOR"; and

(ii) in the matter preceding paragraph (1), by striking "The Director" and inserting "In accordance with subtitle A of title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the appropriate Federal banking agency"; and

(E) in subsection (b), as so redesignated, by striking "Director" and inserting "appropriate Federal banking agency";

(4) in section 4 (12 U.S.C. 1463)—

(A) in subsection (a)—

(i) in the subsection heading, by striking "FEDERAL";

(ii) by striking paragraphs (1) and (2) and inserting the following:

"(1) EXAMINATION AND SAFE AND SOUND OPERATION.—

"(A) FEDERAL SAVINGS ASSOCIATIONS.—The Comptroller shall provide for the examination and safe and sound operation of Federal savings associations.

"(B) STATE SAVINGS ASSOCIATIONS.—The Corporation shall provide for the examination and safe and sound operation of State savings associations.

"(2) REGULATIONS FOR SAVINGS ASSOCIATIONS.—The Comptroller may prescribe regulations with respect to savings associations, as the Comptroller determines to be appropriate to carry out the purposes of this Act."; and

(iii) in paragraph (3), by striking "Director" each place that term appears and inserting "Comptroller and the Corporation";

(B) in subsection (b)—

(i) in paragraph (2)—

(I) in subparagraph (A), by adding "and" at the end;

(II) in subparagraph (B), by striking "; and" and inserting a period; and

(III) by striking subparagraph (C); and

(ii) by striking "Director" each place that term appears and inserting "Comptroller";

(C) in subsection (c)—

(i) by striking "All regulations and policies of the Director" and inserting "The regulations of the Comptroller and the policies of the Comptroller and the Corporation"; and

(ii) by striking "of the Currency";

(D) in subsection (e)(5), by striking "Director" and inserting "Comptroller";

(E) in subsection (f), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency"; and

(F) in subsection (h), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(5) in section 5 (12 U.S.C. 1464)—

(A) in subsection (a), by striking "Director", each place such term appears and inserting "Comptroller of the Currency";

(B) in subsection (b), by striking "Director", each place such term appears and inserting "Comptroller of the Currency";

(C) in subsection (c)—

(i) in paragraph (5)—

(I) in subparagraph (A), by striking "Director" and inserting "appropriate Federal banking agency"; and

(II) in subparagraph (B)—

(aa) by striking "The Director" and inserting "The appropriate Federal banking agency"; and

(bb) by striking "the Director" and inserting "the appropriate Federal banking agency";

(D) in subsection (d)—

(i) in paragraph (1)—

(I) in subparagraph (A)—

(aa) in the first sentence, by striking "Director" and inserting "appropriate Federal banking agency";

(bb) in the second sentence—

(AA) by striking "Director's own name and through the Director's own attorneys" and inserting "name of the appropriate Federal banking agency and through the attorneys of the appropriate Federal banking agency"; and

(BB) by striking "Director" each place that term appears and inserting "appropriate Federal banking agency"; and

(cc) in the third sentence, by striking "Director" each place that term appears and inserting "Comptroller";

(II) in subparagraph (B)—

(aa) in clauses (i) through (iv), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(III) in clause (v)—

(aa) in the matter preceding subclause (I), by striking "Director" and inserting "appropriate Federal banking agency";

(bb) in subclause (II), by striking "subpenas" and inserting "subpoenas"; and

(cc) in the matter following subclause (II), by striking "subpena" and inserting "subpoena";

(IV) in clause (vi)—

(aa) in the first sentence, by striking "Director" and inserting "appropriate Federal banking agency"; and

(bb) in the second sentence, by striking "Director" and inserting "Comptroller";

(V) in clause (vii)—

(aa) in the first sentence, by striking "subpena" and inserting "subpoena";

(bb) in the second sentence, by striking "subpenaed" and inserting "subpoenaed"; and

(cc) in the third sentence, by striking "Director" and inserting "appropriate Federal banking agency";

(ii) in paragraph (2)—

(I) in subparagraph (A)—

(aa) by striking "Director of the Office of Thrift Supervision" and inserting "appropriate Federal banking agency";

(bb) by striking "any insured savings association" and inserting "an insured savings association"; and

(cc) by striking "Director determines, in the Director's discretion" and inserting "appropriate Federal banking agency determines, in the discretion of the appropriate Federal banking agency";

(II) in subparagraph (B), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(III) in subparagraphs (C) and (D), by striking "Director" and inserting "appropriate Federal banking agency";

(IV) in subparagraph (E)—

(aa) in clause (ii)—

(AA) in the clause heading, by striking "OR RTC"; and

(BB) by striking "or the Resolution Trust Corporation, as appropriate," each place that term appears; and

(bb) by striking "Director" each place that term appears and inserting "appropriate Federal banking agency"; and

(iii) in paragraph (3)—

(I) in subparagraph (A), by striking "Director" each place that term appears and inserting "Comptroller"; and

(II) in subparagraph (B)—

(aa) in the subparagraph heading, by striking "OR RTC";

(bb) by striking "Corporation or the Resolution Trust"; and

(cc) by striking "Director" and inserting "Comptroller";

(iv) in paragraph (4), by striking "Director" and inserting "appropriate Federal banking agency";

(v) in paragraph (6)—

(I) in subparagraph (A), by striking "Director" and inserting "Comptroller"; and

(II) in subparagraphs (B) and (C), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(vi) in paragraph (7)—

(I) in subparagraphs (A), (B), and (D), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(II) in subparagraph (C), by striking "Director" and inserting "Federal Deposit Insurance Corporation or the Comptroller, as appropriate,"; and

(III) by striking subparagraph (E) and inserting the following:

"(E) ADMINISTRATION BY THE COMPTROLLER AND THE CORPORATION.—The Comptroller may issue such regulations, and the appropriate Federal banking agency may issue such orders, including those issued pursuant to section 8 of the Federal Deposit Insurance Act, as may be necessary to administer and carry out this paragraph and to prevent evasion of this paragraph.";

(E) in subsection (e)(2), strike "Director" and insert "Comptroller";

(F) in subsection (i)—

(i) by striking "Director", each place such term appears, and inserting "Comptroller";

(ii) in paragraph (2), in the heading, by striking "DIRECTOR" and inserting "COMPTROLLER";

(iii) in paragraph (5)(A), by striking "of the Currency"; and

(iv) except as provided in clauses (i) through (iii), by striking "Director" each place such term appears and inserting "Comptroller";

(G) in subsection (o)—

(i) in paragraph (1), by striking "Director" and inserting "Comptroller"; and

(ii) in paragraph (2)(B), by striking "Director's determination" and inserting "determination of the Comptroller";

(H) in subsections (m), (n), (o), and (p), by striking "Director", each place such term appears, and inserting "Comptroller";

(I) in subsection (q)—

(i) in paragraph (6), by striking "of Governors of the Federal Reserve System";

(ii) by striking "Director" each place that term appears and inserting "Board"; and

(iii) by inserting "in consultation with the Comptroller and the Corporation," before "considers";

(J) in subsection (r)(3), by striking "Director" and inserting "Comptroller of the Currency";

(K) in subsection (s)—

(i) in paragraph (1), strike "Director" and insert "Comptroller of the Currency";

(ii) in paragraph (2), strike "Director" and insert "Comptroller of the Currency";

(iii) in paragraph (3), by striking "Director's discretion, the Director" and inserting "discretion of the appropriate Federal banking agency, the appropriate Federal banking agency,";

(iv) in paragraph (4), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency"; and

(v) in paragraph (5)—

(I) by striking "Director", each place such term appears, and inserting "appropriate Federal banking agency"; and

(II) by striking "Director's approval" and inserting "approval of the appropriate Federal banking agency";

(L) in subsection (t)—

(i) in paragraph (1), by striking subparagraph (D);

(ii) by striking paragraph (3) and inserting the following:

"(3) [Repealed].";

(iii) in paragraph (5)—

(I) in subparagraph (B), by striking "Corporation, in its sole discretion" and inserting "appropriate Federal banking agency, in the sole discretion of the appropriate Federal banking agency"; and

(II) by striking subparagraph (D);

(iv) in paragraph (6)—

(I) by striking subparagraph (A) and inserting the following:

"(A) [Reserved].";

(II) in subparagraph (B), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(III) in subparagraph (C)—

(aa) in clause (i), by striking "Director's prior approval" and inserting "prior approval of the appropriate Federal banking agency";

(bb) in clause (ii), by striking "Director's discretion" and inserting "discretion of the appropriate Federal banking agency"; and

(cc) by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(IV) in subparagraph (E), by striking "Director shall" and inserting "appropriate Federal banking agency may"; and

(V) in subparagraph (F), by striking "Director" and all that follows through the end of the subparagraph and inserting "appropriate Federal banking agency under this Act or any other provision of law.";

(v) in paragraph (7), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(vi) by striking paragraph (8) and inserting the following:

"(8) [Repealed].";

(vii) in paragraph (9)—

(I) in subparagraph (A), by striking "Director" and inserting "Comptroller";

(II) in subparagraph (C), by striking "of the Currency"; and

(III) by striking subparagraph (B) and redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively; and

(viii) except as provided in clauses (i) through (vii), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(M) in subsection (u), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(N) in subsection (v)—

(i) in paragraph (2), by striking "Director's determinations" and inserting "determinations of the appropriate Federal banking agency"; and

(ii) by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(O) in subsection (w)(1)—

(i) in subparagraph (A)(II), by striking "Director's intention" and inserting "intention of the Comptroller"; and

(ii) in subparagraph (B), by striking "Director's intention" and inserting "intention of the Comptroller"; and

(P) except as provided in subparagraphs (A) through (J), by striking "Director" each place that term appears and inserting "Comptroller";

(6) in section 8 (12 U.S.C. 1466a), by striking "Director" each place that term appears and inserting "Comptroller";

(7) in section 9 (12 U.S.C. 1467)—

(A) in subsection (a), by striking "assessed by the Director" and all that follows through the end of the subsection and inserting the following: "assessed by—

"(1) the Comptroller, against each such Federal savings association, as the Comptroller deems necessary or appropriate; and

"(2) the Corporation, against each such State savings association, as the Corporation deems necessary or appropriate.";

(B) in subsection (b), by striking "Director", each place such term appears, and inserting "Comptroller or Corporation, as appropriate";

(C) in subsection (e)—

(i) by striking "Only the Director" and inserting "The Comptroller"; and

(ii) by striking "Director's designee" and inserting "designee of the Comptroller";

(D) by striking subsection (f) and inserting the following:

"(f) [Reserved].";

(E) in subsection (g)—

(i) in paragraph (1), by striking "Director" and inserting "appropriate Federal banking agency"; and

(ii) in paragraph (2), by striking "Director, or the Corporation, as the case may be," and inserting "appropriate Federal banking agency for the savings association";

(F) in subsection (i), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(G) in subsection (j), by striking "Director's sole discretion" and inserting "sole discretion of the appropriate Federal banking agency";

(H) in subsection (k), by striking "Director may assess against institutions for which the Director is the appropriate Federal banking agency, as defined in section 3 of the Federal Deposit Insurance Act," and inserting "appropriate Federal banking agency may assess against an institution"; and

(I) except as provided in subparagraphs (A) through (G), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(8) in section 10 (12 U.S.C. 1467a)—

(A) in subsection (a)(1), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(B) in subsection (b)—

(i) in paragraph (2), by striking "and the regional office of the Director of the district in which its principal office is located,"; and

(ii) in paragraph (6), by striking "Director's own motion or application" and inserting "motion or application of the Board";

(C) in subsection (c)—

(i) in paragraph (2)(F), by striking "of Governors of the Federal Reserve System";

(ii) in paragraph (4)(B), in the subparagraph heading, by striking "BY DIRECTOR";

(iii) in paragraph (6)(D), in the subparagraph heading, by striking "BY DIRECTOR"; and

(iv) in paragraph (9)(E), by inserting "(in consultation with the appropriate Federal banking agency)" after "including a determination";

(D) in subsection (g)(5)(B), by striking "the Director's discretion" and inserting "the discretion of the Board";

(E) in subsection (l), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(F) in subsection (m), by striking "Director" and inserting "appropriate Federal banking agency";

(G) in subsection (p)—

(i) in paragraph (1)—

(I) by striking "Director determines" the 1st place such term appears and inserting "Board or the appropriate Federal banking agency for the savings association determines";

(II) by striking "Director may" and inserting "Board may"; and

(III) by striking "Director determines" the 2nd place such term appears and inserting "Board, in consultation with the appropriate Federal banking agency for the savings association determines"; and

(ii) in paragraph (2), by striking "Director", each place such term appears, and inserting "Board";

(H) in subsection (q), by striking "Director", each place such term appears, and inserting "Board";

(I) in subsection (r), by striking "Director", each place such term appears, and inserting "Board or appropriate Federal banking agency";

(J) in subsection (s)—

(i) in paragraph (2)—

(I) in subparagraph (B)(ii), by striking "Director's judgment" and inserting "judgment of the appropriate Federal banking agency for the savings association"; and

(II) by striking "Director" each place that term appears and inserting "appropriate Federal banking agency for the savings association"; and

(ii) in paragraph (4), by striking "Director" and inserting "Comptroller"; and

(K) except as provided in subparagraphs (A) through (J), by striking "Director" each place that term appears and inserting "Board";

(9) in section 11 (12 U.S.C. 1468), by striking "Director" each place that term appears and inserting "appropriate Federal banking agency";

(10) in section 12 (12 U.S.C. 1468a), by striking "the Director" and inserting "a Federal banking agency"; and

(11) in section 13 (12 U.S.C. 1468a) is amended by striking "Director" and inserting "a Federal banking agency".

SEC. 370. HOUSING ACT OF 1948.

Section 502(c) of the Housing Act of 1948 (12 U.S.C. 1701c(c)) is amended—

(1) in the matter preceding paragraph (1), by striking "and the Director of the Office of Thrift Supervision" and inserting ", the Comptroller of the Currency, and the Federal Deposit Insurance Corporation"; and

(2) in paragraph (3), by striking "Board" and inserting "Agency".

SEC. 371. HOUSING AND COMMUNITY DEVELOPMENT ACT OF 1992.

Section 543 of the Housing and Community Development Act of 1992 (Public Law 102–550; 106 Stat. 3798) is amended—

(1) in subsection (c)(1)—

(A) by striking subparagraphs (D) through (F); and

(B) by redesignating subparagraphs (G) and (H) as subparagraphs (D) and (E), respectively; and

(2) in subsection (f)—

(A) in paragraph (2), by striking "the Office of Thrift Supervision," each place that term appears; and

(B) in paragraph (3)—

(i) in the matter preceding subparagraph (A), by striking "the Office of Thrift Supervision,"; and

(ii) in subparagraph (D), by striking "Office of Thrift Supervision,".

SEC. 372. HOUSING AND URBAN-RURAL RECOVERY ACT OF 1983.

Section 469 of the Housing and Urban-Rural Recovery Act of 1983 (12 U.S.C. 1701p–1) is amended in the first sentence, by striking "Federal Home Loan Bank Board" and inserting "Federal Housing Finance Agency".

SEC. 373. NATIONAL HOUSING ACT.

Section 202(f) of the National Housing Act (12 U.S.C. 1708(f)) is amended—

(1) by striking paragraph (5) and inserting the following:

"(5) if the mortgagee is a national bank, a subsidiary or affiliate of such bank, a Federal savings association or a subsidiary or affiliate of a savings association, the Comptroller of the Currency;";

(2) in paragraph (6), by adding "and" at the end;

(3) in paragraph (7)—

(A) by inserting "or State savings association" after "State bank"; and

(B) by striking "; and" and inserting a period; and

(4) by striking paragraph (8).

SEC. 374. NEIGHBORHOOD REINVESTMENT CORPORATION ACT.

Section 606(c)(3) of the Neighborhood Reinvestment Corporation Act (42 U.S.C. 8105(c)(3)) is amended by striking "Federal Home Loan Bank Board" and inserting "Federal Housing Finance Agency".

SEC. 375. PUBLIC LAW 93–100.

Section 5(d) of Public Law 93–100 (12 U.S.C. 1470(a)) is amended—

(1) in paragraph (1), by striking "Federal Savings and Loan Insurance Corporation with respect to insured institutions, the Board of Governors of the Federal Reserve System with respect to State member insured banks, and the Federal Deposit Insurance Corporation with respect to State nonmember insured banks" and inserting "appropriate Federal banking agency, with respect to the institutions subject to the jurisdiction of each such agency,"; and

(2) in paragraph (2), by striking "supervisory" and inserting "banking".

SEC. 376. SECURITIES EXCHANGE ACT OF 1934.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 3(a)(34) (15 U.S.C. 78c(a)(34))—

(A) in subparagraph (A)—

(i) in clause (i), by striking "or a subsidiary or a department or division of any such bank" and inserting "a subsidiary or a department or division of any such bank, a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary or department or division of any such Federal savings association";

(ii) in clause (ii), by striking "or a subsidiary or a department or division of such subsidiary" and inserting "a subsidiary or a department or division of such subsidiary, or a savings and loan holding company";

(iii) in clause (iii), by striking "or a subsidiary or department or division thereof;" and inserting "a subsidiary or department or division of any such bank, a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary or a department or division of any such State savings association; and";

(iv) by striking clause (iv); and

(v) by redesignating clause (v) as clause (iv);

(B) in subparagraph (B)—

(i) in clause (i), by striking "or a subsidiary of any such bank" and inserting "a subsidiary of any such bank, a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary of any such Federal savings association";

(ii) in clause (ii), by striking "or a subsidiary of a bank holding company which is a bank other than a bank specified in clause (i), (iii), or (iv) of this subparagraph" and inserting "a subsidiary of a bank holding company that is a bank other than a bank specified in clause (i) or (iii) of this subparagraph, or a savings and loan holding company";

(iii) in clause (iii), by striking "or a subsidiary thereof;" and inserting "a subsidiary of any such bank, a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary of any such State savings association; and";

(iv) by striking clause (iv); and

(v) by redesignating clause (v) as clause (iv);

(C) in subparagraph (C)—

(i) in clause (i), by striking "bank" and inserting "bank or a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(ii) in clause (ii), by striking "or a subsidiary of a bank holding company which is a bank other than a bank specified in clause (i), (iii), or (iv) of this subparagraph" and inserting "a subsidiary of a bank holding company that is a bank other than a bank specified in clause (i) or (iii) of this subparagraph, or a savings and loan holding company";

(iii) in clause (iii), by striking "System)" and inserting, "System) or a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation; and";

(iv) by striking clause (iv); and

(v) by redesignating clause (v) as clause (iv);

(D) in subparagraph (D)—

(i) in clause (i), by inserting after "bank" the following: "or a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(ii) in clause (ii), by adding "and" at the end;

(iii) by striking clause (iii);

(iv) by redesignating clause (iv) as clause (iii); and

(v) in clause (iii), as so redesignated, by inserting after "bank" the following: "or a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(E) in subparagraph (F)—

(i) in clause (i), by inserting after "bank" the following: "or a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(ii) by striking clause (ii);

(iii) by redesignating clauses (iii), (iv), and (v) as clauses (ii), (iii), and (iv), respectively; and

(iv) in clause (iii), as so redesignated, by inserting before the semicolon the following: "or a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(F) in subparagraph (G)—

(i) in clause (i), by inserting after "national bank" the following: ", a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act), the deposits of which are insured by the Federal Deposit Insurance Corporation,";

(ii) in clause (iii)—

(I) by inserting after "bank)" the following: ", a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act), the deposits of which are insured by the Federal Deposit Insurance Corporation,"; and

(II) by adding "and" at the end;

(iii) by striking clause (iv); and

(iv) by redesignating clause (v) as clause (iv); and

(G) in the undesignated matter following subparagraph (H), by striking ", and the term 'District of Columbia savings and loan association' means any association subject to examination and supervision by the Office of Thrift Supervision under section 8 of the Home Owners' Loan Act of 1933";

(2) in section 12(i) (15 U.S.C. 78l(i))—

(A) in paragraph (1), by inserting after "national banks" the following: "and Federal savings associations, the accounts of which are insured by the Federal Deposit Insurance Corporation";

(B) by striking "(3)" and all that follows through "vested in the Office of Thrift Supervision" and inserting "and (3) with respect to all other insured banks and State savings associations, the accounts of which are insured by the Federal Deposit Insurance Corporation, are vested in the Federal Deposit Insurance Corporation"; and

(C) in the second sentence, by striking "the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision" and inserting "and the Federal Deposit Insurance Corporation";

(3) in section 15C(g)(1) (15 U.S.C. 78o–5(g)(1)), by striking "the Director of the Office of Thrift Supervision, the Federal Savings and Loan Insurance Corporation,"; and

(4) in section 23(b)(1) (15 U.S.C. 78w(b)(1)), by striking ", other than the Office of Thrift Supervision,".

SEC. 377. TITLE 18, UNITED STATES CODE.

Title 18, United States Code, is amended—

(1) in section 212(c)(2)—

(A) by striking subparagraph (C); and

(B) by redesignating subparagraphs (D) through (H) as subparagraphs (C) through (G), respectively;

(2) in section 657, by striking "Office of Thrift Supervision, the Resolution Trust Corporation,";

(3) in section 981(a)(1)(D)—

(A) by striking "Resolution Trust Corporation,"; and

(B) by striking "or the Office of Thrift Supervision";

(4) in section 982(a)(3)—

(A) by striking "Resolution Trust Corporation,"; and

(B) by striking "or the Office of Thrift Supervision";

(5) in section 1006—

(A) by striking "Office of Thrift Supervision,"; and

(B) by striking "the Resolution Trust Corporation,";

(6) in section 1014—

(A) by striking "the Office of Thrift Supervision"; and

(B) by striking "the Resolution Trust Corporation,"; and

(7) in section 1032(1)—

(A) by striking "the Resolution Trust Corporation,"; and

(B) by striking "or the Director of the Office of Thrift Supervision".

SEC. 378. TITLE 31, UNITED STATES CODE.

Title 31, United States Code, is amended—

(1) in section 321—

(A) in subsection (c)—

(i) in paragraph (1), by adding "and" at the end;

(ii) in paragraph (2), by striking "; and" and inserting a period; and

(iii) by striking paragraph (3); and

(B) by striking subsection (e); and

(2) in section 714(a), by striking "the Office of the Comptroller of the Currency, and the Office of Thrift Supervision." and inserting "and the Office of the Comptroller of the Currency.".

TITLE IV—REGULATION OF ADVISERS TO HEDGE FUNDS AND OTHERS

SEC. 401. SHORT TITLE.

This title may be cited as the "Private Fund Investment Advisers Registration Act of 2010".

SEC. 402. DEFINITIONS.

(a) INVESTMENT ADVISERS ACT OF 1940 DEFINITIONS.—Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)) is amended by adding at the end the following:

"(29) The term 'private fund' means an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3), but for section 3(c)(1) or 3(c)(7) of that Act.

"(30) The term 'foreign private adviser' means any investment adviser who—

"(A) has no place of business in the United States;

"(B) has, in total, fewer than 15 clients and investors in the United States in private funds advised by the investment adviser;

"(C) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25,000,000, or such higher amount as the Commission may, by rule, deem appropriate in accordance with the purposes of this title; and

"(D) neither—

"(i) holds itself out generally to the public in the United States as an investment adviser; nor

"(ii) acts as—

"(I) an investment adviser to any investment company registered under the Investment Company Act of 1940; or

"(II) a company that has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940 (15 U.S.C. 80a–53), and has not withdrawn its election.".

(b) OTHER DEFINITIONS.—As used in this title, the terms "investment adviser" and "private fund" have the same meanings as in section 202 of the Investment Advisers Act of 1940, as amended by this title.

SEC. 403. ELIMINATION OF PRIVATE ADVISER EXEMPTION; LIMITED EXEMPTION FOR FOREIGN PRIVATE ADVISERS; LIMITED INTRASTATE EXEMPTION.

Section 203(b) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(b)) is amended—

(1) in paragraph (1), by inserting ", other than an investment adviser who acts as an investment adviser to any private fund," before "all of whose";

(2) by striking paragraph (3) and inserting the following:

"(3) any investment adviser that is a foreign private adviser;"; and

(3) in paragraph (5), by striking "or" at the end;

(4) in paragraph (6)—

(A) by striking "any investment adviser" and inserting "(A) any investment adviser";

(B) by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively; and

(C) in clause (ii) (as so redesignated), by striking the period at the end and inserting "; or"; and

(D) by adding at the end the following:

"(B) any investment adviser that is registered with the Commodity Futures Trading Commission as a commodity trading advisor and advises a private fund, provided that, if after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, the business of the advisor should become predominately the provision of securities-related advice, then such adviser shall register with the Commission.".

(5) by adding at the end the following:

"(7) any investment adviser, other than any entity that has elected to be regulated or is regulated as a business development company pursuant to section 54 of the Investment Company Act of 1940 (15 U.S.C. 80a–54), who solely advises—

"(A) small business investment companies that are licensees under the Small Business Investment Act of 1958;

"(B) entities that have received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company under the Small Business Investment Act of 1958, which notice or license has not been revoked; or

"(C) applicants that are affiliated with 1 or more licensed small business investment companies described in subparagraph (A) and that have applied for another license under the Small Business Investment Act of 1958, which application remains pending.".

SEC. 404. COLLECTION OF SYSTEMIC RISK DATA; REPORTS; EXAMINATIONS; DISCLOSURES.

Section 204 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–4) is amended—

(1) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively; and

(2) by inserting after subsection (a) the following:

"(b) RECORDS AND REPORTS OF PRIVATE FUNDS.—

"(1) IN GENERAL.—The Commission may require any investment adviser registered under this title—

"(A) to maintain such records of, and file with the Commission such reports regarding, private funds advised by the investment adviser, as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Financial Stability Oversight Council (in this subsection referred to as the 'Council'); and

"(B) to provide or make available to the Council those reports or records or the information contained therein.

"(2) TREATMENT OF RECORDS.—The records and reports of any private fund to which an investment adviser registered under this title provides investment advice shall be deemed to be the records and reports of the investment adviser.

"(3) REQUIRED INFORMATION.—The records and reports required to be maintained by an investment adviser and subject to inspection by the Commission under this subsection shall include, for each private fund advised by the investment adviser, a description of—

"(A) the amount of assets under management and use of leverage, including off-balance-sheet leverage;

"(B) counterparty credit risk exposure;

"(C) trading and investment positions;

"(D) valuation policies and practices of the fund;

"(E) types of assets held;

"(F) side arrangements or side letters, whereby certain investors in a fund obtain more favorable rights or entitlements than other investors;

"(G) trading practices; and

"(H) such other information as the Commission, in consultation with the Council, determines is necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk, which may include the establishment of different reporting requirements for different classes of fund advisers, based on the type or size of private fund being advised.

"(4) MAINTENANCE OF RECORDS.—An investment adviser registered under this title shall maintain such records of private funds advised by the investment adviser for such period or periods as the Commission, by rule, may prescribe as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk.

"(5) FILING OF RECORDS.—The Commission shall issue rules requiring each investment adviser to a private fund to file reports containing such information as the Commission deems necessary and appropriate in the public interest and for the protection of investors or for the assessment of systemic risk.

"(6) EXAMINATION OF RECORDS.—

"(A) PERIODIC AND SPECIAL EXAMINATIONS.—The Commission—

"(i) shall conduct periodic inspections of the records of private funds maintained by an investment adviser registered under this title in accordance with a schedule established by the Commission; and

"(ii) may conduct at any time and from time to time such additional, special, and other examinations as the Commission may prescribe as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk.

"(B) AVAILABILITY OF RECORDS.—An investment adviser registered under this title shall make available to the Commission any copies or extracts from such records as may be prepared without undue effort, expense, or delay, as the Commission or its representatives may reasonably request.

"(7) INFORMATION SHARING.—

"(A) IN GENERAL.—The Commission shall make available to the Council copies of all reports, documents, records, and information filed with or provided to the Commission by an investment adviser under this subsection as the Council may consider necessary for the purpose of assessing the systemic risk posed by a private fund.

"(B) CONFIDENTIALITY.—The Council shall maintain the confidentiality of information received under this paragraph in all such reports, documents, records, and information, in a manner consistent with the level of confidentiality established for the Commission pursuant to paragraph (8). The Council shall be exempt from section 552 of title 5, United States Code, with respect to any information in any report, document, record, or information made available, to the Council under this subsection.".

"(8) COMMISSION CONFIDENTIALITY OF REPORTS.—Notwithstanding any other provision of law, the Commission may not be compelled to disclose any report or information contained therein required to be filed with the Commission under this subsection, except that nothing in this subsection authorizes the Commission—

"(A) to withhold information from Congress, upon an agreement of confidentiality; or

"(B) prevent the Commission from complying with—

"(i) a request for information from any other Federal department or agency or any self-regulatory organization requesting the report or information for purposes within the scope of its jurisdiction; or

"(ii) an order of a court of the United States in an action brought by the United States or the Commission.

"(9) OTHER RECIPIENTS CONFIDENTIALITY.—Any department, agency, or self-regulatory organization that receives reports or information from the Commission under this subsection shall maintain the confidentiality of such reports, documents, records, and information in a manner consistent with the level of confidentiality established for the Commission under paragraph (8).

"(10) PUBLIC INFORMATION EXCEPTION.—

"(A) IN GENERAL.—The Commission, the Council, and any other department, agency, or self-regulatory organization that receives information, reports, documents, records, or information from the Commission under this subsection, shall be exempt from the provisions of section 552 of title 5, United States Code, with respect to any such report, document, record, or information. Any proprietary information of an investment adviser ascertained by the Commission from any report required to be filed with the Commission pursuant to this subsection shall be subject to the same limitations on public disclosure as any facts ascertained during an examination, as provided by section 210(b) of this title.

"(B) PROPRIETARY INFORMATION.—For purposes of this paragraph, proprietary information includes sensitive, nonpublic information regarding—

"(i) the investment or trading strategies of the investment adviser;

"(ii) analytical or research methodologies;

"(iii) trading data;

"(iv) computer hardware or software containing intellectual property; and

"(v) any additional information that the Commission determines to be proprietary.

"(11) ANNUAL REPORT TO CONGRESS.—The Commission shall report annually to Congress on how the Commission has used the data collected pursuant to this subsection to monitor the markets for the protection of investors and the integrity of the markets.".

SEC. 405. DISCLOSURE PROVISION AMENDMENT.

Section 210(c) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–10(c)) is amended by inserting before the period at the end the following: "or for purposes of assessment of potential systemic risk".

SEC. 406. CLARIFICATION OF RULEMAKING AUTHORITY.

Section 211 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–11) is amended—

(1) in subsection (a), by inserting before the period at the end of the first sentence the following: ", including rules and regulations defining technical, trade, and other terms used in this title, except that the Commission may not define the term 'client' for purposes of paragraphs (1) and (2) of section 206 to include an investor in a private fund managed by an investment adviser, if such private fund has entered into an advisory contract with such adviser"; and

(2) by adding at the end the following:

"(e) DISCLOSURE RULES ON PRIVATE FUNDS.—The Commission and the Commodity Futures Trading Commission shall, after consultation with the Council but not later than 12 months after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, jointly promulgate rules to establish the form and content of the reports required to be filed with the Commission under subsection 204(b) and with the Commodity Futures Trading Commission by investment advisers that are registered both under this title and the Commodity Exchange Act (7 U.S.C. 1a et seq.).".

SEC. 407. EXEMPTION OF AND REPORTING BY VENTURE CAPITAL FUND ADVISERS.

Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3) is amended by adding at the end the following:

"(l) EXEMPTION OF VENTURE CAPITAL FUND ADVISERS.—No investment adviser that acts as an investment adviser solely to 1 or more venture capital funds shall be subject to the registration requirements of this title with respect to the provision of investment advice relating to a venture capital fund. Not later than 1 year after the date of enactment of this subsection, the Commission shall issue final rules to define the term 'venture capital fund' for purposes of this subsection. The Commission shall require such advisers to maintain such records and provide to the Commission such annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors.".

SEC. 408. EXEMPTION OF AND REPORTING BY CERTAIN PRIVATE FUND ADVISERS.

Section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3) is amended by adding at the end the following:

"(m) EXEMPTION OF AND REPORTING BY CERTAIN PRIVATE FUND ADVISERS.—

"(1) IN GENERAL.—The Commission shall provide an exemption from the registration requirements under this section to any investment adviser of private funds, if each of such investment adviser acts solely as an adviser to private funds and has assets under management in the United States of less than $150,000,000.

"(2) REPORTING.—The Commission shall require investment advisers exempted by reason of this subsection to maintain such records and provide to the Commission such annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors.

"(n) REGISTRATION AND EXAMINATION OF MID-SIZED PRIVATE FUND ADVISERS.—In prescribing regulations to carry out the requirements of this section with respect to investment advisers acting as investment advisers to mid-sized private funds, the Commission shall take into account the size, governance, and investment strategy of such funds to determine whether they pose systemic risk, and shall provide for registration and examination procedures with respect to the investment advisers of such funds which reflect the level of systemic risk posed by such funds.".

SEC. 409. FAMILY OFFICES.

(a) IN GENERAL.—Section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(11)) is amended by striking "or (G)" and inserting the following: "; (G) any family office, as defined by rule, regulation, or order of the Commission, in accordance with the purposes of this title; or (H)".

(b) RULEMAKING.—The rules, regulations, or orders issued by the Commission pursuant to section 202(a)(11)(G) of the Investment Advisers Act of 1940, as added by this section, regarding the definition of the term "family office" shall provide for an exemption that—

(1) is consistent with the previous exemptive policy of the Commission, as reflected in exemptive orders for family offices in effect on the date of enactment of this Act, and the grandfathering provisions in paragraph (3);

(2) recognizes the range of organizational, management, and employment structures and arrangements employed by family offices; and

(3) does not exclude any person who was not registered or required to be registered under the Investment Advisers Act of 1940 on January 1, 2010 from the definition of the term "family office", solely because such person provides investment advice to, and was engaged before January 1, 2010 in providing investment advice to—

(A) natural persons who, at the time of their applicable investment, are officers, directors, or employees of the family office who—

(i) have invested with the family office before January 1, 2010; and

(ii) are accredited investors, as defined in Regulation D of the Commission (or any successor thereto) under the Securities Act of 1933, or, as the Commission may prescribe by rule, the successors-in-interest thereto;

(B) any company owned exclusively and controlled by members of the family of the family office, or as the Commission may prescribe by rule;

(C) any investment adviser registered under the Investment Adviser Act of 1940 that provides investment advice to the family office and who identifies investment opportunities to the family office, and invests in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office, and whose assets as to which the family office directly or indirectly provides investment advice represent, in the aggregate, not more than 5 percent of the value of the total assets as to which the family office provides investment advice.

(c) ANTIFRAUD AUTHORITY.—A family office that would not be a family office, but for subsection (b)(3), shall be deemed to be an investment adviser for the purposes of paragraphs (1), (2) and (4) of section 206 of the Investment Advisers Act of 1940.

SEC. 410. STATE AND FEDERAL RESPONSIBILITIES; ASSET THRESHOLD FOR FEDERAL REGISTRATION OF INVESTMENT ADVISERS.

Section 203A(a) of the of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3a(a)) is amended—

(1) by redesignating paragraph (2) as paragraph (3); and

(2) by inserting after paragraph (1) the following:

"(2) TREATMENT OF MID-SIZED INVESTMENT ADVISERS.—

"(A) IN GENERAL.—No investment adviser described in subparagraph (B) shall register under section 203, unless the investment adviser is an adviser to an investment company registered under the Investment Company Act of 1940, or a company which has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940, and has not withdrawn the election, except that, if by effect of this paragraph an investment adviser would be required to register with 15 or more States, then the adviser may register under section 203.

"(B) COVERED PERSONS.—An investment adviser described in this subparagraph is an investment adviser that—

"(i) is required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the State in which it maintains its principal office and place of business and, if registered, would be subject to examination as an investment adviser by any such commissioner, agency, or office; and "(ii) has assets under management between—

"(I) the amount specified under subparagraph (A) of paragraph (1), as such amount may have been adjusted by the Commission pursuant to that subparagraph; and

"(II) $100,000,000, or such higher amount as the Commission may, by rule, deem appropriate in accordance with the purposes of this title.".

SEC. 411. CUSTODY OF CLIENT ASSETS.

The Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.) is amended by adding at the end the following new section:

"SEC. 223. CUSTODY OF CLIENT ACCOUNTS.

"An investment adviser registered under this title shall take such steps to safeguard client assets over which such adviser has custody, including, without limitation, verification of such assets by an independent public accountant, as the Commission may, by rule, prescribe.".

SEC. 412. COMPTROLLER GENERAL STUDY ON CUSTODY RULE COSTS.

The Comptroller General of the United States shall—

(1) conduct a study of—

(A) the compliance costs associated with the current Securities and Exchange Commission rules 204–2 (17 C.F.R. Parts 275.204–2) and rule 206(4)–2 (17 C.F.R. 275.206(4)–2) under the Investment Advisers Act of 1940 regarding custody of funds or securities of clients by investment advisers; and

(B) the additional costs if subsection (b)(6) of rule 206(4)–2 (17 C.F.R. 275.206(4)–2(b)(6)) relating to operational independence were eliminated; and

(2) submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of such study, not later than 3 years after the date of enactment of this Act.

SEC. 413. ADJUSTING THE ACCREDITED INVESTOR STANDARD.

(a) IN GENERAL.—The Commission shall adjust any net worth standard for an accredited investor, as set forth in the rules of the Commission under the Securities Act of 1933, so that the individual net worth of any natural person, or joint net worth with the spouse of that person, at the time of purchase, is more than $1,000,000 (as such amount is adjusted periodically by rule of the Commission), excluding the value of the primary residence of such natural person, except that during the 4-year period that begins on the date of enactment of this Act, any net worth standard shall be $1,000,000, excluding the value of the primary residence of such natural person.

(b) REVIEW AND ADJUSTMENT.—

(1) INITIAL REVIEW AND ADJUSTMENT.—

(A) INITIAL REVIEW.—The Commission may undertake a review of the definition of the term "accredited investor", as such term applies to natural persons, to determine whether the requirements of the definition, excluding the requirement relating to the net worth standard described in subsection (a), should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy.

(B) ADJUSTMENT OR MODIFICATION.—Upon completion of a review under subparagraph (A), the Commission may, by notice and comment rulemaking, make such adjustments to the definition of the term "accredited investor", excluding adjusting or modifying the requirement relating to the net worth standard described in subsection (a), as such term applies to natural persons, as the Commission may deem appropriate for the protection of investors, in the public interest, and in light of the economy.

(2) SUBSEQUENT REVIEWS AND ADJUSTMENT.—

(A) SUBSEQUENT REVIEWS.—Not earlier than 4 years after the date of enactment of this Act, and not less frequently than once every 4 years thereafter, the Commission shall undertake a review of the definition, in its entirety, of the term "accredited investor", as defined in section 230.215 of title 17, Code of Federal Regulations, or any successor thereto, as such term applies to natural persons, to determine whether the requirements of the definition should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy.

(B) ADJUSTMENT OR MODIFICATION.—Upon completion of a review under subparagraph (A), the Commission may, by notice and comment rulemaking, make such adjustments to the definition of the term "accredited investor", as defined in section 230.215 of title 17, Code of Federal Regulations, or any successor thereto, as such term applies to natural persons, as the Commission may deem appropriate for the protection of investors, in the public interest, and in light of the economy.

SEC. 414. RULE OF CONSTRUCTION RELATING TO THE COMMODITIES EXCHANGE ACT.

The Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.) is further amended by adding at the end the following new section:

"SEC. 224. RULE OF CONSTRUCTION RELATING TO THE COMMODITIES EXCHANGE ACT.

"Nothing in this title shall relieve any person of any obligation or duty, or affect the availability of any right or remedy available to the Commodity Futures Trading Commission or any private party, arising under the Commodity Exchange Act (7 U.S.C. 1 et seq.) governing commodity pools, commodity pool operators, or commodity trading advisors.".

SEC. 415. GAO STUDY AND REPORT ON ACCREDITED INVESTORS.

The Comptroller General of the United States shall conduct a study on the appropriate criteria for determining the financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds, and shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of such study not later than 3 years after the date of enactment of this Act.

SEC. 416. GAO STUDY ON SELF-REGULATORY ORGANIZATION FOR PRIVATE FUNDS.

The Comptroller General of the United States shall—

(1) conduct a study of the feasibility of forming a self-regulatory organization to oversee private funds; and

(2) submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of such study, not later than 1 year after the date of enactment of this Act.

SEC. 417. COMMISSION STUDY AND REPORT ON SHORT SELLING.

(a) STUDIES.—The Division of Risk, Strategy, and Financial Innovation of the Commission shall conduct—

(1) a study, taking into account current scholarship, on the state of short selling on national securities exchanges and in the over-the-counter markets, with particular attention to the impact of recent rule changes and the incidence of—

(A) the failure to deliver shares sold short; or

(B) delivery of shares on the fourth day following the short sale transaction; and

(2) a study of—

(A) the feasibility, benefits, and costs of requiring reporting publicly, in real time short sale positions of publicly listed securities, or, in the alternative, reporting such short positions in real time only to the Commission and the Financial Industry Regulatory Authority; and

(B) the feasibility, benefits, and costs of conducting a voluntary pilot program in which public companies will agree to have all trades of their shares marked "short", "market maker short", "buy", "buy-to-cover", or "long", and reported in real time through the Consolidated Tape.

(b) REPORTS.—The Commission shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives—

(1) on the results of the study required under subsection (a)(1), including recommendations for market improvements, not later than 2 years after the date of enactment of this Act; and

(2) on the results of the study required under subsection (a)(2), not later than 1 year after the date of enactment of this Act.

SEC. 418. QUALIFIED CLIENT STANDARD.

Section 205(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–5(e)) is amended by adding at the end the following: "With respect to any factor used in any rule or regulation by the Commission in making a determination under this subsection, if the Commission uses a dollar amount test in connection with such factor, such as a net asset threshold, the Commission shall, by order, not later than 1 year after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, and every 5 years thereafter, adjust for the effects of inflation on such test. Any such adjustment that is not a multiple of $100,000 shall be rounded to the nearest multiple of $100,000.".

SEC. 419. TRANSITION PERIOD.

Except as otherwise provided in this title, this title and the amendments made by this title shall become effective 1 year after the date of enactment of this Act, except that any investment adviser may, at the discretion of the investment adviser, register with the Commission under the Investment Advisers Act of 1940 during that 1-year period, subject to the rules of the Commission.

TITLE V—INSURANCE

Subtitle A—Federal Insurance Office

SEC. 501. SHORT TITLE.

This subtitle may be cited as the "Federal Insurance Office Act of 2010".

SEC. 502. FEDERAL INSURANCE OFFICE.

(a) ESTABLISHMENT OF OFFICE.—Subchapter I of chapter 3 of subtitle I of title 31, United States Code, is amended—

(1) by redesignating section 312 as section 315;

(2) by redesignating section 313 as section 312; and

(3) by inserting after section 312 (as so redesignated) the following new sections:

"SEC. 313. FEDERAL INSURANCE OFFICE.

"(a) ESTABLISHMENT.—There is established within the Department of the Treasury the Federal Insurance Office.

"(b) LEADERSHIP.—The Office shall be headed by a Director, who shall be appointed by the Secretary of the Treasury. The position of Director shall be a career reserved position in the Senior Executive Service, as that position is defined under section 3132 of title 5, United States Code.

"(c) FUNCTIONS.—

"(1) AUTHORITY PURSUANT TO DIRECTION OF SECRETARY.—The Office, pursuant to the direction of the Secretary, shall have the authority—

"(A) to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system;

"(B) to monitor the extent to which traditionally underserved communities and consumers, minorities (as such term is defined in section 1204(c) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 1811 note)), and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health insurance;

"(C) to recommend to the Financial Stability Oversight Council that it designate an insurer, including the affiliates of such insurer, as an entity subject to regulation as a nonbank financial company supervised by the Board of Governors pursuant to title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act;

"(D) to assist the Secretary in administering the Terrorism Insurance Program established in the Department of the Treasury under the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note);

"(E) to coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors (or a successor entity) and assisting the Secretary in negotiating covered agreements (as such term is defined in subsection (r));

"(F) to determine, in accordance with subsection (f), whether State insurance measures are preempted by covered agreements;

"(G) to consult with the States (including State insurance regulators) regarding insurance matters of national importance and prudential insurance matters of international importance; and

"(H) to perform such other related duties and authorities as may be assigned to the Office by the Secretary.

"(2) ADVISORY FUNCTIONS.—The Office shall advise the Secretary on major domestic and prudential international insurance policy issues.

"(3) ADVISORY CAPACITY ON COUNCIL.—The Director shall serve in an advisory capacity on the Financial Stability Oversight Council established under the Financial Stability Act of 2010.

"(d) SCOPE.—The authority of the Office shall extend to all lines of insurance except—

"(1) health insurance, as determined by the Secretary in coordination with the Secretary of Health and Human Services based on section 2791 of the Public Health Service Act (42 U.S.C. 300gg–91);

"(2) long-term care insurance, except long-term care insurance that is included with life or annuity insurance components, as determined by the Secretary in coordination with the Secretary of Health and Human Services, and in the case of long-term care insurance that is included with such components, the Secretary shall coordinate with the Secretary of Health and Human Services in performing the functions of the Office; and

"(3) crop insurance, as established by the Federal Crop Insurance Act (7 U.S.C. 1501 et seq.).

"(e) GATHERING OF INFORMATION.—

"(1) IN GENERAL.—In carrying out the functions required under subsection (c), the Office may—

"(A) receive and collect data and information on and from the insurance industry and insurers;

"(B) enter into information-sharing agreements;

"(C) analyze and disseminate data and information; and

"(D) issue reports regarding all lines of insurance except health insurance.

"(2) COLLECTION OF INFORMATION FROM INSURERS AND AFFILIATES.—

"(A) IN GENERAL.—Except as provided in paragraph (3), the Office may require an insurer, or any affiliate of an insurer, to submit such data or information as the

Office may reasonably require in carrying out the functions described under subsection (c).

"(B) RULE OF CONSTRUCTION.—Notwithstanding any other provision of this section, for purposes of subparagraph (A), the term 'insurer' means any entity that writes insurance or reinsures risks and issues contracts or policies in 1 or more States.

"(3) EXCEPTION FOR SMALL INSURERS.—Paragraph (2) shall not apply with respect to any insurer or affiliate thereof that meets a minimum size threshold that the Office may establish, whether by order or rule.

"(4) ADVANCE COORDINATION.—Before collecting any data or information under paragraph (2) from an insurer, or affiliate of an insurer, the Office shall coordinate with each relevant Federal agency and State insurance regulator (or other relevant Federal or State regulatory agency, if any, in the case of an affiliate of an insurer) and any publicly available sources to determine if the information to be collected is available from, and may be obtained in a timely manner by, such Federal agency or State insurance regulator, individually or collectively, other regulatory agency, or publicly available sources. If the Director determines that such data or information is available, and may be obtained in a timely manner, from such an agency, regulator, regulatory agency, or source, the Director shall obtain the data or information from such agency, regulator, regulatory agency, or source. If the Director determines that such data or information is not so available, the Director may collect such data or information from an insurer (or affiliate) only if the Director complies with the requirements of subchapter I of chapter 35 of title 44, United States Code (relating to Federal information policy; commonly known as the Paperwork Reduction Act), in collecting such data or information. Notwithstanding any other provision of law, each such relevant Federal agency and State insurance regulator or other Federal or State regulatory agency is authorized to provide to the Office such data or information.

"(5) CONFIDENTIALITY.—

"(A) RETENTION OF PRIVILEGE.—The submission of any nonpublicly available data and information to the Office under this subsection shall not constitute a waiver of, or otherwise affect, any privilege arising under Federal or State law (including the rules of any Federal or State court) to which the data or information is otherwise subject.

"(B) CONTINUED APPLICATION OF PRIOR CONFIDENTIALITY AGREEMENTS.—Any requirement under Federal or State law to the extent otherwise applicable, or any requirement pursuant to a written agreement in effect between the original source of any nonpublicly available data or information and the source of such data or information to the Office, regarding the privacy or confidentiality of any data or information in the possession of the source to the Office, shall continue to apply to such data or information after the data or information has been provided pursuant to this subsection to the Office.

"(C) INFORMATION-SHARING AGREEMENT.—Any data or information obtained by the Office may be made available to State insurance regulators, individually or collectively, through an information-sharing agreement that—

"(i) shall comply with applicable Federal law; and

"(ii) shall not constitute a waiver of, or otherwise affect, any privilege under Federal or State law (including the rules of any Federal or State court) to which the data or information is otherwise subject.

"(D) AGENCY DISCLOSURE REQUIREMENTS.—Section 552 of title 5, United States Code, shall apply to any data or information submitted to the Office by an insurer or an affiliate of an insurer.

"(6) SUBPOENAS AND ENFORCEMENT.—The Director shall have the power to require by subpoena the production of the data or information requested under paragraph (2), but only upon a written finding by the Director that such data or information is required to carry out the functions described under subsection (c) and that the Office has coordinated with such regulator or agency as required under paragraph (4). Subpoenas shall bear the signature of the Director and shall be served by any person or class of persons designated by the Director for that purpose. In the case of contumacy or failure to obey a subpoena, the subpoena shall be enforceable by order of any appropriate district court of the United States. Any failure to obey the order of the court may be punished by the court as a contempt of court.

"(f) PREEMPTION OF STATE INSURANCE MEASURES.—

"(1) STANDARD.—A State insurance measure shall be preempted pursuant to this section or section 314 if, and only to the extent that the Director determines, in accordance with this subsection, that the measure—

"(A) results in less favorable treatment of a non-United States insurer domiciled in a foreign jurisdiction that is subject to a covered agreement than a United States insurer domiciled, licensed, or otherwise admitted in that State; and

"(B) is inconsistent with a covered agreement.

"(2) DETERMINATION.—

"(A) NOTICE OF POTENTIAL INCONSISTENCY.—Before making any determination under paragraph (1), the Director shall—

"(i) notify and consult with the appropriate State regarding any potential inconsistency or preemption;

"(ii) notify and consult with the United States Trade Representative regarding any potential inconsistency or preemption;

"(iii) cause to be published in the Federal Register notice of the issue regarding the potential inconsistency or preemption, including a description of each State insurance measure at issue and any applicable covered agreement;

"(iv) provide interested parties a reasonable opportunity to submit written comments to the Office; and

"(v) consider any comments received.

"(B) SCOPE OF REVIEW.—For purposes of this subsection, any determination of the Director regarding State insurance measures, and any preemption under paragraph (1) as a result of such determination, shall be limited to the subject matter contained within the covered agreement involved and shall achieve a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.

"(C) NOTICE OF DETERMINATION OF INCONSISTENCY.—Upon making any determination under paragraph (1), the Director shall—

"(i) notify the appropriate State of the determination and the extent of the inconsistency;

"(ii) establish a reasonable period of time, which shall not be less than 30 days, before the determination shall become effective; and

"(iii) notify the Committees on Financial Services and Ways and Means of the House of Representatives and the Committees on Banking, Housing, and Urban Affairs and Finance of the Senate.

"(3) NOTICE OF EFFECTIVENESS.—Upon the conclusion of the period referred to in paragraph (2)(C)(ii), if the basis for such determination still exists, the determination shall become effective and the Director shall—

"(A) cause to be published a notice in the Federal Register that the preemption has become effective, as well as the effective date; and

"(B) notify the appropriate State.

"(4) LIMITATION.—No State may enforce a State insurance measure to the extent that such measure has been preempted under this subsection.

"(g) APPLICABILITY OF ADMINISTRATIVE PROCEDURES ACT.—Determinations of inconsistency made pursuant to subsection (f)(2) shall be subject to the applicable provisions of subchapter II of chapter 5 of title 5, United States Code (relating to administrative procedure), and chapter 7 of such title (relating to judicial review), except that in any action for judicial review of a determination of inconsistency, the court shall determine the matter de novo.

"(h) REGULATIONS, POLICIES, AND PROCEDURES.—The Secretary may issue orders, regulations, policies, and procedures to implement this section.

"(i) CONSULTATION.—The Director shall consult with State insurance regulators, individually or collectively, to the extent the Director determines appropriate, in carrying out the functions of the Office.

"(j) SAVINGS PROVISIONS.—Nothing in this section shall—

"(1) preempt—

"(A) any State insurance measure that governs any insurer's rates, premiums, underwriting, or sales practices;

"(B) any State coverage requirements for insurance;

"(C) the application of the antitrust laws of any State to the business of insurance; or

"(D) any State insurance measure governing the capital or solvency of an insurer, except to the extent that such State insurance measure results in less favorable treatment of a non-United State insurer than a United States insurer;

"(2) be construed to alter, amend, or limit any provision of the Consumer Financial Protection Agency Act of 2010; or

"(3) affect the preemption of any State insurance measure otherwise inconsistent with and preempted by Federal law.

"(k) RETENTION OF EXISTING STATE REGULATORY AUTHORITY.—Nothing in this section or section 314 shall be construed to establish or provide the Office or the Department of the Treasury with general supervisory or regulatory authority over the business of insurance.

"(l) RETENTION OF AUTHORITY OF FEDERAL FINANCIAL REGULATORY AGENCIES.—Nothing in this section or section 314 shall be construed to limit the authority of any Federal financial regulatory agency, including the authority to develop and coordinate policy, negotiate, and enter into agreements with foreign governments, authorities, regulators, and multinational regulatory committees and to preempt State measures to affect uniformity with international regulatory agreements.

"(m) RETENTION OF AUTHORITY OF UNITED STATES TRADE REPRESENTATIVE.—Nothing in this section or section 314 shall be construed to affect the authority of the Office of the United States Trade Representative pursuant to section 141 of the Trade Act of 1974 (19 U.S.C. 2171) or any other provision of law, including authority over the development and coordination of United States international trade policy and the administration of the United States trade agreements program.

"(n) ANNUAL REPORTS TO CONGRESS.—

"(1) SECTION 313(f) REPORTS.—Beginning September 30, 2011, the Director shall submit a report on or before September 30 of each calendar year to the President and to the Committees on Financial Services and Ways and Means of the House of Representatives and the Committees on Banking, Housing, and Urban Affairs and Finance of the Senate on any actions taken by the Office pursuant to subsection (f) (regarding preemption of inconsistent State insurance measures).

"(2) INSURANCE INDUSTRY.—Beginning September 30, 2011, the Director shall submit a report on or before September 30 of each calendar year to the President and to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on the insurance industry and any other information as deemed relevant by the Director or requested by such Committees.

"(o) REPORTS ON U.S. AND GLOBAL REINSURANCE MARKET.—The Director shall submit to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate—

"(1) a report received not later than September 30, 2012, describing the breadth and scope of the global reinsurance market and the critical role such market plays in supporting insurance in the United States; and

"(2) a report received not later than January 1, 2013, and updated not later than January 1, 2015, describing the impact of part II of the Nonadmitted and Reinsurance Reform Act of 2010 on the ability of State regulators to access reinsurance information for regulated companies in their jurisdictions.

"(p) STUDY AND REPORT ON REGULATION OF INSURANCE.—

"(1) IN GENERAL.—Not later than 18 months after the date of enactment of this section, the Director shall conduct a study and submit a report to Congress on how to modernize and improve the system of insurance regulation in the United States.

"(2) CONSIDERATIONS.—The study and report required under paragraph (1) shall be based on and guided by the following considerations:

"(A) Systemic risk regulation with respect to insurance.

"(B) Capital standards and the relationship between capital allocation and liabilities, including standards relating to liquidity and duration risk.

"(C) Consumer protection for insurance products and practices, including gaps in State regulation.

"(D) The degree of national uniformity of State insurance regulation.

"(E) The regulation of insurance companies and affiliates on a consolidated basis.

"(F) International coordination of insurance regulation.

"(3) ADDITIONAL FACTORS.—The study and report required under paragraph (1) shall also examine the following factors:

"(A) The costs and benefits of potential Federal regulation of insurance across various lines of insurance (except health insurance).

"(B) The feasibility of regulating only certain lines of insurance at the Federal level, while leaving other lines of insurance to be regulated at the State level.

"(C) The ability of any potential Federal regulation or Federal regulators to eliminate or minimize regulatory arbitrage.

"(D) The impact that developments in the regulation of insurance in foreign jurisdictions might have on the potential Federal regulation of insurance.

"(E) The ability of any potential Federal regulation or Federal regulator to provide robust consumer protection for policyholders.

"(F) The potential consequences of subjecting insurance companies to a Federal resolution authority, including the effects of any Federal resolution authority—

"(i) on the operation of State insurance guaranty fund systems, including the loss of guaranty fund coverage if an insurance company is subject to a Federal resolution authority;

"(ii) on policyholder protection, including the loss of the priority status of policyholder claims over other unsecured general creditor claims;

"(iii) in the case of life insurance companies, on the loss of the special status of separate account assets and separate account liabilities; and

"(iv) on the international competitiveness of insurance companies.

"(G) Such other factors as the Director determines necessary or appropriate, consistent with the principles set forth in paragraph (2).

"(4) REQUIRED RECOMMENDATIONS.—The study and report required under paragraph (1) shall also contain any legislative, administrative, or regulatory recommendations, as the Director determines appropriate, to carry out or effectuate the findings set forth in such report.

"(5) CONSULTATION.—With respect to the study and report required under paragraph (1), the Director shall consult with the State insurance regulators, consumer organizations, representatives of the insurance industry and policyholders, and other organizations and experts, as appropriate.

"(q) USE OF EXISTING RESOURCES.—To carry out this section, the Office may employ personnel, facilities, and any other resource of the Department of the Treasury available to the Secretary and the Secretary shall dedicate specific personnel to the Office.

"(r) DEFINITIONS.—In this section and section 314, the following definitions shall apply:

"(1) AFFILIATE.—The term 'affiliate' means, with respect to an insurer, any person who controls, is controlled by, or is under common control with the insurer.

"(2) COVERED AGREEMENT.—The term 'covered agreement' means a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that—

"(A) is entered into between the United States and one or more foreign governments, authorities, or regulatory entities; and

"(B) relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.

"(3) INSURER.—The term 'insurer' means any person engaged in the business of insurance, including reinsurance.

"(4) FEDERAL FINANCIAL REGULATORY AGENCY.—The term 'Federal financial regulatory agency' means the Department of the Treasury, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, or the National Credit Union Administration.

"(5) NON-UNITED STATES INSURER.—The term 'non-United States insurer' means an insurer that is organized under the laws of a jurisdiction other than a State, but does not include any United States branch of such an insurer.

"(6) OFFICE.—The term 'Office' means the Federal Insurance Office established by this section.

"(7) STATE INSURANCE MEASURE.—The term 'State insurance measure' means any State law, regulation, administrative ruling, bulletin, guideline, or practice relating to or affecting prudential measures applicable to insurance or reinsurance.

"(8) STATE INSURANCE REGULATOR.—The term 'State insurance regulator' means any State regulatory authority responsible for the supervision of insurers.

"(9) SUBSTANTIALLY EQUIVALENT TO THE LEVEL OF PROTECTION ACHIEVED.—The term 'substantially equivalent to the level of protection achieved' means the prudential measures of a foreign government, authority, or regulatory entity achieve a similar outcome in consumer protection as the outcome achieved under State insurance or reinsurance regulation.

"(10) UNITED STATES INSURER.—The term 'United States insurer' means—

"(A) an insurer that is organized under the laws of a State; or

"(B) a United States branch of a non-United States insurer.

"(s) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated for the Office for each fiscal year such sums as may be necessary.

"SEC. 314. COVERED AGREEMENTS.

"(a) AUTHORITY.—The Secretary and the United States Trade Representative are authorized, jointly, to negotiate and enter into covered agreements on behalf of the United States.

"(b) REQUIREMENTS FOR CONSULTATION WITH CONGRESS.—

"(1) IN GENERAL.—Before initiating negotiations to enter into a covered agreement under subsection (a), during such negotiations, and before entering into any such agreement, the Secretary and the United States Trade Representative shall jointly consult with the Committee on Financial Services and the Committee on Ways and Means of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs and the Committee on Finance of the Senate.

"(2) SCOPE.—The consultation described in paragraph (1) shall include consultation with respect to—

"(A) the nature of the agreement;

"(B) how and to what extent the agreement will achieve the applicable purposes, policies, priorities, and objectives of section 313 and this section; and

"(C) the implementation of the agreement, including the general effect of the agreement on existing State laws.

"(c) SUBMISSION AND LAYOVER PROVISIONS.—A covered agreement under subsection (a) may enter into force with respect to the United States only if—

"(1) the Secretary and the United States Trade Representative jointly submit to the congressional committees specified in subsection (b)(1), on a day on which both Houses of Congress are in session, a copy of the final legal text of the agreement; and

"(2) a period of 90 calendar days beginning on the date on which the copy of the final legal text of the agreement is submitted to the congressional committees under paragraph (1) has expired.".

(b) DUTIES OF SECRETARY.—Section 321(a) of title 31, United States Code, is amended—

(1) in paragraph (7), by striking "; and" and inserting a semicolon;

(2) in paragraph (8)(C), by striking the period at the end and inserting "; and"; and

(3) by adding at the end the following new paragraph:

"(9) advise the President on major domestic and international prudential policy issues in connection with all lines of insurance except health insurance.".

(c) CLERICAL AMENDMENT.—The table of sections for subchapter I of chapter 3 of title 31, United States Code, is amended by striking the item relating to section 312 and inserting the following new items:

Subtitle B—State-Based Insurance Reform

SEC. 511. SHORT TITLE.

This subtitle may be cited as the "Nonadmitted and Reinsurance Reform Act of 2010".

SEC. 512. EFFECTIVE DATE.

Except as otherwise specifically provided in this subtitle, this subtitle shall take effect upon the expiration of the 12-month period beginning on the date of the enactment of this subtitle.

PART I—NONADMITTED INSURANCE

SEC. 521. REPORTING, PAYMENT, AND ALLOCATION OF PREMIUM TAXES.

(a) HOME STATE'S EXCLUSIVE AUTHORITY.—No State other than the home State of an insured may require any premium tax payment for nonadmitted insurance.

(b) ALLOCATION OF NONADMITTED PREMIUM TAXES.—

(1) IN GENERAL.—The States may enter into a compact or otherwise establish procedures to allocate among the States the premium taxes paid to an insured's home State described in subsection (a).

(2) EFFECTIVE DATE.—Except as expressly otherwise provided in such compact or other procedures, any such compact or other procedures—

(A) if adopted on or before the expiration of the 330-day period that begins on the date of the enactment of this subtitle, shall apply to any premium taxes that, on or after such date of enactment, are required to be paid to any State that is subject to such compact or procedures; and

(B) if adopted after the expiration of such 330-day period, shall apply to any premium taxes that, on or after January 1 of the first calendar year that begins after the expiration of such 330-day period, are required to be paid to any State that is subject to such compact or procedures.

(3) REPORT.—Upon the expiration of the 330-day period referred to in paragraph (2), the NAIC may submit a report to the Committee on Financial Services and the Committee on the Judiciary of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate identifying and describing any compact or other procedures for allocation among the States of premium taxes that have been adopted during such period by any States.

(4) NATIONWIDE SYSTEM.—The Congress intends that each State adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact, that provide for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance consistent with this section.

(c) ALLOCATION BASED ON TAX ALLOCATION REPORT.—To facilitate the payment of premium taxes among the States, an insured's home State may require surplus lines brokers and insureds who have independently procured insurance to annually file tax allocation reports with the insured's home State detailing the portion of the nonadmitted insurance policy premium or premiums attributable to properties, risks, or exposures located in each State. The filing of a nonadmitted insurance tax allocation report and the payment of tax may be made by a person authorized by the insured to act as its agent.

SEC. 522. REGULATION OF NONADMITTED INSURANCE BY INSURED'S HOME STATE.

(a) HOME STATE AUTHORITY.—Except as otherwise provided in this section, the placement of nonadmitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's home State.

(b) BROKER LICENSING.—No State other than an insured's home State may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate nonadmitted insurance with respect to such insured.

(c) ENFORCEMENT PROVISION.—With respect to section 521 and subsections (a) and (b) of this section, any law, regulation, provision, or action of any State that applies or purports to apply to nonadmitted insurance sold to, solicited by, or negotiated with an insured whose home State is another State shall be preempted with respect to such application.

(d) WORKERS' COMPENSATION EXCEPTION.—This section may not be construed to preempt any State law, rule, or regulation that restricts the placement of workers' compensation insurance or excess insurance for self-funded workers' compensation plans with a nonadmitted insurer.

SEC. 523. PARTICIPATION IN NATIONAL PRODUCER DATABASE.

After the expiration of the 2-year period beginning on the date of the enactment of this subtitle, a State may not collect any fees relating to licensing of an individual or entity as a surplus lines broker in the State unless the State has in effect at such time laws or regulations that provide for participation by the State in the national insurance producer database of the NAIC, or any other equivalent uniform national database, for the licensure of surplus lines brokers and the renewal of such licenses.

SEC. 524. UNIFORM STANDARDS FOR SURPLUS LINES ELIGIBILITY.

A State may not—

(1) impose eligibility requirements on, or otherwise establish eligibility criteria for, nonadmitted insurers domiciled in a United States jurisdiction, except in conformance with such requirements and criteria in sections 5A(2) and 5C(2)(a) of the Non-Admitted Insurance Model Act, unless the State has adopted nationwide uniform requirements, forms, and procedures developed in accordance with section 521(b) of this subtitle that include alternative nationwide uniform eligibility requirements; or

(2) prohibit a surplus lines broker from placing nonadmitted insurance with, or procuring nonadmitted insurance from, a nonadmitted insurer domiciled outside the United States that is listed on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department of the NAIC.

SEC. 525. STREAMLINED APPLICATION FOR COMMERCIAL PURCHASERS.

A surplus lines broker seeking to procure or place nonadmitted insurance in a State for an exempt commercial purchaser shall not be required to satisfy any State requirement to make a due diligence search to determine whether the full amount or type of insurance sought by such exempt commercial purchaser can be obtained from admitted insurers if—

(1) the broker procuring or placing the surplus lines insurance has disclosed to the exempt commercial purchaser that such insurance may or may not be available from the admitted market that may provide greater protection with more regulatory oversight; and

(2) the exempt commercial purchaser has subsequently requested in writing the broker to procure or place such insurance from a nonadmitted insurer.

SEC. 526. GAO STUDY OF NONADMITTED INSURANCE MARKET.

(a) IN GENERAL.—The Comptroller General of the United States shall conduct a study of the nonadmitted insurance market to determine the effect of the enactment of this part on the size and market share of the nonadmitted insurance market for providing coverage typically provided by the admitted insurance market.

(b) CONTENTS.—The study shall determine and analyze—

(1) the change in the size and market share of the nonadmitted insurance market and in the number of insurance companies and insurance holding companies providing such business in the 18-month period that begins upon the effective date of this subtitle;

(2) the extent to which insurance coverage typically provided by the admitted insurance market has shifted to the nonadmitted insurance market;

(3) the consequences of any change in the size and market share of the nonadmitted insurance market, including differences in the price and availability of coverage available in both the admitted and nonadmitted insurance markets;

(4) the extent to which insurance companies and insurance holding companies that provide both admitted and nonadmitted insurance have experienced shifts in the volume of business between admitted and nonadmitted insurance; and

(5) the extent to which there has been a change in the number of individuals who have nonadmitted insurance policies, the type of coverage provided under such policies, and whether such coverage is available in the admitted insurance market.

(c) CONSULTATION WITH NAIC.—In conducting the study under this section, the Comptroller General shall consult with the NAIC.

(d) REPORT.—The Comptroller General shall complete the study under this section and submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives regarding the findings of the study not later than 30 months after the effective date of this subtitle.

SEC. 527. DEFINITIONS.

For purposes of this part, the following definitions shall apply:

(1) ADMITTED INSURER.—The term "admitted insurer" means, with respect to a State, an insurer licensed to engage in the business of insurance in such State.

(2) AFFILIATE.—The term "affiliate" means, with respect to an insured, any entity that controls, is controlled by, or is under common control with the insured.

(3) AFFILIATED GROUP.—The term "affiliated group" means any group of entities that are all affiliated.

(4) CONTROL.—An entity has "control" over another entity if—

(A) the entity directly or indirectly or acting through 1 or more other persons owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the other entity; or

(B) the entity controls in any manner the election of a majority of the directors or trustees of the other entity.

(5) EXEMPT COMMERCIAL PURCHASER.—The term "exempt commercial purchaser" means any person purchasing commercial insurance that, at the time of placement, meets the following requirements:

(A) The person employs or retains a qualified risk manager to negotiate insurance coverage.

(B) The person has paid aggregate nationwide commercial property and casualty insurance premiums in excess of $100,000 in the immediately preceding 12 months.

(C)(i) The person meets at least 1 of the following criteria:

(I) The person possesses a net worth in excess of $20,000,000, as such amount is adjusted pursuant to clause (ii).

(II) The person generates annual revenues in excess of $50,000,000, as such amount is adjusted pursuant to clause (ii).

(III) The person employs more than 500 full-time or full-time equivalent employees per individual insured or is a member of an affiliated group employing more than 1,000 employees in the aggregate.

(IV) The person is a not-for-profit organization or public entity generating annual budgeted expenditures of at least $30,000,000, as such amount is adjusted pursuant to clause (ii).

(V) The person is a municipality with a population in excess of 50,000 persons.

(ii) Effective on the fifth January 1 occurring after the date of the enactment of this subtitle and each fifth January 1 occurring thereafter, the amounts in subclauses (I), (II), and (IV) of clause (i) shall be adjusted to reflect the percentage change for such 5-year period in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics of the Department of Labor.

(6) HOME STATE.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term "home State" means, with respect to an insured—

(i) the State in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence; or

(ii) if 100 percent of the insured risk is located out of the State referred to in clause (i), the State to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated.

(B) AFFILIATED GROUPS.—If more than 1 insured from an affiliated group are named insureds on a single nonadmitted insurance contract, the term "home State" means the home State, as determined pursuant to subparagraph (A), of the member of the affiliated group that has the largest percentage of premium attributed to it under such insurance contract.

(7) INDEPENDENTLY PROCURED INSURANCE.—The term "independently procured insurance" means insurance procured directly by an insured from a nonadmitted insurer.

(8) NAIC.—The term "NAIC" means the National Association of Insurance Commissioners or any successor entity.

(9) NONADMITTED INSURANCE.—The term "nonadmitted insurance" means any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance.

(10) NON-ADMITTED INSURANCE MODEL ACT.—The term "Non-Admitted Insurance Model Act" means the provisions of the Non-Admitted Insurance Model Act, as adopted by the NAIC on August 3, 1994, and amended on September 30, 1996, December 6, 1997, October 2, 1999, and June 8, 2002.

(11) NONADMITTED INSURER.—The term "nonadmitted insurer"—

(A) means, with respect to a State, an insurer not licensed to engage in the business of insurance in such State; but

(B) does not include a risk retention group, as that term is defined in section 2(a)(4) of the Liability Risk Retention Act of 1986 (15 U.S.C. 3901(a)(4)).

(12) PREMIUM TAX.—The term "premium tax" means, with respect to surplus lines or independently procured insurance coverage, any tax, fee, assessment, or other charge imposed by a government entity directly or indirectly based on any payment made as consideration for an insurance contract for such insurance, including premium deposits, assessments, registration fees, and any other compensation given in consideration for a contract of insurance.

(13) QUALIFIED RISK MANAGER.—The term "qualified risk manager" means, with respect to a policyholder of commercial insurance, a person who meets all of the following requirements:

(A) The person is an employee of, or third-party consultant retained by, the commercial policyholder.

(B) The person provides skilled services in loss prevention, loss reduction, or risk and insurance coverage analysis, and purchase of insurance.

(C) The person—

(i)(I) has a bachelor's degree or higher from an accredited college or university in risk management, business administration, finance, economics, or any other field determined by a State insurance commissioner or other State regulatory official or entity to demonstrate minimum competence in risk management; and

(II)(aa) has 3 years of experience in risk financing, claims administration, loss prevention, risk and insurance analysis, or purchasing commercial lines of insurance; or

(bb) has—

(AA) a designation as a Chartered Property and Casualty Underwriter (in this subparagraph referred to as "CPCU") issued by the American Institute for CPCU/Insurance Institute of America;

(BB) a designation as an Associate in Risk Management (ARM) issued by the American Institute for CPCU/Insurance Institute of America;

(CC) a designation as Certified Risk Manager (CRM) issued by the National Alliance for Insurance Education & Research;

(DD) a designation as a RIMS Fellow (RF) issued by the Global Risk Management Institute; or

(EE) any other designation, certification, or license determined by a State insurance commissioner or other State insurance regulatory official or entity to demonstrate minimum competency in risk management;

(ii)(I) has at least 7 years of experience in risk financing, claims administration, loss prevention, risk and insurance coverage analysis, or purchasing commercial lines of insurance; and

(II) has any 1 of the designations specified in subitems (AA) through (EE) of clause (i)(II)(bb);

(iii) has at least 10 years of experience in risk financing, claims administration, loss prevention, risk and insurance coverage analysis, or purchasing commercial lines of insurance; or

(iv) has a graduate degree from an accredited college or university in risk management, business administration, finance, economics, or any other field determined by a State insurance commissioner or other State regulatory official or entity to demonstrate minimum competence in risk management.

(14) REINSURANCE.—The term "reinsurance" means the assumption by an insurer of all or part of a risk undertaken originally by another insurer.

(15) SURPLUS LINES BROKER.—The term "surplus lines broker" means an individual, firm, or corporation which is licensed in a State to sell, solicit, or negotiate insurance on properties, risks, or exposures located or to be performed in a State with nonadmitted insurers.

(16) STATE.—The term "State" includes any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and American Samoa.

PART II—REINSURANCE

SEC. 531. REGULATION OF CREDIT FOR REINSURANCE AND REINSURANCE AGREEMENTS.

(a) CREDIT FOR REINSURANCE.—If the State of domicile of a ceding insurer is an NAIC-accredited State, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk, then no other State may deny such credit for reinsurance.

(b) ADDITIONAL PREEMPTION OF EXTRATERRITORIAL APPLICATION OF STATE LAW.—In addition to the application of subsection (a), all laws, regulations, provisions, or other actions of a State that is not the domiciliary State of the ceding insurer, except those with respect to taxes and assessments on insurance companies or insurance income, are preempted to the extent that they—

(1) restrict or eliminate the rights of the ceding insurer or the assuming insurer to resolve disputes pursuant to contractual arbitration to the extent such contractual provision is not inconsistent with the provisions of title 9, United States Code;

(2) require that a certain State's law shall govern the reinsurance contract, disputes arising from the reinsurance contract, or requirements of the reinsurance contract;

(3) attempt to enforce a reinsurance contract on terms different than those set forth in the reinsurance contract, to the extent that the terms are not inconsistent with this part; or

(4) otherwise apply the laws of the State to reinsurance agreements of ceding insurers not domiciled in that State.

SEC. 532. REGULATION OF REINSURER SOLVENCY.

(a) DOMICILIARY STATE REGULATION.—If the State of domicile of a reinsurer is an NAIC-accredited State or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, such State shall be solely responsible for regulating the financial solvency of the reinsurer.

(b) NONDOMICILIARY STATES.—

(1) LIMITATION ON FINANCIAL INFORMATION REQUIREMENTS.—If the State of domicile of a reinsurer is an NAIC-accredited State or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, no other State may require the reinsurer to provide any additional financial information other than the information the reinsurer is required to file with its domiciliary State.

(2) RECEIPT OF INFORMATION.—No provision of this section shall be construed as preventing or prohibiting a State that is not the State of domicile of a reinsurer from receiving a copy of any financial statement filed with its domiciliary State.

SEC. 533. DEFINITIONS.

For purposes of this part, the following definitions shall apply:

(1) CEDING INSURER.—The term "ceding insurer" means an insurer that purchases reinsurance.

(2) DOMICILIARY STATE.—The terms "State of domicile" and "domiciliary State" mean, with respect to an insurer or

reinsurer, the State in which the insurer or reinsurer is incorporated or entered through, and licensed.

(3) NAIC.—The term "NAIC" means the National Association of Insurance Commissioners or any successor entity.

(4) REINSURANCE.—The term "reinsurance" means the assumption by an insurer of all or part of a risk undertaken originally by another insurer.

(5) REINSURER.—

(A) IN GENERAL.—The term "reinsurer" means an insurer to the extent that the insurer—

(i) is principally engaged in the business of reinsurance;

(ii) does not conduct significant amounts of direct insurance as a percentage of its net premiums; and

(iii) is not engaged in an ongoing basis in the business of soliciting direct insurance.

(B) DETERMINATION.—A determination of whether an insurer is a reinsurer shall be made under the laws of the State of domicile in accordance with this paragraph.

(6) STATE.—The term "State" includes any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and American Samoa.

PART III—RULE OF CONSTRUCTION

SEC. 541. RULE OF CONSTRUCTION.

Nothing in this subtitle or the amendments made by this subtitle shall be construed to modify, impair, or supersede the application of the antitrust laws. Any implied or actual conflict between this subtitle and any amendments to this subtitle and the antitrust laws shall be resolved in favor of the operation of the antitrust laws.

SEC. 542. SEVERABILITY.

If any section or subsection of this subtitle, or any application of such provision to any person or circumstance, is held to be unconstitutional, the remainder of this subtitle, and the application of the provision to any other person or circumstance, shall not be affected.

TITLE VI—IMPROVEMENTS TO REGULATION OF BANK AND SAVINGS ASSOCIATION HOLDING COMPANIES AND DEPOSITORY INSTITUTIONS

SEC. 601. SHORT TITLE.

This title may be cited as the "Bank and Savings Association Holding Company and Depository Institution Regulatory Improvements Act of 2010".

SEC. 602. DEFINITION.

For purposes of this title, a company is a "commercial firm" if the annual gross revenues derived by the company and all of its affiliates from activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k))) and, if applicable, from the ownership or control of one or more insured depository institutions, represent less than 15 percent of the consolidated annual gross revenues of the company.

SEC. 603. MORATORIUM AND STUDY ON TREATMENT OF CREDIT CARD BANKS, INDUSTRIAL LOAN COMPANIES, AND CERTAIN OTHER COMPANIES UNDER THE BANK HOLDING COMPANY ACT OF 1956.

(a) MORATORIUM.—

(1) DEFINITIONS.—In this subsection—

(A) the term "credit card bank" means an institution described in section 2(c)(2)(F) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(F));

(B) the term "industrial bank" means an institution described in section 2(c)(2)(H) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(H)); and

(C) the term "trust bank" means an institution described in section 2(c)(2)(D) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(D)).

(2) MORATORIUM ON PROVISION OF DEPOSIT INSURANCE.—The Corporation may not approve an application for deposit insurance under section 5 of the Federal Deposit Insurance Act (12 U.S.C. 1815) that is received after November 23, 2009, for an industrial bank, a credit card bank, or a trust bank that is directly or indirectly owned or controlled by a commercial firm.

(3) CHANGE IN CONTROL.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the appropriate Federal banking agency shall disapprove a change in control, as provided in section 7(j) of the Federal Deposit Insurance Act (12 U.S.C. 1817(j)), of an industrial bank, a credit card bank, or a trust bank if the change in control would result in direct or indirect control of the industrial bank, credit card bank, or trust bank by a commercial firm.

(B) EXCEPTIONS.—Subparagraph (A) shall not apply to a change in control of an industrial bank, credit card bank, or trust bank—

(i) that—

(I) is in danger of default, as determined by the appropriate Federal banking agency;

(II) results from the merger or whole acquisition of a commercial firm that directly or indirectly controls the industrial bank, credit card bank, or trust bank in a bona fide merger with or acquisition by another commercial firm, as determined by the appropriate Federal banking agency; or

(III) results from an acquisition of voting shares of a publicly traded company that controls an industrial bank, credit card bank, or trust bank, if, after the acquisition, the acquiring shareholder (or group of shareholders acting in concert) holds less than 25 percent of any class of the voting shares of the company; and

(ii) that has obtained all regulatory approvals otherwise required for such change of control under any applicable Federal or State law, including section 7(j) of the Federal Deposit Insurance Act (12 U.S.C. 1817(j)).

(4) SUNSET.—This subsection shall cease to have effect 3 years after the date of enactment of this Act.

(b) GOVERNMENT ACCOUNTABILITY OFFICE STUDY OF EXCEPTIONS UNDER THE BANK HOLDING COMPANY ACT OF 1956.—

(1) STUDY REQUIRED.—The Comptroller General of the United States shall carry out a study to determine whether it is necessary, in order to strengthen the safety and soundness of institutions or the stability of the financial system, to eliminate the exceptions under section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) for institutions described in—

(A) section 2(a)(5)(E) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)(5)(E));

(B) section 2(a)(5)(F) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)(5)(F));

(C) section 2(c)(2)(D) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(D));

(D) section 2(c)(2)(F) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(F));

(E) section 2(c)(2)(H) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(H)); and

(F) section 2(c)(2)(B) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(B)).

(2) CONTENT OF STUDY.—

(A) IN GENERAL.—The study required under paragraph (1), with respect to the institutions referenced in each of subparagraphs (A) through (E) of paragraph (1), shall, to the extent feasible be based on information provided to the Comptroller General by the appropriate Federal or State regulator, and shall—

(i) identify the types and number of institutions excepted from section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) under each of the subparagraphs described in subparagraphs (A) through (E) of paragraph (1);

(ii) generally describe the size and geographic locations of the institutions described in clause (i);

(iii) determine the extent to which the institutions described in clause (i) are held by holding companies that are commercial firms;

(iv) determine whether the institutions described in clause (i) have any affiliates that are commercial firms;

(v) identify the Federal banking agency responsible for the supervision of the institutions described in clause (i) on and after the transfer date;

(vi) determine the adequacy of the Federal bank regulatory framework applicable to each category of institution described in clause (i), including any restrictions (including limitations on affiliate transactions or cross-marketing) that apply to transactions between an institution, the holding company of the institution, and any other affiliate of the institution; and

(vii) evaluate the potential consequences of subjecting the institutions described in clause (i) to the requirements of the Bank Holding Company Act of 1956, including with respect to the availability and allocation of credit, the stability of the financial system and the economy, the safe and sound operation of each category of institution, and the impact on the types of activities in which such institutions, and the holding companies of such institutions, may engage.

(B) SAVINGS ASSOCIATIONS.—With respect to institutions described in paragraph (1)(F), the study required under paragraph (1) shall—

(i) determine the adequacy of the Federal bank regulatory framework applicable to such institutions, including any restrictions (including limitations on affiliate transactions or cross-marketing) that apply to transactions between an institution, the holding company of the institution, and any other affiliate of the institution; and

(ii) evaluate the potential consequences of subjecting the institutions described in paragraph (1)(F) to the requirements of the Bank Holding Company Act of 1956, including with respect to the availability and allocation of credit, the stability of the financial system and the economy, the safe and sound operation of such institutions, and the impact on the types of activities in which such institutions, and the holding companies of such institutions, may engage.

(3) REPORT.—Not later than 18 months after the date of enactment of this Act, the Comptroller General shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the study required under paragraph (1).

SEC. 604. REPORTS AND EXAMINATIONS OF HOLDING COMPANIES; REGULATION OF FUNCTIONALLY REGULATED SUBSIDIARIES.

(a) REPORTS BY BANK HOLDING COMPANIES.—Sections 5(c)(1) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(c)(1)) is amended—

(1) by striking subclause (A)(ii) and inserting the following:

"(ii) compliance by the bank holding company or subsidiary with—

"(I) this Act;

"(II) Federal laws that the Board has specific jurisdiction to enforce against the company or subsidiary; and

"(III) other than in the case of an insured depository institution or functionally regulated subsidiary, any other applicable provision of Federal law.";

(2) by striking subparagraph (B) and inserting the following:

"(B) USE OF EXISTING REPORTS AND OTHER SUPERVISORY INFORMATION.—The Board shall, to the fullest extent possible, use—

"(i) reports and other supervisory information that the bank holding company or any subsidiary thereof has been required to provide to other Federal or State regulatory agencies;

"(ii) externally audited financial statements of the bank holding company or subsidiary;

"(iii) information otherwise available from Federal or State regulatory agencies; and

"(iv) information that is otherwise required to be reported publicly."; and

(3) by adding at the end the following:

"(C) AVAILABILITY.—Upon the request of the Board, the bank holding company or a subsidiary of the bank holding company shall promptly provide to the Board any information described in clauses (i) through (iii) of subparagraph (B).".

(b) EXAMINATIONS OF BANK HOLDING COMPANIES.—Section 5(c)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(c)(2)) is amended to read as follows:

"(2) EXAMINATIONS.—

"(A) IN GENERAL.—Subject to subtitle B of the Consumer Financial Protection Act of 2010, the Board may make examinations of a bank holding company and each subsidiary of a bank holding company in order to—

"(i) inform the Board of—

"(I) the nature of the operations and financial condition of the bank holding company and the subsidiary;

"(II) the financial, operational, and other risks within the bank holding company system that may pose a threat to—

"(aa) the safety and soundness of the bank holding company or of any depository institution subsidiary of the bank holding company; or

"(bb) the stability of the financial system of the United States; and

"(III) the systems of the bank holding company for monitoring and controlling the risks described in subclause (II); and

"(ii) monitor the compliance of the bank holding company and the subsidiary with—

"(I) this Act;

"(II) Federal laws that the Board has specific jurisdiction to enforce against the company or subsidiary; and

"(III) other than in the case of an insured depository institution or functionally regulated subsidiary, any other applicable provisions of Federal law.

"(B) USE OF REPORTS TO REDUCE EXAMINATIONS.—For purposes of this paragraph, the Board shall, to the fullest extent possible, rely on—

"(i) examination reports made by other Federal or State regulatory agencies relating to a bank holding company and any subsidiary of a bank holding company; and

"(ii) the reports and other information required under paragraph (1).

"(C) COORDINATION WITH OTHER REGULATORS.—The Board shall—

"(i) provide reasonable notice to, and consult with, the appropriate Federal banking agency, the Securities and Exchange Commission, the Commodity Futures Trading Commission, or State regulatory agency, as appropriate, for a subsidiary that is a depository institution or a functionally regulated subsidiary of a bank holding company before commencing an examination of the subsidiary under this section; and

"(ii) to the fullest extent possible, avoid duplication of examination activities, reporting requirements, and requests for information.".

(c) AUTHORITY TO REGULATE FUNCTIONALLY REGULATED SUBSIDIARIES OF BANK HOLDING COMPANIES.—The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended—

(1) in section 5(c)(5)(B) (12 U.S.C. 1844(c)(5)(B)), by striking clause (v) and inserting the following:

"(v) an entity that is subject to regulation by, or registration with, the Commodity Futures Trading Commission, with respect to activities conducted as a futures commission merchant, commodity trading adviser, commodity pool, commodity pool operator, swap execution facility, swap data repository, swap dealer, major swap participant, and activities that are incidental to such commodities and swaps activities."; and

(2) by striking section 10A (12 U.S.C. 1848a).

(d) ACQUISITIONS OF BANKS.—Section 3(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(c)) is amended by adding at the end the following:

"(7) FINANCIAL STABILITY.—In every case, the Board shall take into consideration the extent to which a proposed acquisition, merger, or consolidation would result in greater or more concentrated risks to the stability of the United States banking or financial system.".

(e) ACQUISITIONS OF NONBANKS.—

(1) NOTICE PROCEDURES.—Section 4(j)(2)(A) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(j)(2)(A)) is amended by striking "or unsound banking practices" and inserting "unsound banking practices, or risk to the stability of the United States banking or financial system".

(2) ACTIVITIES THAT ARE FINANCIAL IN NATURE.—Section 4(k)(6)(B) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)(6)(B)) is amended to read as follows:

"(B) APPROVAL NOT REQUIRED FOR CERTAIN FINANCIAL ACTIVITIES.—

"(i) IN GENERAL.—Except as provided in subsection (j) with regard to the acquisition of a savings association and clause (ii), a financial holding company may commence any activity, or acquire any company, pursuant to paragraph (4) or any regulation prescribed or order issued under paragraph (5), without prior approval of the Board.

"(ii) EXCEPTION.—A financial holding company may not acquire a company, without the prior approval of the Board, in a transaction in which the total consolidated assets to be acquired by the financial holding company exceed $10,000,000,000.

"(iii) HART-SCOTT-RODINO FILING REQUIREMENT.—Solely for purposes of section 7A(c)(8) of the Clayton Act (15 U.S.C. 18a(c)(8)), the transactions subject to the requirements of this paragraph shall be treated as if the approval of the Board is not required.".

(f) BANK MERGER ACT TRANSACTIONS.—Section 18(c)(5) of the Federal Deposit Insurance Act (12 U.S.C. 1828(c)(5)) is amended, in the matter immediately following subparagraph (B), by striking "and the convenience and needs of the community to be served" and inserting "the convenience and needs of the community to be served, and the risk to the stability of the United States banking or financial system".

(g) REPORTS BY SAVINGS AND LOAN HOLDING COMPANIES.—Section 10(b)(2) of the Home Owners' Loan Act (12 U.S.C. 1467a(b)(2) is amended—

(1) by striking "Each savings" and inserting the following:

"(A) IN GENERAL.—Each savings"; and

(2) by adding at the end the following:

"(B) USE OF EXISTING REPORTS AND OTHER SUPERVISORY INFORMATION.—The Board shall, to the fullest extent possible, use—

"(i) reports and other supervisory information that the savings and loan holding company or any subsidiary thereof has been required to provide to other Federal or State regulatory agencies;

"(ii) externally audited financial statements of the savings and loan holding company or subsidiary;

"(iii) information that is otherwise available from Federal or State regulatory agencies; and

"(iv) information that is otherwise required to be reported publicly.

"(C) AVAILABILITY.—Upon the request of the Board, a savings and loan holding company or a subsidiary of a savings and loan holding company shall promptly provide to the Board any information described in clauses (i) through (iii) of subparagraph (B).".

(h) EXAMINATION OF SAVINGS AND LOAN HOLDING COMPANIES.—

(1) DEFINITIONS.—Section 2 of the Home Owners' Loan Act (12 U.S.C. 1462) is amended by adding at the end the following:

"(10) APPROPRIATE FEDERAL BANKING AGENCY.—The term 'appropriate Federal banking agency' has the same meaning as in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

"(11) FUNCTIONALLY REGULATED SUBSIDIARY.—The term 'functionally regulated subsidiary' has the same meaning as in section 5(c)(5) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(c)(5)).".

(2) EXAMINATION.—Section 10(b) of the Home Owners' Loan Act (12 U.S.C. 1467a(b)) is amended by striking paragraph (4) and inserting the following:

"(4) EXAMINATIONS.—

"(A) IN GENERAL.—Subject to subtitle B of the Consumer Financial Protection Act of 2010, the Board may make examinations of a savings and loan holding company and each subsidiary of a savings and loan holding company system, in order to—

"(i) inform the Board of—

"(I) the nature of the operations and financial condition of the savings and loan holding company and the subsidiary;

"(II) the financial, operational, and other risks within the savings and loan holding company system that may pose a threat to—

"(aa) the safety and soundness of the savings and loan holding company or of any depository institution subsidiary of the savings and loan holding company; or

"(bb) the stability of the financial system of the United States; and

"(III) the systems of the savings and loan holding company for monitoring and controlling the risks described in subclause (II); and

"(ii) monitor the compliance of the savings and loan holding company and the subsidiary with—

"(I) this Act;

"(II) Federal laws that the Board has specific jurisdiction to enforce against the company or subsidiary; and

"(III) other than in the case of an insured depository institution or functionally regulated subsidiary, any other applicable provisions of Federal law.

"(B) USE OF REPORTS TO REDUCE EXAMINATIONS.—For purposes of this subsection, the Board shall, to the fullest extent possible, rely on—

"(i) the examination reports made by other Federal or State regulatory agencies relating to a savings and loan holding company and any subsidiary; and

"(ii) the reports and other information required under paragraph (2).

"(C) COORDINATION WITH OTHER REGULATORS.—The Board shall—

"(i) provide reasonable notice to, and consult with, the appropriate Federal banking agency, the Securities and Exchange Commission, the Commodity Futures Trading Commission, or State regulatory agency, as appropriate, for a subsidiary that is a depository institution or a functionally regulated subsidiary of a savings and loan holding company before commencing an examination of the subsidiary under this section; and

"(ii) to the fullest extent possible, avoid duplication of examination activities, reporting requirements, and requests for information.".

(i) DEFINITION OF THE TERM "SAVINGS AND LOAN HOLDING COMPANY".—Section 10(a)(1)(D)(ii) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(D)(ii)) is amended to read as follows:

"(ii) EXCLUSION.—The term 'savings and loan holding company' does not include—

"(I) a bank holding company that is registered under, and subject to, the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.), or to any company directly or indirectly controlled by such company (other than a savings association);

"(II) a company that controls a savings association that functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(D)); or

"(III) a company described in subsection (c)(9)(C) solely by virtue of such company's control of an intermediate holding company established pursuant to section 10A.".

(j) EFFECTIVE DATE.—The amendments made by this section shall take effect on the transfer date.

SEC. 605. ASSURING CONSISTENT OVERSIGHT OF PERMISSIBLE ACTIVITIES OF DEPOSITORY INSTITUTION SUBSIDIARIES OF HOLDING COMPANIES.

(a) IN GENERAL.—The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by inserting after section 25 the following new section:

"SEC. 26. ASSURING CONSISTENT OVERSIGHT OF SUBSIDIARIES OF HOLDING COMPANIES.

"(a) DEFINITIONS.—For purposes of this section:

"(1) BOARD.—The term 'Board' means the Board of Governors of the Federal Reserve System.

"(2) FUNCTIONALLY REGULATED SUBSIDIARY.—The term 'functionally regulated subsidiary' has the same meaning as in section 5(c)(5) of the Bank Holding Company Act.

"(3) LEAD INSURED DEPOSITORY INSTITUTION.—The term 'lead insured depository institution' has the same meaning as in section 2(o)(8) of the Bank Holding Company Act.

"(b) EXAMINATION REQUIREMENTS.—Subject to subtitle B of the Consumer Financial Protection Act of 2010, the Board shall examine the activities of a nondepository institution subsidiary (other than a functionally regulated subsidiary or a subsidiary of a depository institution) of a depository institution holding company that are permissible for the insured depository institution subsidiaries of the depository institution holding company in the same manner, subject to the same standards, and with the same frequency as would be required if such activities were conducted in the lead insured depository institution of the depository institution holding company.

"(c) STATE COORDINATION.—

"(1) CONSULTATION AND COORDINATION.—If a nondepository institution subsidiary is supervised by a State bank supervisor or other State regulatory authority, the Board, in conducting the examinations required in subsection (b), shall consult and coordinate with such State regulator.

"(2) ALTERNATING EXAMINATIONS PERMITTED.—The examinations required under subsection (b) may be conducted in joint or alternating manner with a State regulator, if the Board determines that an examination of a nondepository institution subsidiary conducted by the State carries out the purposes of this section.

"(d) APPROPRIATE FEDERAL BANKING AGENCY BACKUP EXAMINATION AUTHORITY.—

"(1) IN GENERAL.—In the event that the Board does not conduct examinations required under subsection (b) in the same manner, subject to the same standards, and with the same frequency as would be required if such activities were conducted by the lead insured depository institution subsidiary of the depository institution holding company, the appropriate Federal banking agency for the lead insured depository institution may recommend in writing (which shall include a written explanation of the concerns giving rise to the recommendation) that the Board perform the examination required under subsection (b).

"(2) EXAMINATION BY AN APPROPRIATE FEDERAL BANKING AGENCY.—If the Board does not, before the end of the 60-day period beginning on the date on which the Board receives a recommendation under paragraph (1), begin an examination as required under subsection (b) or provide a written explanation or plan to the appropriate Federal banking agency making such recommendation responding to the concerns raised by the appropriate Federal banking agency for the lead insured depository institution, the appropriate Federal banking agency for the lead insured depository institution may, subject to the Consumer Financial Protection Act of 2010, examine the activities that are permissible for a depository institution subsidiary conducted by such nondepository institution subsidiary (other than a functionally regulated subsidiary or a subsidiary of a depository institution) of the depository institution holding company as if the nondepository institution subsidiary were an insured depository institution for which the appropriate Federal banking agency of the lead insured depository institution was the appropriate Federal banking agency, to determine whether the activities—

"(A) pose a material threat to the safety and soundness of any insured depository institution subsidiary of the depository institution holding company;

"(B) are conducted in accordance with applicable Federal law; and

"(C) are subject to appropriate systems for monitoring and controlling the financial, operating, and other material risks of the activities that may pose a material threat to the safety and soundness of the insured depository institution subsidiaries of the holding company.

"(3) AGENCY COORDINATION WITH THE BOARD.—An appropriate Federal banking agency that conducts an examination pursuant to paragraph (2) shall coordinate examination of the activities of nondepository institution subsidiaries described in subsection (b) with the Board in a manner that—

"(A) avoids duplication;

"(B) shares information relevant to the supervision of the depository institution holding company;

"(C) achieves the objectives of subsection (b); and

"(D) ensures that the depository institution holding company and the subsidiaries of the depository institution holding company are not subject to conflicting supervisory demands by such agency and the Board.

"(4) FEE PERMITTED FOR EXAMINATION COSTS.—An appropriate Federal banking agency that conducts an examination or enforcement action pursuant to this section may collect an assessment, fee, or such other charge from the subsidiary as the appropriate Federal banking agency determines necessary or appropriate to carry out the responsibilities of the appropriate Federal banking agency in connection with such examination.

"(e) REFERRALS FOR ENFORCEMENT BY APPROPRIATE FEDERAL BANKING AGENCY.—

"(1) RECOMMENDATION OF ENFORCEMENT ACTION.—The appropriate Federal banking agency for the lead insured depository institution, based upon its examination of a nondepository institution subsidiary conducted pursuant to subsection (d), or other relevant information, may submit to the Board, in writing, a recommendation that the Board take enforcement action against such nondepository institution subsidiary, together with an explanation of the concerns giving rise to the recommendation, if the appropriate Federal banking agency determines (by a vote of its members, if applicable) that the activities of the nondepository institution subsidiary pose a material threat to the safety and soundness of any insured depository institution subsidiary of the depository institution holding company.

"(2) BACK-UP AUTHORITY OF THE APPROPRIATE FEDERAL BANKING AGENCY.—If, within the 60-day period beginning on the date on which the Board receives a recommendation under paragraph (1), the Board does not take enforcement action against the nondepository institution subsidiary or provide a plan for supervisory or enforcement action that is acceptable to the appropriate Federal banking agency that made the recommendation pursuant to paragraph (1), such agency may take the recommended enforcement action against the nondepository institution subsidiary, in the same manner as if the nondepository institution subsidiary were an insured depository institution for which the agency was the appropriate Federal banking agency.

"(f) COORDINATION AMONG APPROPRIATE FEDERAL BANKING AGENCIES.—Each Federal banking agency, prior to or when exercising authority under subsection (d) or (e) shall—

"(1) provide reasonable notice to, and consult with, the appropriate Federal banking agency or State bank supervisor (or other State regulatory agency) of the nondepository institution subsidiary of a depository institution holding company that is described in subsection (d) before commencing any examination of the subsidiary;

"(2) to the fullest extent possible—

"(A) rely on the examinations, inspections, and reports of the appropriate Federal banking agency or the State bank supervisor (or other State regulatory agency) of the subsidiary;

"(B) avoid duplication of examination activities, reporting requirements, and requests for information; and

"(C) ensure that the depository institution holding company and the subsidiaries of the depository institution holding company are not subject to conflicting supervisory demands by the appropriate Federal banking agencies.

"(g) RULE OF CONSTRUCTION.—No provision of this section shall be construed as limiting any authority of the Board, the Corporation, or the Comptroller of the Currency under any other provision of law.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the transfer date.

SEC. 606. REQUIREMENTS FOR FINANCIAL HOLDING COMPANIES TO REMAIN WELL CAPITALIZED AND WELL MANAGED.

(a) AMENDMENT.—Section 4(l)(1) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(l)(1)) is amended—

(1) in subparagraph (B), by striking "and" at the end;

(2) by redesignating subparagraph (C) as subparagraph (D);

(3) by inserting after subparagraph (B) the following:

"(C) the bank holding company is well capitalized and well managed; and"; and

(4) in subparagraph (D)(ii), as so redesignated, by striking "subparagraphs (A) and (B)" and inserting "subparagraphs (A), (B), and (C)".

(b) HOME OWNERS' LOAN ACT AMENDMENT.—Section 10(c)(2) of the Home Owners' Loan Act (12 U.S.C. 1467a(c)(2)) is amended by adding at the end the following new subparagraph:

"(H) Any activity that is permissible for a financial holding company (as such term is defined under section 2(p) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(p)) to conduct under section 4(k) of the Bank Holding Company Act of 1956 if—

"(i) the savings and loan holding company meets all of the criteria to qualify as a financial holding company, and complies with all of the requirements applicable to a financial holding company, under sections 4(l) and 4(m) of the Bank Holding Company Act and section 804(c) of the Community Reinvestment Act of 1977 (12 U.S.C. 2903(c)) as if the savings and loan holding company was a bank holding company; and

"(ii) the savings and loan holding company conducts the activity in accordance with the same terms, conditions, and requirements that apply to the conduct of such activity by a bank holding company under the Bank Holding Company Act of 1956 and the Board's regulations and interpretations under such Act.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the transfer date.

SEC. 607. STANDARDS FOR INTERSTATE ACQUISITIONS.

(a) ACQUISITION OF BANKS.—Section 3(d)(1)(A) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(d)(1)(A)) is amended by striking "adequately capitalized and adequately managed" and inserting "well capitalized and well managed".

(b) INTERSTATE BANK MERGERS.—Section 44(b)(4)(B) of the Federal Deposit Insurance Act (12 U.S.C. 1831u(b)(4)(B)) is amended by striking "will continue to be adequately capitalized and adequately managed" and inserting "will be well capitalized and well managed".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the transfer date.

SEC. 608. ENHANCING EXISTING RESTRICTIONS ON BANK TRANSACTIONS WITH AFFILIATES.

(a) AFFILIATE TRANSACTIONS.—Section 23A of the Federal Reserve Act (12 U.S.C. 371c) is amended—

(1) in subsection (b)—

(A) in paragraph (1), by striking subparagraph (D) and inserting the following:

"(D) any investment fund with respect to which a member bank or affiliate thereof is an investment adviser; and"; and

(B) in paragraph (7)—

(i) in subparagraph (A), by inserting before the semicolon at the end the following: ", including a purchase of assets subject to an agreement to repurchase";

(ii) in subparagraph (C), by striking ", including assets subject to an agreement to repurchase,";

(iii) in subparagraph (D)—

(I) by inserting "or other debt obligations" after "acceptance of securities"; and

(II) by striking "or" at the end; and

(iv) by adding at the end the following:

"(F) a transaction with an affiliate that involves the borrowing or lending of securities, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate; or

"(G) a derivative transaction, as defined in paragraph (3) of section 5200(b) of the Revised Statutes of the United States (12 U.S.C. 84(b)), with an affiliate, to the extent that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate;";

(2) in subsection (c)—

(A) in paragraph (1)—

(i) in the matter preceding subparagraph (A), by striking "subsidiary" and all that follows through "time of the transaction" and inserting "subsidiary, and any credit exposure of a member bank or a subsidiary to an affiliate resulting from a securities borrowing or lending transaction, or a derivative transaction, shall be secured at all times"; and

(ii) in each of subparagraphs (A) through (D), by striking "or letter of credit" and inserting "letter of credit, or credit exposure";

(B) by striking paragraph (2);

(C) by redesignating paragraphs (3) through (5) as paragraphs (2) through (4), respectively;

(D) in paragraph (2), as so redesignated, by inserting before the period at the end ", or credit exposure to an affiliate resulting from a securities borrowing or lending transaction, or derivative transaction"; and

(E) in paragraph (3), as so redesignated—

(i) by inserting "or other debt obligations" after "securities"; and

(ii) by striking "or guarantee" and all that follows through "behalf of," and inserting "guarantee, acceptance, or letter of credit issued on behalf of, or credit exposure from a securities borrowing or lending transaction, or derivative transaction to,";

(3) in subsection (d)(4), in the matter preceding subparagraph (A), by striking "or issuing" and all that follows through "behalf of," and inserting "issuing a guarantee, acceptance, or letter of credit on behalf of, or having credit exposure resulting from a securities borrowing or lending transaction, or derivative transaction to,"; and

(4) in subsection (f)—

(A) in paragraph (2)—

(i) by striking "or order";

(ii) by striking "if it finds" and all that follows through the end of the paragraph and inserting the following: "if—

"(i) the Board finds the exemption to be in the public interest and consistent with the purposes of this section, and notifies the Federal Deposit Insurance Corporation of such finding; and

"(ii) before the end of the 60-day period beginning on the date on which the Federal Deposit Insurance Corporation receives notice of the finding under clause (i), the Federal Deposit Insurance Corporation does not object, in writing, to the finding, based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund.";

(iii) by striking the Board and inserting the following:

"(A) IN GENERAL.—The Board"; and

(iv) by adding at the end the following:

"(B) ADDITIONAL EXEMPTIONS.—

"(i) NATIONAL BANKS.—The Comptroller of the Currency may, by order, exempt a transaction of a national bank from the requirements of this section if—

"(I) the Board and the Office of the Comptroller of the Currency jointly find the exemption to be in the public interest and consistent with the purposes of this section and notify the Federal Deposit Insurance Corporation of such finding; and

"(II) before the end of the 60-day period beginning on the date on which the Federal Deposit Insurance Corporation receives notice of the finding under subclause (I), the Federal Deposit Insurance Corporation does not object, in writing, to the finding, based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund.

"(ii) STATE BANKS.—The Federal Deposit Insurance Corporation may, by order, exempt a transaction of a State nonmember bank, and the Board may, by order, exempt a transaction of a State member bank, from the requirements of this section if—

"(I) the Board and the Federal Deposit Insurance Corporation jointly find that the exemption is in the public interest and consistent with the purposes of this section; and

"(II) the Federal Deposit Insurance Corporation finds that the exemption does not present an unacceptable risk to the Deposit Insurance Fund."; and

(B) by adding at the end the following:

"(4) AMOUNTS OF COVERED TRANSACTIONS.—The Board may issue such regulations or interpretations as the Board determines are necessary or appropriate with respect to the manner in which a netting agreement may be taken into account in determining the amount of a covered transaction between a member bank or a subsidiary and an affiliate, including the extent to which netting agreements between a member bank or a subsidiary and an affiliate may be taken into account in determining whether a covered transaction is fully secured for purposes of subsection (d)(4). An interpretation under this paragraph with respect to a specific member bank, subsidiary, or affiliate shall be issued jointly with the appropriate Federal banking agency for such member bank, subsidiary, or affiliate.".

(b) TRANSACTIONS WITH AFFILIATES.—Section 23B(e) of the Federal Reserve Act (12 U.S.C. 371c–1(e)) is amended—

(1) by striking the undesignated matter following subparagraph (B);

(2) by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively, and adjusting the clause margins accordingly;

(3) by redesignating paragraphs (1) and (2) as subparagraphs (A) and (B), respectively, and adjusting the subparagraph margins accordingly;

(4) by striking "The Board" and inserting the following: "(1) IN GENERAL.—The Board";

(5) in paragraph (1)(B), as so redesignated—

(A) in the matter preceding clause (i), by inserting before "regulations" the following: "subject to paragraph (2), if the Board finds that an exemption or exclusion is in the public interest and is consistent with the purposes of this section, and notifies the Federal Deposit Insurance Corporation of such finding,"; and

(B) in clause (ii), by striking the comma at the end and inserting a period; and

(6) by adding at the end the following:

"(2) EXCEPTION.—The Board may grant an exemption or exclusion under this subsection only if, during the 60-day period beginning on the date of receipt of notice of the finding from the Board under paragraph (1)(B), the Federal Deposit Insurance Corporation does not object, in writing, to such exemption or exclusion, based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund.".

(c) HOME OWNERS' LOAN ACT.—Section 11 of the Home Owners' Loan Act (12 U.S.C. 1468) is amended by adding at the end the following:

"(d) EXEMPTIONS.—

"(1) FEDERAL SAVINGS ASSOCIATIONS.—The Comptroller of the Currency may, by order, exempt a transaction of a Federal savings association from the requirements of this section if—

"(A) the Board and the Office of the Comptroller of the Currency jointly find the exemption to be in the public interest and consistent with the purposes of this section and notify the Federal Deposit Insurance Corporation of such finding; and

"(B) before the end of the 60-day period beginning on the date on which the Federal Deposit Insurance Corporation receives notice of the finding under subparagraph (A), the Federal Deposit Insurance Corporation does not object, in writing, to the finding, based on a determination that the exemption presents an unacceptable risk to the Deposit Insurance Fund.

"(2) STATE SAVINGS ASSOCIATION.—The Federal Deposit Insurance Corporation may, by order, exempt a transaction of a State savings association from the requirements of this section if the Board and the Federal Deposit Insurance Corporation jointly find that—

"(A) the exemption is in the public interest and consistent with the purposes of this section; and

"(B) the exemption does not present an unacceptable risk to the Deposit Insurance Fund.".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect 1 year after the transfer date.

SEC. 609. ELIMINATING EXCEPTIONS FOR TRANSACTIONS WITH FINANCIAL SUBSIDIARIES.

(a) AMENDMENT.—Section 23A(e) of the Federal Reserve Act (12 U.S.C. 371c(e)) is amended—

(1) by striking paragraph (3); and

(2) by redesignating paragraph (4) as paragraph (3).

(b) PROSPECTIVE APPLICATION OF AMENDMENT.—The amendments made by this section shall apply with respect to any covered transaction between a bank and a subsidiary of the bank, as those terms are defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c), that is entered into on or after the date of enactment of this Act.

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect 1 year after the transfer date.

SEC. 610. LENDING LIMITS APPLICABLE TO CREDIT EXPOSURE ON DERIVATIVE TRANSACTIONS, REPURCHASE AGREEMENTS, REVERSE REPURCHASE AGREEMENTS, AND SECURITIES LENDING AND BORROWING TRANSACTIONS.

(a) NATIONAL BANKS.—Section 5200(b) of the Revised Statutes of the United States (12 U.S.C. 84(b)) is amended—

(1) in paragraph (1), by striking "shall include" and all that follows through the end of the paragraph and inserting the following: "shall include—

"(A) all direct or indirect advances of funds to a person made on the basis of any obligation of that person to repay the funds or repayable from specific property pledged by or on behalf of the person;

"(B) to the extent specified by the Comptroller of the Currency, any liability of a national banking association to advance funds to or on behalf of a person pursuant to a contractual commitment; and

"(C) any credit exposure to a person arising from a derivative transaction, repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between the national banking association and the person;";

(2) in paragraph (2), by striking the period at the end and inserting "; and"; and

(3) by adding at the end the following:

"(3) the term 'derivative transaction' includes any transaction that is a contract, agreement, swap, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets.".

(b) SAVINGS ASSOCIATIONS.—Section 5(u)(3) of the Home Owners' Loan Act (12 U.S.C. 1464(u)(3)) is amended by striking "Director" each place that term appears and inserting "Comptroller of the Currency".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect 1 year after the transfer date.

SEC. 611. CONSISTENT TREATMENT OF DERIVATIVE TRANSACTIONS IN LENDING LIMITS.

(a) AMENDMENT.—Section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) is amended by adding at the end the following:

"(y) STATE LENDING LIMIT TREATMENT OF DERIVATIVES TRANSACTIONS.—An insured State bank may engage in a derivative transaction, as defined in section 5200(b)(3) of the Revised Statutes of the United States (12 U.S.C. 84(b)(3)), only if the law with respect to lending limits of the State in which the insured State bank is chartered takes into consideration credit exposure to derivative transactions.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect 18 months after the transfer date.

SEC. 612. RESTRICTION ON CONVERSIONS OF TROUBLED BANKS.

(a) CONVERSION OF A NATIONAL BANKING ASSOCIATION.—The Act entitled "An Act to provide for the conversion of national banking associations into and their merger or consolidation with State banks, and for other purposes." (12 U.S.C. 214 et seq.) is amended by adding at the end the following:

"SEC. 10. PROHIBITION ON CONVERSION.

"A national banking association may not convert to a State bank or State savings association during any period in which the national banking association is subject to a cease and desist order (or other formal enforcement order) issued by, or a memorandum of understanding entered into with, the Comptroller of the Currency with respect to a significant supervisory matter.".

(b) CONVERSION OF A STATE BANK OR SAVINGS ASSOCIATION.—Section 5154 of the Revised Statutes of the United States (12 U.S.C. 35) is amended by adding at the end the following: "The Comptroller of the Currency may not approve the conversion of a State bank or State savings association to a national banking association or Federal savings association during any period in which the State bank or State savings association is subject to a cease and desist order (or other formal enforcement order) issued by, or a memorandum of understanding entered into with, a State bank supervisor or the appropriate Federal banking agency with respect to a significant supervisory matter or a final enforcement action by a State Attorney General.''.

(c) CONVERSION OF A FEDERAL SAVINGS ASSOCIATION.—Section 5(i) of the Home Owners' Loan Act (12 U.S.C. 1464(i)) is amended by adding at the end the following:

''(6) LIMITATION ON CERTAIN CONVERSIONS BY FEDERAL SAVINGS ASSOCIATIONS.—A Federal savings association may not convert to a State bank or State savings association during any period in which the Federal savings association is subject to a cease and desist order (or other formal enforcement order) issued by, or a memorandum of understanding entered into with, the Office of Thrift Supervision or the Comptroller of the Currency with respect to a significant supervisory matter.''.

(d) EXCEPTION.—The prohibition on the approval of conversions under the amendments made by subsections (a), (b), and (c) shall not apply, if—

(1) the Federal banking agency that would be the appropriate Federal banking agency after the proposed conversion gives the appropriate Federal banking agency or State bank supervisor that issued the cease and desist order (or other formal enforcement order) or memorandum of understanding, as appropriate, written notice of the proposed conversion including a plan to address the significant supervisory matter in a manner that is consistent with the safe and sound operation of the institution;

(2) within 30 days of receipt of the written notice required under paragraph (1), the appropriate Federal banking agency or State bank supervisor that issued the cease and desist order (or other formal enforcement order) or memorandum of understanding, as appropriate, does not object to the conversion or the plan to address the significant supervisory matter;

(3) after conversion of the insured depository institution, the appropriate Federal banking agency after the conversion implements such plan; and

(4) in the case of a final enforcement action by a State Attorney General, approval of the conversion is conditioned on compliance by the insured depository institution with the terms of such final enforcement action.

(e) NOTIFICATION OF PENDING ENFORCEMENT ACTIONS.—

(1) COPY OF CONVERSION APPLICATION.—At the time an insured depository institution files a conversion application, the insured depository institution shall transmit a copy of the conversion application to—

(A) the appropriate Federal banking agency for the insured depository institution; and

(B) the Federal banking agency that would be the appropriate Federal banking agency of the insured depository institution after the proposed conversion.

(2) NOTIFICATION AND ACCESS TO INFORMATION.—Upon receipt of a copy of the application described in paragraph (1), the appropriate Federal banking agency for the insured depository institution proposing the conversion shall—

(A) notify the Federal banking agency that would be the appropriate Federal banking agency for the institution after the proposed conversion in writing of any ongoing supervisory or investigative proceedings that the appropriate Federal banking agency for the institution proposing to convert believes is likely to result, in the near term and absent the proposed conversion, in a cease and desist order (or other formal enforcement order) or memorandum of understanding with respect to a significant supervisory matter; and

(B) provide the Federal banking agency that would be the appropriate Federal banking agency for the institution after the proposed conversion access to all investigative and supervisory information relating to the proceedings described in subparagraph (A).

SEC. 613. DE NOVO BRANCHING INTO STATES.

(a) NATIONAL BANKS.—Section 5155(g)(1)(A) of the Revised Statutes of the United States (12 U.S.C. 36(g)(1)(A)) is amended to read as follows:

"(A) the law of the State in which the branch is located, or is to be located, would permit establishment of the branch, if the national bank were a State bank chartered by such State; and".

(b) STATE INSURED BANKS.—Section 18(d)(4)(A)(i) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(4)(A)(i)) is amended to read as follows:

"(i) the law of the State in which the branch is located, or is to be located, would permit establishment of the branch, if the bank were a State bank chartered by such State; and".

SEC. 614. LENDING LIMITS TO INSIDERS.

(a) EXTENSIONS OF CREDIT.—Section 22(h)(9)(D)(i) of the Federal Reserve Act (12 U.S.C. 375b(9)(D)(i)) is amended—

(1) by striking the period at the end and inserting "; or";

(2) by striking "a person" and inserting "the person";

(3) by striking "extends credit by making" and inserting the following: "extends credit to a person by—

"(I) making"; and

(4) by adding at the end the following:

"(II) having credit exposure to the person arising from a derivative transaction (as defined in section 5200(b) of the Revised Statutes of the United States (12 U.S.C. 84(b))), repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction between the member bank and the person.".

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect 1 year after the transfer date.

SEC. 615. LIMITATIONS ON PURCHASES OF ASSETS FROM INSIDERS.

(a) AMENDMENT TO THE FEDERAL DEPOSIT INSURANCE ACT.—Section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) is amended by adding at the end the following:

"(z) GENERAL PROHIBITION ON SALE OF ASSETS.—

"(1) IN GENERAL.—An insured depository institution may not purchase an asset from, or sell an asset to, an executive officer, director, or principal shareholder of the insured depository institution, or any related interest of such person (as such terms are defined in section 22(h) of Federal Reserve Act), unless—

"(A) the transaction is on market terms; and

"(B) if the transaction represents more than 10 percent of the capital stock and surplus of the insured depository institution, the transaction has been approved in advance by a majority of the members of the board of directors of the insured depository institution who do not have an interest in the transaction.

"(2) RULEMAKING.—The Board of Governors of the Federal Reserve System may issue such rules as may be necessary to define terms and to carry out the purposes this subsection. Before proposing or adopting a rule under this paragraph, the Board of Governors of the Federal Reserve System shall consult with the Comptroller of the Currency and the Corporation as to the terms of the rule.".

(b) AMENDMENTS TO THE FEDERAL RESERVE ACT.—Section 22(d) of the Federal Reserve Act (12 U.S.C. 375) is amended to read as follows:

"(d) [Reserved]".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the transfer date.

SEC. 616. REGULATIONS REGARDING CAPITAL LEVELS.

(a) CAPITAL LEVELS OF BANK HOLDING COMPANIES.—Section 5(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(b)) is amended—

(1) by inserting after "orders" the following: ", including regulations and orders relating to the capital requirements for bank holding companies,"; and

(2) by adding at the end the following: "In establishing capital regulations pursuant to this subsection, the Board shall seek to make such requirements countercyclical, so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of the company.".

(b) CAPITAL LEVELS OF SAVINGS AND LOAN HOLDING COMPANIES.—Section 10(g)(1) of the Home Owners' Loan Act (12 U.S.C. 1467a(g)(1)) is amended—

(1) by inserting after "orders" the following: ", including regulations and orders relating to capital requirements for savings and loan holding companies,"; and

(2) by inserting at the end the following: "In establishing capital regulations pursuant to this subsection, the appropriate Federal banking agency shall seek to make such requirements countercyclical so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of the company.".

(c) CAPITAL LEVELS OF INSURED DEPOSITORY INSTITUTIONS.—Section 908(a)(1) of the International Lending Supervision Act of 1983 (12 U.S.C. 3907(a)(1)) is amended by adding at the end the following: "Each appropriate Federal banking agency shall seek to make the capital standards required under this section or other provisions of Federal law for insured depository institutions countercyclical so that the amount of capital required to be maintained by an insured depository institution increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of the insured depository institution.''

(d) SOURCE OF STRENGTH.—The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by inserting after section 38 (12 U.S.C. 1831o) the following:

''SEC. 38A. SOURCE OF STRENGTH.

''(a) HOLDING COMPANIES.—The appropriate Federal banking agency for a bank holding company or savings and loan holding company shall require the bank holding company or savings and loan holding company to serve as a source of financial strength for any subsidiary of the bank holding company or savings and loan holding company that is a depository institution.

''(b) OTHER COMPANIES.—If an insured depository institution is not the subsidiary of a bank holding company or savings and loan holding company, the appropriate Federal banking agency for the insured depository institution shall require any company that directly or indirectly controls the insured depository institution to serve as a source of financial strength for such institution.

''(c) REPORTS.—The appropriate Federal banking agency for an insured depository institution described in subsection (b) may, from time to time, require the company, or a company that directly or indirectly controls the insured depository institution, to submit a report, under oath, for the purposes of—

''(1) assessing the ability of such company to comply with the requirement under subsection (b); and

''(2) enforcing the compliance of such company with the requirement under subsection (b).

''(d) RULES.—Not later than 1 year after the transfer date, as defined in section 311 of the Enhancing Financial Institution Safety and Soundness Act of 2010, the appropriate Federal banking agencies shall jointly issue final rules to carry out this section.

''(e) DEFINITION.—In this section, the term 'source of financial strength' means the ability of a company that directly or indirectly owns or controls an insured depository institution to provide financial assistance to such insured depository institution in the event of the financial distress of the insured depository institution.''.

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect on the transfer date.

SEC. 617. ELIMINATION OF ELECTIVE INVESTMENT BANK HOLDING COMPANY FRAMEWORK.

(a) AMENDMENT.—Section 17 of the Securities Exchange Act of 1934 (15 U.S.C. 78q) is amended—

(1) by striking subsection (i); and

(2) by redesignating subsections (j) and (k) as subsections (i) and (j), respectively.

(b) EFFECTIVE DATE.—The amendments made by this section shall take effect on the transfer date.

SEC. 618. SECURITIES HOLDING COMPANIES.

(a) DEFINITIONS.—In this section—

(1) the term ''associated person of a securities holding company'' means a person directly or indirectly controlling, controlled by, or under common control with, a securities holding company;

(2) the term "foreign bank" has the same meaning as in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(7));

(3) the term "insured bank" has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(4) the term "securities holding company"—

(A) means—

(i) a person (other than a natural person) that owns or controls 1 or more brokers or dealers registered with the Commission; and

(ii) the associated persons of a person described in clause (i); and

(B) does not include a person that is—

(i) a nonbank financial company supervised by the Board under title I;

(ii) an insured bank (other than an institution described in subparagraphs (D), (F), or (H) of section 2(c)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)) or a savings association;

(iii) an affiliate of an insured bank (other than an institution described in subparagraphs (D), (F), or (H) of section 2(c)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)) or an affiliate of a savings association;

(iv) a foreign bank, foreign company, or company that is described in section 8(a) of the International Banking Act of 1978 (12 U.S.C. 3106(a));

(v) a foreign bank that controls, directly or indirectly, a corporation chartered under section 25A of the Federal Reserve Act (12 U.S.C. 611 et seq.); or

(vi) subject to comprehensive consolidated supervision by a foreign regulator;

(5) the term "supervised securities holding company" means a securities holding company that is supervised by the Board of Governors under this section; and

(6) the terms "affiliate", "bank", "bank holding company", "company", "control", "savings association", and "subsidiary" have the same meanings as in section 2 of the Bank Holding Company Act of 1956.

(b) SUPERVISION OF A SECURITIES HOLDING COMPANY NOT HAVING A BANK OR SAVINGS ASSOCIATION AFFILIATE.—

(1) IN GENERAL.—A securities holding company that is required by a foreign regulator or provision of foreign law to be subject to comprehensive consolidated supervision may register with the Board of Governors under paragraph (2) to become a supervised securities holding company. Any securities holding company filing such a registration shall be supervised in accordance with this section, and shall comply with the rules and orders prescribed by the Board of Governors applicable to supervised securities holding companies.

(2) REGISTRATION AS A SUPERVISED SECURITIES HOLDING COMPANY.—

(A) REGISTRATION.—A securities holding company that elects to be subject to comprehensive consolidated supervision shall register by filing with the Board of Governors such information and documents as the Board of Governors, by regulation, may prescribe as necessary or appropriate in furtherance of the purposes of this section.

(B) EFFECTIVE DATE.—A securities holding company that registers under subparagraph (A) shall be deemed to be a supervised securities holding company, effective on the date that is 45 days after the date of receipt of the registration information and documents under subparagraph (A) by the Board of Governors, or within such shorter period as the Board of Governors, by rule or order, may determine.

(c) SUPERVISION OF SECURITIES HOLDING COMPANIES.—

(1) RECORDKEEPING AND REPORTING.—

(A) RECORDKEEPING AND REPORTING REQUIRED.—Each supervised securities holding company and each affiliate of a supervised securities holding company shall make and keep for periods determined by the Board of Governors such records, furnish copies of such records, and make such reports, as the Board of Governors determines to be necessary or appropriate to carry out this section, to prevent evasions thereof, and to monitor compliance by the supervised securities holding company or affiliate with applicable provisions of law.

(B) FORM AND CONTENTS.—

(i) IN GENERAL.—Any record or report required to be made, furnished, or kept under this paragraph shall—

(I) be prepared in such form and according to such specifications (including certification by a registered public accounting firm), as the Board of Governors may require; and

(II) be provided promptly to the Board of Governors at any time, upon request by the Board of Governors.

(ii) CONTENTS.—Records and reports required to be made, furnished, or kept under this paragraph may include—

(I) a balance sheet or income statement of the supervised securities holding company or an affiliate of a supervised securities holding company;

(II) an assessment of the consolidated capital and liquidity of the supervised securities holding company;

(III) a report by an independent auditor attesting to the compliance of the supervised securities holding company with the internal risk management and internal control objectives of the supervised securities holding company; and

(IV) a report concerning the extent to which the supervised securities holding company or affiliate has complied with the provisions of this section and any regulations prescribed and orders issued under this section.

(2) USE OF EXISTING REPORTS.—

(A) IN GENERAL.—The Board of Governors shall, to the fullest extent possible, accept reports in fulfillment of the requirements of this paragraph that a supervised securities holding company or an affiliate of a supervised securities holding company has been required to provide to another regulatory agency or a self-regulatory organization.

(B) AVAILABILITY.—A supervised securities holding company or an affiliate of a supervised securities holding company shall promptly provide to the Board of Governors, at the request of the Board of Governors, any report described in subparagraph (A), as permitted by law.

(3) EXAMINATION AUTHORITY.—

(A) FOCUS OF EXAMINATION AUTHORITY.—The Board of Governors may make examinations of any supervised securities holding company and any affiliate of a supervised securities holding company to carry out this subsection, to prevent evasions thereof, and to monitor compliance by the supervised securities holding company or affiliate with applicable provisions of law.

(B) DEFERENCE TO OTHER EXAMINATIONS.—For purposes of this subparagraph, the Board of Governors shall, to the fullest extent possible, use the reports of examination made by other appropriate Federal or State regulatory authorities with respect to any functionally regulated subsidiary or any institution described in subparagraph (D), (F), or (H) of section 2(c)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)).

(d) CAPITAL AND RISK MANAGEMENT.—

(1) IN GENERAL.—The Board of Governors shall, by regulation or order, prescribe capital adequacy and other risk management standards for supervised securities holding companies that are appropriate to protect the safety and soundness of the supervised securities holding companies and address the risks posed to financial stability by supervised securities holding companies.

(2) DIFFERENTIATION.—In imposing standards under this subsection, the Board of Governors may differentiate among supervised securities holding companies on an individual basis, or by category, taking into consideration the requirements under paragraph (3).

(3) CONTENT.—Any standards imposed on a supervised securities holding company under this subsection shall take into account—

(A) the differences among types of business activities carried out by the supervised securities holding company;

(B) the amount and nature of the financial assets of the supervised securities holding company;

(C) the amount and nature of the liabilities of the supervised securities holding company, including the degree of reliance on short-term funding;

(D) the extent and nature of the off-balance sheet exposures of the supervised securities holding company;

(E) the extent and nature of the transactions and relationships of the supervised securities holding company with other financial companies;

(F) the importance of the supervised securities holding company as a source of credit for households, businesses, and State and local governments, and as a source of liquidity for the financial system; and

(G) the nature, scope, and mix of the activities of the supervised securities holding company.

(4) NOTICE.—A capital requirement imposed under this subsection may not take effect earlier than 180 days after the date on which a supervised securities holding company is provided notice of the capital requirement.

(e) OTHER PROVISIONS OF LAW APPLICABLE TO SUPERVISED SECURITIES HOLDING COMPANIES.—

(1) FEDERAL DEPOSIT INSURANCE ACT.—Subsections (b), (c) through (s), and (u) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) shall apply to any supervised securities holding company, and to any subsidiary (other than a bank or an institution described in subparagraph (D), (F), or (H) of section 2(c)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2))) of a supervised securities holding company, in the same manner as such subsections apply to a bank holding company for which the Board of Governors is the appropriate Federal banking agency. For purposes of applying such subsections to a supervised securities holding company or a subsidiary (other than a bank or an institution described in subparagraph (D), (F), or (H) of section 2(c)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2))) of a supervised securities holding company, the Board of Governors shall be deemed the appropriate Federal banking agency for the supervised securities holding company or subsidiary.

(2) BANK HOLDING COMPANY ACT OF 1956.—Except as the Board of Governors may otherwise provide by regulation or order, a supervised securities holding company shall be subject to the provisions of the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) in the same manner and to the same extent a bank holding company is subject to such provisions, except that a supervised securities holding company may not, by reason of this paragraph, be deemed to be a bank holding company for purposes of section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843).

SEC. 619. PROHIBITIONS ON PROPRIETARY TRADING AND CERTAIN RELATIONSHIPS WITH HEDGE FUNDS AND PRIVATE EQUITY FUNDS.

The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended by adding at the end the following:

"SEC. 13. PROHIBITIONS ON PROPRIETARY TRADING AND CERTAIN RELATIONSHIPS WITH HEDGE FUNDS AND PRIVATE EQUITY FUNDS.

"(a) IN GENERAL.—

"(1) PROHIBITION.—Unless otherwise provided in this section, a banking entity shall not—

"(A) engage in proprietary trading; or

"(B) acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund.

"(2) NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD.—Any nonbank financial company supervised by the Board that engages in proprietary trading or takes or retains any equity, partnership, or other ownership interest in or sponsors a hedge fund or a private equity fund shall be subject, by rule, as provided in subsection (b)(2), to additional capital requirements for and additional quantitative limits with regards to such proprietary trading and taking or retaining any equity, partnership, or other ownership interest in or sponsorship of a hedge fund or a private equity fund, except that permitted activities as described in subsection (d) shall not be subject to the additional capital and additional quantitative limits except as provided in subsection (d)(3), as if the nonbank financial company supervised by the Board were a banking entity.

"(b) STUDY AND RULEMAKING.—

"(1) STUDY.—Not later than 6 months after the date of enactment of this section, the Financial Stability Oversight Council shall study and make recommendations on implementing the provisions of this section so as to—

"(A) promote and enhance the safety and soundness of banking entities;

"(B) protect taxpayers and consumers and enhance financial stability by minimizing the risk that insured depository institutions and the affiliates of insured depository institutions will engage in unsafe and unsound activities;

"(C) limit the inappropriate transfer of Federal subsidies from institutions that benefit from deposit insurance and liquidity facilities of the Federal Government to unregulated entities;

"(D) reduce conflicts of interest between the self-interest of banking entities and nonbank financial companies supervised by the Board, and the interests of the customers of such entities and companies;

"(E) limit activities that have caused undue risk or loss in banking entities and nonbank financial companies supervised by the Board, or that might reasonably be expected to create undue risk or loss in such banking entities and nonbank financial companies supervised by the Board;

"(F) appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system; and

"(G) appropriately time the divestiture of illiquid assets that are affected by the implementation of the prohibitions under subsection (a).

"(2) RULEMAKING.—

"(A) IN GENERAL.—Unless otherwise provided in this section, not later than 9 months after the completion of the study under paragraph (1), the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, shall consider the findings of the study under paragraph (1) and adopt rules to carry out this section, as provided in subparagraph (B).

"(B) COORDINATED RULEMAKING.—

"(i) REGULATORY AUTHORITY.—The regulations issued under this paragraph shall be issued by—

"(I) the appropriate Federal banking agencies, jointly, with respect to insured depository institutions;

"(II) the Board, with respect to any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act, any nonbank financial company supervised by the Board, and any subsidiary of any of the foregoing (other than a subsidiary for which an agency described in subclause (I), (III), or (IV) is the primary financial regulatory agency);

"(III) the Commodity Futures Trading Commission, with respect to any entity for which the Commodity Futures Trading Commission is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and

"(IV) the Securities and Exchange Commission, with respect to any entity for which the Securities and Exchange Commission is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

"(ii) COORDINATION, CONSISTENCY, AND COMPARABILITY.—In developing and issuing regulations pursuant to this section, the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall consult and coordinate with each other, as appropriate, for the purposes of assuring, to the extent possible, that such regulations are comparable and provide for consistent application and implementation of the applicable provisions of this section to avoid providing advantages or imposing disadvantages to the companies affected by this subsection and to protect the safety and soundness of banking entities and nonbank financial companies supervised by the Board.

"(iii) COUNCIL ROLE.—The Chairperson of the Financial Stability Oversight Council shall be responsible for coordination of the regulations issued under this section.

"(c) EFFECTIVE DATE.—

"(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), this section shall take effect on the earlier of—

"(A) 12 months after the date of the issuance of final rules under subsection (b); or

"(B) 2 years after the date of enactment of this section.

"(2) CONFORMANCE PERIOD FOR DIVESTITURE.—A banking entity or nonbank financial company supervised by the Board shall bring its activities and investments into compliance with the requirements of this section not later than 2 years after the date on which the requirements become effective pursuant to this section or 2 years after the date on which the entity or company becomes a nonbank financial company supervised by the Board. The Board may, by rule or order, extend this two-year period for not more than one year at a time, if, in the judgment of the Board, such an extension is consistent with the purposes of this section and would not be detrimental to the public interest. The extensions made by the Board under the preceding sentence may not exceed an aggregate of 3 years.

"(3) EXTENDED TRANSITION FOR ILLIQUID FUNDS.—

"(A) APPLICATION.—The Board may, upon the application of a banking entity, extend the period during which the banking entity, to the extent necessary to fulfill a contractual obligation that was in effect on May 1, 2010, may take or retain its equity, partnership, or other ownership interest in, or otherwise provide additional capital to, an illiquid fund.

"(B) TIME LIMIT ON APPROVAL.—The Board may grant 1 extension under subparagraph (A), which may not exceed 5 years.

"(4) DIVESTITURE REQUIRED.—Except as otherwise provided in subsection (d)(1)(G), a banking entity may not engage in any activity prohibited under subsection (a)(1)(B) after the earlier of—

"(A) the date on which the contractual obligation to invest in the illiquid fund terminates; and

"(B) the date on which any extensions granted by the Board under paragraph (3) expire.

"(5) ADDITIONAL CAPITAL DURING TRANSITION PERIOD.—Notwithstanding paragraph (2), on the date on which the rules are issued under subsection (b)(2), the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall issue rules, as provided in subsection (b)(2), to impose additional capital requirements, and any other restrictions, as appropriate, on any equity, partnership, or ownership interest in or sponsorship of a hedge fund or private equity fund by a banking entity.

"(6) SPECIAL RULEMAKING.—Not later than 6 months after the date of enactment of this section, the Board shall issues rules to implement paragraphs (2) and (3).

"(d) PERMITTED ACTIVITIES.—

"(1) IN GENERAL.—Notwithstanding the restrictions under subsection (a), to the extent permitted by any other provision of Federal or State law, and subject to the limitations under paragraph (2) and any restrictions or limitations that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, may determine, the following activities (in this section referred to as 'permitted activities') are permitted:

"(A) The purchase, sale, acquisition, or disposition of obligations of the United States or any agency thereof, obligations, participations, or other instruments of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.), and obligations of any State or of any political subdivision thereof.

"(B) The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) in connection with underwriting or market-making-related activities, to the extent that any such activities permitted by this subparagraph are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.

"(C) Risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.

"(D) The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) on behalf of customers.

"(E) Investments in one or more small business investment companies, as defined in section 102 of the Small Business Investment Act of 1958 (15 U.S.C. 662), investments designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), or investments that are qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

"(F) The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company, provided that such activities by any affiliate are solely for the general account of the regulated insurance company, if—

"(i) the purchase, sale, acquisition, or disposition is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which each such insurance company is domiciled; and

"(ii) the appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and territories of the United States, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in clause (i) is insufficient to protect the safety and soundness of the banking entity, or of the financial stability of the United States.

"(G) Organizing and offering a private equity or hedge fund, including serving as a general partner, managing member, or trustee of the fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the fund, including any necessary expenses for the foregoing, only if—

"(i) the banking entity provides bona fide trust, fiduciary, or investment advisory services;

"(ii) the fund is organized and offered only in connection with the provision of bona fide trust, fiduciary, or investment advisory services and only to persons that are customers of such services of the banking entity;

"(iii) the banking entity does not acquire or retain an equity interest, partnership interest, or other ownership interest in the funds except for a de minimis investment subject to and in compliance with paragraph (4);

"(iv) the banking entity complies with the restrictions under paragraphs (1) and (2) of subparagraph (f);

"(v) the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the hedge fund or private equity fund or of any hedge fund or private equity fund in which such hedge fund or private equity fund invests;

"(vi) the banking entity does not share with the hedge fund or private equity fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name;

"(vii) no director or employee of the banking entity takes or retains an equity interest, partnership interest, or other ownership interest in the hedge fund or private equity fund, except for any director or employee of the banking entity who is directly engaged in providing investment advisory or other services to the hedge fund or private equity fund; and

"(viii) the banking entity discloses to prospective and actual investors in the fund, in writing, that any losses in such hedge fund or private equity fund are borne solely by investors in the fund and not by the banking entity, and otherwise complies with any additional rules of the appropriate Federal banking agencies, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, as provided in subsection (b)(2), designed to ensure that losses in such hedge fund or private equity fund are borne solely by investors in the fund and not by the banking entity.

"(H) Proprietary trading conducted by a banking entity pursuant to paragraph (9) or (13) of section 4(c), provided that the trading occurs solely outside of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States.

"(I) The acquisition or retention of any equity, partnership, or other ownership interest in, or the sponsorship of, a hedge fund or a private equity fund by a banking entity pursuant to paragraph (9) or (13) of section 4(c) solely outside of the United States, provided that no ownership interest in such hedge fund or private equity fund is offered for sale or sold to a resident of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States.

"(J) Such other activity as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission determine, by rule, as provided in subsection (b)(2), would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.

"(2) LIMITATION ON PERMITTED ACTIVITIES.—

"(A) IN GENERAL.—No transaction, class of transactions, or activity may be deemed a permitted activity under paragraph (1) if the transaction, class of transactions, or activity—

"(i) would involve or result in a material conflict of interest (as such term shall be defined by rule as provided in subsection (b)(2)) between the banking entity and its clients, customers, or counterparties;

"(ii) would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies (as such terms shall be defined by rule as provided in subsection (b)(2));

"(iii) would pose a threat to the safety and soundness of such banking entity; or

"(iv) would pose a threat to the financial stability of the United States.

"(B) RULEMAKING.—The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall issue regulations to implement subparagraph (A), as part of the regulations issued under subsection (b)(2).

"(3) CAPITAL AND QUANTITATIVE LIMITATIONS.—The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall, as provided in subsection (b)(2), adopt rules imposing additional capital requirements and quantitative limitations, including diversification requirements, regarding the activities permitted under this section if the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission determine that additional capital and quantitative limitations are appropriate to protect the safety and soundness of banking entities engaged in such activities.

"(4) DE MINIMIS INVESTMENT.—

"(A) IN GENERAL.—A banking entity may make and retain an investment in a hedge fund or private equity fund that the banking entity organizes and offers, subject to the limitations and restrictions in subparagraph (B) for the purposes of—

"(i) establishing the fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors; or "(ii) making a de minimis investment.

"(B) LIMITATIONS AND RESTRICTIONS ON INVESTMENTS.—

"(i) REQUIREMENT TO SEEK OTHER INVESTORS.—A banking entity shall actively seek unaffiliated investors to reduce or dilute the investment of the banking entity to the amount permitted under clause (ii).

"(ii) LIMITATIONS ON SIZE OF INVESTMENTS.—Notwithstanding any other provision of law, investments by a banking entity in a hedge fund or private equity fund shall—

"(I) not later than 1 year after the date of establishment of the fund, be reduced through redemption, sale, or dilution to an amount that is not more than 3 percent of the total ownership interests of the fund;

"(II) be immaterial to the banking entity, as defined, by rule, pursuant to subsection (b)(2), but in no case may the aggregate of all of the interests of the banking entity in all such funds exceed 3 percent of the Tier 1 capital of the banking entity.

"(iii) CAPITAL.—For purposes of determining compliance with applicable capital standards under paragraph (3), the aggregate amount of the outstanding investments by a banking entity under this paragraph, including retained earnings, shall be deducted from the assets and tangible equity of the banking entity, and the amount of the deduction shall increase commensurate with the leverage of the hedge fund or private equity fund.

"(C) EXTENSION.—Upon an application by a banking entity, the Board may extend the period of time to meet the requirements under subparagraph (B)(ii)(I) for 2 additional years, if the Board finds that an extension would be consistent with safety and soundness and in the public interest.

"(e) ANTI-EVASION.—

"(1) RULEMAKING.—The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall issue regulations, as part of the rulemaking provided for in subsection (b)(2), regarding internal controls and recordkeeping, in order to insure compliance with this section.

"(2) TERMINATION OF ACTIVITIES OR INVESTMENT.—Notwithstanding any other provision of law, whenever an appropriate Federal banking agency, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, as appropriate, has reasonable cause to believe that a banking entity or nonbank financial company supervised by the Board under the respective agency's jurisdiction has made an investment or engaged in an activity in a manner that functions as an evasion of the requirements of this section (including through an abuse of any permitted activity) or otherwise violates the restrictions under this section, the appropriate Federal banking agency, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, as appropriate, shall order, after due notice and opportunity for hearing, the banking entity or nonbank financial company supervised by the Board to terminate the activity and, as relevant, dispose of the investment. Nothing in this paragraph shall be construed to limit the inherent authority of any Federal agency or State regulatory authority to further restrict any investments or activities under otherwise applicable provisions of law.

"(f) LIMITATIONS ON RELATIONSHIPS WITH HEDGE FUNDS AND PRIVATE EQUITY FUNDS.—

"(1) IN GENERAL.—No banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund, or that organizes and offers a hedge fund or private equity fund pursuant to paragraph (d)(1)(G), and no affiliate of such entity, may enter into a transaction with the fund, or with any other hedge fund or private equity fund that is controlled by such fund, that would be a covered transaction, as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c), with the hedge fund or private equity fund, as if such banking entity and the affiliate thereof were a member bank and the hedge fund or private equity fund were an affiliate thereof.

"(2) TREATMENT AS MEMBER BANK.—A banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a hedge fund or private equity fund, or that organizes and offers a hedge fund or private equity fund pursuant to paragraph (d)(1)(G), shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c–1), as if such banking entity were a member bank and such hedge fund or private equity fund were an affiliate thereof.

"(3) PERMITTED SERVICES.—

"(A) IN GENERAL.—Notwithstanding paragraph (1), the Board may permit a banking entity to enter into any prime brokerage transaction with any hedge fund or private equity fund in which a hedge fund or private equity fund managed, sponsored, or advised by such banking entity has taken an equity, partnership, or other ownership interest, if—

"(i) the banking entity is in compliance with each of the limitations set forth in subsection (d)(1)(G) with regard to a hedge fund or private equity fund organized and offered by such banking entity;

"(ii) the chief executive officer (or equivalent officer) of the banking entity certifies in writing annually (with a duty to update the certification if the information in the certification materially changes) that the conditions specified in subsection (d)(1)(g)(v) are satisfied; and

"(iii) the Board has determined that such transaction is consistent with the safe and sound operation and condition of the banking entity.

"(B) TREATMENT OF PRIME BROKERAGE TRANSACTIONS.— For purposes of subparagraph (A), a prime brokerage transaction described in subparagraph (A) shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c-1) as if the counterparty were an affiliate of the banking entity.

"(4) APPLICATION TO NONBANK FINANCIAL COMPANIES SUPERVISED BY THE BOARD.—The appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall adopt rules, as provided in subsection (b)(2), imposing additional capital charges or other restrictions for nonbank financial companies supervised by the Board to address the risks to and conflicts of interest of banking entities described in paragraphs (1), (2), and (3) of this subsection.

"(g) RULES OF CONSTRUCTION.—

"(1) LIMITATION ON CONTRARY AUTHORITY.—Except as provided in this section, notwithstanding any other provision of law, the prohibitions and restrictions under this section shall apply to activities of a banking entity or nonbank financial company supervised by the Board, even if such activities are authorized for a banking entity or nonbank financial company supervised by the Board.

"(2) SALE OR SECURITIZATION OF LOANS.—Nothing in this section shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize loans in a manner otherwise permitted by law.

"(3) AUTHORITY OF FEDERAL AGENCIES AND STATE REGULATORY AUTHORITIES.—Nothing in this section shall be construed to limit the inherent authority of any Federal agency or State regulatory authority under otherwise applicable provisions of law.

"(h) DEFINITIONS.—In this section, the following definitions shall apply:

"(1) BANKING ENTITY.—The term 'banking entity' means any insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity. For purposes of this paragraph, the term 'insured depository institution' does not include an institution that functions solely in a trust or fiduciary capacity, if—

"(A) all or substantially all of the deposits of such institution are in trust funds and are received in a bona fide fiduciary capacity;

"(B) no deposits of such institution which are insured by the Federal Deposit Insurance Corporation are offered or marketed by or through an affiliate of such institution;

"(C) such institution does not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others or make commercial loans; and

"(D) such institution does not—

"(i) obtain payment or payment related services from any Federal Reserve bank, including any service referred to in section 11A of the Federal Reserve Act (12 U.S.C. 248a); or

"(ii) exercise discount or borrowing privileges pursuant to section 19(b)(7) of the Federal Reserve Act (12 U.S.C. 461(b)(7)).

"(2) HEDGE FUND; PRIVATE EQUITY FUND.—The terms 'hedge fund' and 'private equity fund' mean an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule, as provided in subsection (b)(2), determine.

"(3) NONBANK FINANCIAL COMPANY SUPERVISED BY THE BOARD.—The term 'nonbank financial company supervised by the Board' means a nonbank financial company supervised by the Board of Governors, as defined in section 102 of the Financial Stability Act of 2010.

"(4) PROPRIETARY TRADING.—The term 'proprietary trading', when used with respect to a banking entity or nonbank financial company supervised by the Board, means engaging as a principal for the trading account of the banking entity or nonbank financial company supervised by the Board in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule as provided in subsection (b)(2), determine.

"(5) SPONSOR.—The term to 'sponsor' a fund means—

"(A) to serve as a general partner, managing member, or trustee of a fund;

"(B) in any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a fund; or

"(C) to share with a fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.

"(6) TRADING ACCOUNT.—The term 'trading account' means any account used for acquiring or taking positions in the securities and instruments described in paragraph (4) principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements), and any such other accounts as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule as provided in subsection (b)(2), determine.

"(7) ILLIQUID FUND.—

"(A) IN GENERAL.—The term 'illiquid fund' means a hedge fund or private equity fund that—

"(i) as of May 1, 2010, was principally invested in, or was invested and contractually committed to principally invest in, illiquid assets, such as portfolio companies, real estate investments, and venture capital investments; and

"(ii) makes all investments pursuant to, and consistent with, an investment strategy to principally invest in illiquid assets. In issuing rules regarding this subparagraph, the Board shall take into consideration the terms of investment for the hedge fund or private equity fund, including contractual obligations, the ability of the fund to divest of assets held by the fund, and any other factors that the Board determines are appropriate.

"(B) HEDGE FUND.—For the purposes of this paragraph, the term 'hedge fund' means any fund identified under subsection (h)(2), and does not include a private equity fund, as such term is used in section 203(m) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(m)).".

SEC. 620. STUDY OF BANK INVESTMENT ACTIVITIES.

(a) STUDY.—

(1) IN GENERAL.—Not later than 18 months after the date of enactment of this Act, the appropriate Federal banking agencies shall jointly review and prepare a report on the activities that a banking entity, as such term is defined in the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et. seq.), may engage in under Federal and State law, including activities authorized by statute and by order, interpretation and guidance.

(2) CONTENT.—In carrying out the study under paragraph (1), the appropriate Federal banking agencies shall review and consider—

(A) the type of activities or investments;

(B) any financial, operational, managerial, or reputation risks associated with or presented as a result of the banking entity engaged in the activity or making the investment; and

(C) risk mitigation activities undertaken by the banking entity with regard to the risks.

(b) REPORT AND RECOMMENDATIONS TO THE COUNCIL AND TO CONGRESS.—The appropriate Federal banking agencies shall submit to the Council, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate the study conducted pursuant to subsection (a) no later than 2 months after its completion. In addition to the information described in subsection (a), the report shall include recommendations regarding—

(1) whether each activity or investment has or could have a negative effect on the safety and soundness of the banking entity or the United States financial system;

(2) the appropriateness of the conduct of each activity or type of investment by banking entities; and

(3) additional restrictions as may be necessary to address risks to safety and soundness arising from the activities or types of investments described in subsection (a).

SEC. 621. CONFLICTS OF INTEREST.

(a) IN GENERAL.—The Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended by inserting after section 27A the following:

"SEC. 27B. CONFLICTS OF INTEREST RELATING TO CERTAIN SECURITIZATIONS.

"(a) IN GENERAL.—An underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity, of an asset-backed security (as such term is defined in section 3 of the Securities and Exchange Act of 1934 (15 U.S.C. 78c), which for the purposes of this section shall include a synthetic asset-backed security), shall not, at any time for a period ending on the date that is one year after the date of the first closing of the sale of the asset-backed security, engage in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such activity.

"(b) RULEMAKING.—Not later than 270 days after the date of enactment of this section, the Commission shall issue rules for the purpose of implementing subsection (a).

"(c) EXCEPTION.—The prohibitions of subsection (a) shall not apply to—

"(1) risk-mitigating hedging activities in connection with positions or holdings arising out of the underwriting, placement, initial purchase, or sponsorship of an asset-backed security, provided that such activities are designed to reduce the specific risks to the underwriter, placement agent, initial purchaser, or sponsor associated with positions or holdings arising out of such underwriting, placement, initial purchase, or sponsorship; or

"(2) purchases or sales of asset-backed securities made pursuant to and consistent with—

"(A) commitments of the underwriter, placement agent, initial purchaser, or sponsor, or any affiliate or subsidiary of any such entity, to provide liquidity for the asset-backed security, or

"(B) bona fide market-making in the asset backed security.

"(d) RULE OF CONSTRUCTION.—This subsection shall not otherwise limit the application of section 15G of the Securities Exchange Act of 1934.".

(b) EFFECTIVE DATE.—Section 27B of the Securities Act of 1933, as added by this section, shall take effect on the effective date of final rules issued by the Commission under subsection (b) of such section 27B, except that subsections (b) and (d) of such section 27B shall take effect on the date of enactment of this Act.

SEC. 622. CONCENTRATION LIMITS ON LARGE FINANCIAL FIRMS.

The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended by adding at the end the following:

"SEC. 14. CONCENTRATION LIMITS ON LARGE FINANCIAL FIRMS.

"(a) DEFINITIONS.—In this section—

"(1) the term 'Council' means the Financial Stability Oversight Council;

"(2) the term 'financial company' means—

"(A) an insured depository institution;

"(B) a bank holding company;

"(C) a savings and loan holding company;

"(D) a company that controls an insured depository institution;

"(E) a nonbank financial company supervised by the Board under title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and

"(F) a foreign bank or company that is treated as a bank holding company for purposes of this Act; and

"(3) the term 'liabilities' means—

"(A) with respect to a United States financial company—

"(i) the total risk-weighted assets of the financial company, as determined under the risk-based capital rules applicable to bank holding companies, as adjusted to reflect exposures that are deducted from regulatory capital; less

"(ii) the total regulatory capital of the financial company under the risk-based capital rules applicable to bank holding companies;

"(B) with respect to a foreign-based financial company—

"(i) the total risk-weighted assets of the United States operations of the financial company, as determined under the applicable risk-based capital rules, as adjusted to reflect exposures that are deducted from regulatory capital; less

"(ii) the total regulatory capital of the United States operations of the financial company, as determined under the applicable risk-based capital rules; and

"(C) with respect to an insurance company or other nonbank financial company supervised by the Board, such assets of the company as the Board shall specify by rule, in order to provide for consistent and equitable treatment of such companies.

"(b) CONCENTRATION LIMIT.—Subject to the recommendations by the Council under subsection (e), a financial company may not merge or consolidate with, acquire all or substantially all of the assets of, or otherwise acquire control of, another company, if the total consolidated liabilities of the acquiring financial company upon consummation of the transaction would exceed 10 percent of the aggregate consolidated liabilities of all financial companies at the end of the calendar year preceding the transaction.

"(c) EXCEPTION TO CONCENTRATION LIMIT.—With the prior written consent of the Board, the concentration limit under subsection (b) shall not apply to an acquisition—

"(1) of a bank in default or in danger of default;

"(2) with respect to which assistance is provided by the Federal Deposit Insurance Corporation under section 13(c) of the Federal Deposit Insurance Act (12 U.S.C. 1823(c)); or

"(3) that would result only in a de minimis increase in the liabilities of the financial company.

"(d) RULEMAKING AND GUIDANCE.—The Board shall issue regulations implementing this section in accordance with the recommendations of the Council under subsection (e), including the definition of terms, as necessary. The Board may issue interpretations or guidance regarding the application of this section to an individual financial company or to financial companies in general.

"(e) COUNCIL STUDY AND RULEMAKING.—

"(1) STUDY AND RECOMMENDATIONS.—Not later than 6 months after the date of enactment of this section, the Council shall—

"(A) complete a study of the extent to which the concentration limit under this section would affect financial stability, moral hazard in the financial system, the efficiency and competitiveness of United States financial firms and financial markets, and the cost and availability of credit and other financial services to households and businesses in the United States; and

"(B) make recommendations regarding any modifications to the concentration limit that the Council determines would more effectively implement this section.

"(2) RULEMAKING.—Not later than 9 months after the date of completion of the study under paragraph (1), and notwithstanding subsections (b) and (d), the Board shall issue final regulations implementing this section, which shall reflect any recommendations by the Council under paragraph (1)(B).".

SEC. 623. INTERSTATE MERGER TRANSACTIONS.

(a) INTERSTATE MERGER TRANSACTIONS.—Section 18(c) of the Federal Deposit Insurance Act (12 U.S.C. 1828(c)) is amended by adding at the end the following:

"(13)(A) Except as provided in subparagraph (B), the responsible agency may not approve an application for an interstate merger transaction if the resulting insured depository institution (including all insured depository institutions which are affiliates of the resulting insured depository institution), upon consummation of the transaction, would control more than 10 percent of the total amount of deposits of insured depository institutions in the United States.

"(B) Subparagraph (A) shall not apply to an interstate merger transaction that involves 1 or more insured depository institutions in default or in danger of default, or with respect to which the Corporation provides assistance under section 13.

"(C) In this paragraph—

"(i) the term 'interstate merger transaction' means a merger transaction involving 2 or more insured depository institutions that have different home States and that are not affiliates; and

"(ii) the term 'home State' means—

"(I) with respect to a national bank, the State in which the main office of the bank is located;

"(II) with respect to a State bank or State savings association, the State by which the State bank or State savings association is chartered; and

"(III) with respect to a Federal savings association, the State in which the home office (as defined by the regulations of the Director of the Office of Thrift Supervision, or, on and after the transfer date, the Comptroller of the Currency) of the Federal savings association is located.".

(b) ACQUISITIONS BY BANK HOLDING COMPANIES.—

(1) IN GENERAL.—Section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843) is amended—

(A) in subsection (i), by adding at the end the following:

"(8) INTERSTATE ACQUISITIONS.—

"(A) IN GENERAL.—The Board may not approve an application by a bank holding company to acquire an insured depository institution under subsection (c)(8) or any other provision of this Act if—

"(i) the home State of such insured depository institution is a State other than the home State of the bank holding company; and "(ii) the applicant (including all insured depository institutions which are affiliates of the applicant) controls, or upon consummation of the transaction would control, more than 10 percent of the total amount of deposits of insured depository institutions in the United States.

"(B) EXCEPTION.—Subparagraph (A) shall not apply to an acquisition that involves an insured depository institution in default or in danger of default, or with respect to which the Federal Deposit Insurance Corporation provides assistance under section 13 of the Federal Deposit Insurance Act (12 U.S.C. 1823)."; and

(B) in subsection (k)(6)(B), by striking "savings association" and inserting "insured depository institution".

(2) DEFINITIONS.—Section 2(o)(4) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(o)(4)) is amended—

(A) in subparagraph (B), by striking "and" at the end;

(B) in subparagraph (C)(ii), by striking the period at the end and inserting a semicolon; and

(C) by adding at the end the following:

"(D) with respect to a State savings association, the State by which the savings association is chartered; and

"(E) with respect to a Federal savings association, the State in which the home office (as defined by the regulations of the Director of the Office of Thrift Supervision, or, on and after the transfer date, the Comptroller of the Currency) of the Federal savings association is located.".

(c) ACQUISITIONS BY SAVINGS AND LOAN HOLDING COMPANIES.—Section 10(e)(2) of the Home Owners' Loan Act (12 U.S.C. 1467a(e)(2)) is amended—

(1) in paragraph (2)—

(A) in subparagraph (C), by striking "or" at the end;

(B) in subparagraph (D), by striking the period at the end and inserting ", or"; and

(C) by adding at the end the following:

"(E) in the case of an application by a savings and loan holding company to acquire an insured depository institution, if—

"(i) the home State of the insured depository institution is a State other than the home State of the savings and loan holding company;

"(ii) the applicant (including all insured depository institutions which are affiliates of the applicant) controls, or upon consummation of the transaction would control, more than 10 percent of the total amount of deposits of insured depository institutions in the United States; and

"(iii) the acquisition does not involve an insured depository institution in default or in danger of default, or with respect to which the Federal Deposit Insurance Corporation provides assistance under section 13 of the Federal Deposit Insurance Act (12 U.S.C. 1823)."; and

(2) by adding at the end the following:

"(7) DEFINITIONS.—For purposes of paragraph (2)(E)—

"(A) the terms 'default', 'in danger of default', and 'insured depository institution' have the same meanings as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813); and

"(B) the term 'home State' means—

"(i) with respect to a national bank, the State in which the main office of the bank is located;

"(ii) with respect to a State bank or State savings association, the State by which the savings association is chartered;

"(iii) with respect to a Federal savings association, the State in which the home office (as defined by the regulations of the Director of the Office of Thrift Supervision, or, on and after the transfer date, the Comptroller of the Currency) of the Federal savings association is located; and

"(iv) with respect to a savings and loan holding company, the State in which the amount of total deposits of all insured depository institution subsidiaries of such company was the greatest on the date on which the company became a savings and loan holding company.".

SEC. 624. QUALIFIED THRIFT LENDERS.

Section 10(m)(3) of the Home Owners' Loan Act (12 U.S.C. 1467a(m)(3)) is amended—

(1) by striking subparagraph (A) and inserting the following:

"(A) IN GENERAL.—A savings association that fails to become or remain a qualified thrift lender shall immediately be subject to the restrictions under subparagraph (B)."; and

(2) in subparagraph (B)(i), by striking subclause (III) and inserting the following:

"(III) DIVIDENDS.—The savings association may not pay dividends, except for dividends that—

"(aa) would be permissible for a national bank;

"(bb) are necessary to meet obligations of a company that controls such savings association; and

"(cc) are specifically approved by the Comptroller of the Currency and the Board after a written request submitted to the Comptroller of the Currency and the Board by the savings association not later than 30 days before the date of the proposed payment.

"(IV) REGULATORY AUTHORITY.—A savings association that fails to become or remain a qualified thrift lender shall be deemed to have violated section 5 of the Home Owners' Loan Act (12 U.S.C. 1464) and subject to actions authorized by section 5(d) of the Home Owners' Loan Act (12 U.S.C. 1464(d)).".

SEC. 625. TREATMENT OF DIVIDENDS BY CERTAIN MUTUAL HOLDING COMPANIES.

(a) IN GENERAL.—Section 10(o) of the Home Owners' Loan Act (12 U.S.C. 1467a(o) is amended by adding at the end the following:

"(11) DIVIDENDS.—

"(A) DECLARATION OF DIVIDENDS.—

"(i) ADVANCE NOTICE REQUIRED.—Each subsidiary of a mutual holding company that is a savings association shall give the appropriate Federal banking agency and the Board notice not later than 30 days before the date of a proposed declaration by the board of directors of the savings association of any dividend on the guaranty, permanent, or other nonwithdrawable stock of the savings association.

"(ii) INVALID DIVIDENDS.—Any dividend described in clause (i) that is declared without giving notice to the appropriate Federal banking agency and the Board under clause (i), or that is declared during the 30-day period preceding the date of a proposed declaration for which notice is given to the appropriate Federal banking agency and the Board under clause (i), shall be invalid and shall confer no rights or benefits upon the holder of any such stock.

"(B) WAIVER OF DIVIDENDS.—A mutual holding company may waive the right to receive any dividend declared by a subsidiary of the mutual holding company, if—

"(i) no insider of the mutual holding company, associate of an insider, or tax-qualified or non-tax-qualified employee stock benefit plan of the mutual holding company holds any share of the stock in the class of stock to which the waiver would apply; or

"(ii) the mutual holding company gives written notice to the Board of the intent of the mutual holding company to waive the right to receive dividends, not later than 30 days before the date of the proposed date of payment of the dividend, and the Board does not object to the waiver.

"(C) RESOLUTION INCLUDED IN WAIVER NOTICE.—A notice of a waiver under subparagraph (B) shall include a copy of the resolution of the board of directors of the mutual holding company, in such form and substance as the Board may determine, together with any supporting materials relied upon by the board of directors of the mutual holding company, concluding that the proposed dividend waiver is consistent with the fiduciary duties of the board of directors to the mutual members of the mutual holding company.

"(D) STANDARDS FOR WAIVER OF DIVIDEND.—The Board may not object to a waiver of dividends under subparagraph (B) if—

"(i) the waiver would not be detrimental to the safe and sound operation of the savings association;

"(ii) the board of directors of the mutual holding company expressly determines that a waiver of the dividend by the mutual holding company is consistent with the fiduciary duties of the board of directors to the mutual members of the mutual holding company; and

"(iii) the mutual holding company has, prior to December 1, 2009—

"(I) reorganized into a mutual holding company under subsection (o);

"(II) issued minority stock either from its mid-tier stock holding company or its subsidiary stock savings association; and

"(III) waived dividends it had a right to receive from the subsidiary stock savings association.

"(E) VALUATION.—

"(i) IN GENERAL.—The appropriate Federal banking agency shall consider waived dividends in determining an appropriate exchange ratio in the event of a full conversion to stock form.

"(ii) EXCEPTION.—In the case of a savings association that has reorganized into a mutual holding company, has issued minority stock from a mid-tier stock holding company or a subsidiary stock savings association of the mutual holding company, and has waived dividends it had a right to receive from a subsidiary savings association before December 1, 2009, the appropriate Federal banking agency shall not consider waived dividends in determining an appropriate exchange ratio in the event of a full conversion to stock form.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the transfer date.

SEC. 626. INTERMEDIATE HOLDING COMPANIES.

The Home Owners' Loan Act (12 U.S.C. 1461 et seq.) is amended by inserting after section 10 (12 U.S.C. 1467a) the following new section:

"SEC. 10A. INTERMEDIATE HOLDING COMPANIES.

"(a) DEFINITION.—For purposes of this section:

"(1) FINANCIAL ACTIVITIES.—The term 'financial activities' means activities described in clauses (i) and (ii) of section 10(c)(9)(A).

"(2) GRANDFATHERED UNITARY SAVINGS AND LOAN HOLDING COMPANY.—The term 'grandfathered unitary savings and loan holding company' means a company described in section 10(c)(9)(C).

"(3) INTERNAL FINANCIAL ACTIVITIES.—The term 'internal financial activities' includes—

"(A) internal financial activities conducted by a grandfathered savings and loan holding company or any affiliate; and

"(B) internal treasury, investment, and employee benefit functions.

"(b) REQUIREMENT.—

"(1) IN GENERAL.—

"(A) ACTIVITIES OTHER THAN FINANCIAL ACTIVITIES.—If a grandfathered unitary savings and loan holding company conducts activities other than financial activities, the Board may require such company to establish and conduct all or a portion of such financial activities in or through an intermediate holding company, which shall be a savings and loan holding company, established pursuant to regulations of the Board, not later than 90 days (or such longer period as the Board may deem appropriate) after the transfer date.

"(B) OTHER ACTIVITIES.—Notwithstanding subparagraph (A), the Board shall require a grandfathered unitary savings and loan holding company to establish an intermediate holding company if the Board makes a determination that the establishment of such intermediate holding company is necessary—

"(i) to appropriately supervise activities that are determined to be financial activities; or

"(ii) to ensure that supervision by the Board does not extend to the activities of such company that are not financial activities.

"(2) INTERNAL FINANCIAL ACTIVITIES.—

"(A) TREATMENT OF INTERNAL FINANCIAL ACTIVITIES.—For purposes of this subsection, the internal financial activities of a grandfathered unitary savings and loan holding company shall not be required to be placed in an intermediate holding company.

"(B) GRANDFATHERED ACTIVITIES.—A grandfathered unitary savings and loan holding company may continue to engage in an internal financial activity, subject to review by the Board to determine whether engaging in such activity presents undue risk to the grandfathered unitary savings and loan holding company or to the financial stability of the United States, if—

"(i) the grandfathered unitary savings and loan holding company engaged in the activity during the year before the date of enactment of this section; and

"(ii) at least ⅔ of the assets or ⅔ of the revenues generated from the activity are from or attributable to the grandfathered unitary savings and loan holding company.

"(3) SOURCE OF STRENGTH.—A grandfathered unitary savings and loan holding company that directly or indirectly controls an intermediate holding company established under this section shall serve as a source of strength to its subsidiary intermediate holding company.

"(4) PARENT COMPANY REPORTS.—The Board, may from time to time, examine and require reports under oath from a grandfathered unitary savings and loan holding company that controls an intermediate holding company, and from the appropriate officers or directors of such company, solely for purposes of ensuring compliance with the provisions of this section, including assessing the ability of the company to serve as a source of strength to its subsidiary intermediate holding company as required under paragraph (3) and enforcing compliance with such requirement.

"(5) LIMITED PARENT COMPANY ENFORCEMENT.—

"(A) IN GENERAL.—In addition to any other authority of the Board, the Board may enforce compliance with the provisions of this subsection that are applicable to any company described in paragraph (1)(A) that controls an intermediate holding company under section 8 of the Federal Deposit Insurance Act, and a company described in paragraph (1)(A) shall be subject to such section (solely for purposes of this subparagraph) in the same manner and to the same extent as if the company described in paragraph (1)(A) were a savings and loan holding company.

"(B) APPLICATION OF OTHER ACT.—Any violation of this subsection by a grandfathered unitary savings and loan holding company that controls an intermediate holding company may also be treated as a violation of the Federal Deposit Insurance Act for purposes of subparagraph (A).

"(C) NO EFFECT ON OTHER AUTHORITY.—No provision of this paragraph shall be construed as limiting any authority of the Board or any other Federal agency under any other provision of law.

"(c) REGULATIONS.—The Board—

"(1) shall promulgate regulations to establish the criteria for determining whether to require a grandfathered unitary savings and loan holding company to establish an intermediate holding company under subsection (b); and

"(2) may promulgate regulations to establish any restrictions or limitations on transactions between an intermediate holding company or a parent of such company and its affiliates, as necessary to prevent unsafe and unsound practices in connection with transactions between the intermediate holding company, or any subsidiary thereof, and its parent company or affiliates that are not subsidiaries of the intermediate holding company, except that such regulations shall not restrict or limit any transaction in connection with the bona fide acquisition or lease by an unaffiliated person of assets, goods, or services.

"(d) RULES OF CONSTRUCTION.—

"(1) ACTIVITIES.—Nothing in this section shall be construed to require a grandfathered unitary savings and loan holding company to conform its activities to permissible activities.

"(2) PERMISSIBLE CORPORATE REORGANIZATION.—The formation of an intermediate holding company as required in subsection (b) shall be presumed to be a permissible corporate reorganization as described in section 10(c)(9)(D).".

SEC. 627. INTEREST-BEARING TRANSACTION ACCOUNTS AUTHORIZED.

(a) REPEAL OF PROHIBITION ON PAYMENT OF INTEREST ON DEMAND DEPOSITS.—

(1) FEDERAL RESERVE ACT.—Section 19(i) of the Federal Reserve Act (12 U.S.C. 371a) is amended to read as follows: "(i) [Repealed]".

(2) HOME OWNERS' LOAN ACT.—The first sentence of section 5(b)(1)(B) of the Home Owners' Loan Act (12 U.S.C. 1464(b)(1)(B)) is amended by striking "savings association may not—" and all that follows through "(ii) permit any" and inserting "savings association may not permit any".

(3) FEDERAL DEPOSIT INSURANCE ACT.—Section 18(g) of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)) is amended to read as follows:

"(g) [Repealed]".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall take effect 1 year after the date of the enactment of this Act.

SEC. 628. CREDIT CARD BANK SMALL BUSINESS LENDING.

Section 2(c)(2)(F)(v) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)(2)(F)(v)) is amended by inserting before the period the following: ", other than credit card loans that are made to businesses that meet the criteria for a small business concern to be eligible for business loans under regulations established by the Small Business Administration under part 121 of title 13, Code of Federal Regulations".

TITLE VII—WALL STREET TRANSPARENCY AND ACCOUNTABILITY

SEC. 701. SHORT TITLE.

This title may be cited as the "Wall Street Transparency and Accountability Act of 2010".

Subtitle A—Regulation of Over-the-Counter Swaps Markets

PART I—REGULATORY AUTHORITY

SEC. 711. DEFINITIONS.

In this subtitle, the terms "prudential regulator", "swap", "swap dealer", "major swap participant", "swap data repository", "associated person of a swap dealer or major swap participant", "eligible contract participant", "swap execution facility", "security-based swap", "security-based swap dealer", "major security-based swap participant", and "associated person of a security-based swap dealer or major security-based swap participant" have the meanings given the terms in section 1a of the Commodity Exchange Act (7 U.S.C. 1a), including any modification of the meanings under section 721(b) of this Act.

SEC. 712. REVIEW OF REGULATORY AUTHORITY.

(a) CONSULTATION.—

(1) COMMODITY FUTURES TRADING COMMISSION.—Before commencing any rulemaking or issuing an order regarding swaps, swap dealers, major swap participants, swap data repositories, derivative clearing organizations with regard to swaps, persons associated with a swap dealer or major swap participant, eligible contract participants, or swap execution facilities pursuant to this subtitle, the Commodity Futures Trading Commission shall consult and coordinate to the extent possible with the Securities and Exchange Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible.

(2) SECURITIES AND EXCHANGE COMMISSION.—Before commencing any rulemaking or issuing an order regarding security-based swaps, security-based swap dealers, major security-based swap participants, security-based swap data repositories, clearing agencies with regard to security-based swaps, persons associated with a security-based swap dealer or major security-based swap participant, eligible contract participants with regard to security-based swaps, or security-based swap execution facilities pursuant to subtitle B, the Securities and Exchange Commission shall consult and coordinate to the

extent possible with the Commodity Futures Trading Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible.

(3) PROCEDURES AND DEADLINE.—Such regulations shall be prescribed in accordance with applicable requirements of title 5, United States Code, and shall be issued in final form not later than 360 days after the date of enactment of this Act.

(4) APPLICABILITY.—The requirements of paragraphs (1) and (2) shall not apply to an order issued—

(A) in connection with or arising from a violation or potential violation of any provision of the Commodity Exchange Act (7 U.S.C. 1 et seq.);

(B) in connection with or arising from a violation or potential violation of any provision of the securities laws; or

(C) in any proceeding that is conducted on the record in accordance with sections 556 and 557 of title 5, United States Code.

(5) EFFECT.—Nothing in this subsection authorizes any consultation or procedure for consultation that is not consistent with the requirements of subchapter II of chapter 5, and chapter 7, of title 5, United States Code (commonly known as the "Administrative Procedure Act").

(6) RULES; ORDERS.—In developing and promulgating rules or orders pursuant to this subsection, each Commission shall consider the views of the prudential regulators.

(7) TREATMENT OF SIMILAR PRODUCTS AND ENTITIES.—

(A) IN GENERAL.—In adopting rules and orders under this subsection, the Commodity Futures Trading Commission and the Securities and Exchange Commission shall treat functionally or economically similar products or entities described in paragraphs (1) and (2) in a similar manner.

(B) EFFECT.—Nothing in this subtitle requires the Commodity Futures Trading Commission or the Securities and Exchange Commission to adopt joint rules or orders that treat functionally or economically similar products or entities described in paragraphs (1) and (2) in an identical manner.

(8) MIXED SWAPS.—The Commodity Futures Trading Commission and the Securities and Exchange Commission, after consultation with the Board of Governors, shall jointly prescribe such regulations regarding mixed swaps, as described in section 1a(47)(D) of the Commodity Exchange Act (7 U.S.C. 1a(47)(D)) and in section 3(a)(68)(D) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)(D)), as may be necessary to carry out the purposes of this title.

(b) LIMITATION.—

(1) COMMODITY FUTURES TRADING COMMISSION.—Nothing in this title, unless specifically provided, confers jurisdiction on the Commodity Futures Trading Commission to issue a rule, regulation, or order providing for oversight or regulation of—

(A) security-based swaps; or

(B) with regard to its activities or functions concerning security-based swaps—

(i) security-based swap dealers;

(ii) major security-based swap participants;

(iii) security-based swap data repositories;

(iv) associated persons of a security-based swap dealer or major security-based swap participant;

(v) eligible contract participants with respect to security-based swaps; or

(vi) swap execution facilities with respect to security-based swaps.

(2) SECURITIES AND EXCHANGE COMMISSION.—Nothing in this title, unless specifically provided, confers jurisdiction on the Securities and Exchange Commission or State securities regulators to issue a rule, regulation, or order providing for oversight or regulation of—

(A) swaps; or

(B) with regard to its activities or functions concerning swaps—

(i) swap dealers;

(ii) major swap participants;

(iii) swap data repositories;

(iv) persons associated with a swap dealer or major swap participant;

(v) eligible contract participants with respect to swaps; or

(vi) swap execution facilities with respect to swaps.

(3) PROHIBITION ON CERTAIN FUTURES ASSOCIATIONS AND NATIONAL SECURITIES ASSOCIATIONS.—

(A) FUTURES ASSOCIATIONS.—Notwithstanding any other provision of law (including regulations), unless otherwise authorized by this title, no futures association registered under section 17 of the Commodity Exchange Act (7 U.S.C. 21) may issue a rule, regulation, or order for the oversight or regulation of, or otherwise assert jurisdiction over, for any purpose, any security-based swap, except that this subparagraph shall not limit the authority of a registered futures association to examine for compliance with, and enforce, its rules on capital adequacy.

(B) NATIONAL SECURITIES ASSOCIATIONS.—Notwithstanding any other provision of law (including regulations), unless otherwise authorized by this title, no national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3) may issue a rule, regulation, or order for the oversight or regulation of, or otherwise assert jurisdiction over, for any purpose, any swap, except that this subparagraph shall not limit the authority of a national securities association to examine for compliance with, and enforce, its rules on capital adequacy.

(c) OBJECTION TO COMMISSION REGULATION.—

(1) FILING OF PETITION FOR REVIEW.—

(A) IN GENERAL.—If either Commission referred to in this section determines that a final rule, regulation, or order of the other Commission conflicts with subsection (a)(7) or (b), then the complaining Commission may obtain review of the final rule, regulation, or order in the United States Court of Appeals for the District of Columbia Circuit by filing in the court, not later than 60 days after the date of publication of the final rule, regulation, or order, a written petition requesting that the rule, regulation, or order be set aside.

(B) EXPEDITED PROCEEDING.—A proceeding described in subparagraph (A) shall be expedited by the United States Court of Appeals for the District of Columbia Circuit.

(2) TRANSMITTAL OF PETITION AND RECORD.—

(A) IN GENERAL.—A copy of a petition described in paragraph (1) shall be transmitted not later than 1 business day after the date of filing by the complaining Commission to the Secretary of the responding Commission.

(B) DUTY OF RESPONDING COMMISSION.—On receipt of the copy of a petition described in paragraph (1), the responding Commission shall file with the United States Court of Appeals for the District of Columbia Circuit—

(i) a copy of the rule, regulation, or order under review (including any documents referred to therein); and

(ii) any other materials prescribed by the United States Court of Appeals for the District of Columbia Circuit.

(3) STANDARD OF REVIEW.—The United States Court of Appeals for the District of Columbia Circuit shall—

(A) give deference to the views of neither Commission; and

(B) determine to affirm or set aside a rule, regulation, or order of the responding Commission under this subsection, based on the determination of the court as to whether the rule, regulation, or order is in conflict with subsection (a)(7) or (b), as applicable.

(4) JUDICIAL STAY.—The filing of a petition by the complaining Commission pursuant to paragraph (1) shall operate as a stay of the rule, regulation, or order until the date on which the determination of the United States Court of Appeals for the District of Columbia Circuit is final (including any appeal of the determination).

(d) JOINT RULEMAKING.—

(1) IN GENERAL.—Notwithstanding any other provision of this title and subsections (b) and (c), the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors, shall further define the terms “swap”, “security-based swap”, “swap dealer”, “security-based swap dealer”, “major swap participant”, “major security-based swap participant”, “eligible contract participant”, and “security-based swap agreement” in section 1a(47)(A)(v) of the Commodity Exchange Act (7 U.S.C. 1a(47)(A)(v)) and section 3(a)(78) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(78)).

(2) AUTHORITY OF THE COMMISSIONS.—

(A) IN GENERAL.—Notwithstanding any other provision of this title, the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors, shall jointly adopt such other rules regarding such definitions as the Commodity Futures Trading Commission and the Securities and

Exchange Commission determine are necessary and appropriate, in the public interest, and for the protection of investors.

(B) TRADE REPOSITORY RECORDKEEPING.—Notwithstanding any other provision of this title, the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors, shall engage in joint rulemaking to jointly adopt a rule or rules governing the books and records that are required to be kept and maintained regarding security-based swap agreements by persons that are registered as swap data repositories under the Commodity Exchange Act, including uniform rules that specify the data elements that shall be collected and maintained by each repository.

(C) BOOKS AND RECORDS.—Notwithstanding any other provision of this title, the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors, shall engage in joint rulemaking to jointly adopt a rule or rules governing books and records regarding security-based swap agreements, including daily trading records, for swap dealers, major swap participants, security-based swap dealers, and security-based swap participants.

(D) COMPARABLE RULES.—Rules and regulations prescribed jointly under this title by the Commodity Futures Trading Commission and the Securities and Exchange Commission shall be comparable to the maximum extent possible, taking into consideration differences in instruments and in the applicable statutory requirements.

(E) TRACKING UNCLEARED TRANSACTIONS.—Any rules prescribed under subparagraph (A) shall require the maintenance of records of all activities relating to security-based swap agreement transactions defined under subparagraph (A) that are not cleared.

(F) SHARING OF INFORMATION.—The Commodity Futures Trading Commission shall make available to the Securities and Exchange Commission information relating to security-based swap agreement transactions defined in subparagraph (A) that are not cleared.

(3) FINANCIAL STABILITY OVERSIGHT COUNCIL.—In the event that the Commodity Futures Trading Commission and the Securities and Exchange Commission fail to jointly prescribe rules pursuant to paragraph (1) or (2) in a timely manner, at the request of either Commission, the Financial Stability Oversight Council shall resolve the dispute—

(A) within a reasonable time after receiving the request;

(B) after consideration of relevant information provided by each Commission; and

(C) by agreeing with 1 of the Commissions regarding the entirety of the matter or by determining a compromise position.

(4) JOINT INTERPRETATION.—Any interpretation of, or guidance by either Commission regarding, a provision of this title, shall be effective only if issued jointly by the Commodity Futures Trading Commission and the Securities and Exchange Commission, after consultation with the Board of Governors,

if this title requires the Commodity Futures Trading Commission and the Securities and Exchange Commission to issue joint regulations to implement the provision.

(e) GLOBAL RULEMAKING TIMEFRAME.—Unless otherwise provided in this title, or an amendment made by this title, the Commodity Futures Trading Commission or the Securities and Exchange Commission, or both, shall individually, and not jointly, promulgate rules and regulations required of each Commission under this title or an amendment made by this title not later than 360 days after the date of enactment of this Act.

(f) RULES AND REGISTRATION BEFORE FINAL EFFECTIVE DATES.—Beginning on the date of enactment of this Act and notwithstanding the effective date of any provision of this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission may, in order to prepare for the effective dates of the provisions of this Act—

(1) promulgate rules, regulations, or orders permitted or required by this Act;

(2) conduct studies and prepare reports and recommendations required by this Act;

(3) register persons under the provisions of this Act; and

(4) exempt persons, agreements, contracts, or transactions from provisions of this Act, under the terms contained in this Act,

provided, however, that no action by the Commodity Futures Trading Commission or the Securities and Exchange Commission described in paragraphs (1) through (4) shall become effective prior to the effective date applicable to such action under the provisions of this Act.

SEC. 713. PORTFOLIO MARGINING CONFORMING CHANGES.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 15(c)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)(3)) is amended by adding at the end the following:

"(C) Notwithstanding any provision of sections 2(a)(1)(C)(i) or 4d(a)(2) of the Commodity Exchange Act and the rules and regulations thereunder, and pursuant to an exemption granted by the Commission under section 36 of this title or pursuant to a rule or regulation, cash and securities may be held by a broker or dealer registered pursuant to subsection (b)(1) and also registered as a futures commission merchant pursuant to section 4f(a)(1) of the Commodity Exchange Act, in a portfolio margining account carried as a futures account subject to section 4d of the Commodity Exchange Act and the rules and regulations thereunder, pursuant to a portfolio margining program approved by the Commodity Futures Trading Commission, and subject to subchapter IV of chapter 7 of title 11 of the United States Code and the rules and regulations thereunder. The Commission shall consult with the Commodity Futures Trading Commission to adopt rules to ensure that such transactions and accounts are subject to comparable requirements to the extent practicable for similar products.".

(b) COMMODITY EXCHANGE ACT.—Section 4d of the Commodity Exchange Act (7 U.S.C. 6d) is amended by adding at the end the following:

"(h) Notwithstanding subsection (a)(2) or the rules and regulations thereunder, and pursuant to an exemption granted by the Commission under section 4(c) of this Act or pursuant to a rule or regulation, a futures commission merchant that is registered pursuant to section 4f(a)(1) of this Act and also registered as a broker or dealer pursuant to section 15(b)(1) of the Securities Exchange Act of 1934 may, pursuant to a portfolio margining program approved by the Securities and Exchange Commission pursuant to section 19(b) of the Securities Exchange Act of 1934, hold in a portfolio margining account carried as a securities account subject to section 15(c)(3) of the Securities Exchange Act of 1934 and the rules and regulations thereunder, a contract for the purchase or sale of a commodity for future delivery or an option on such a contract, and any money, securities or other property received from a customer to margin, guarantee or secure such a contract, or accruing to a customer as the result of such a contract. The Commission shall consult with the Securities and Exchange Commission to adopt rules to ensure that such transactions and accounts are subject to comparable requirements to the extent practical for similar products.".

(c) DUTY OF COMMODITY FUTURES TRADING COMMISSION.—Section 20 of the Commodity Exchange Act (7 U.S.C. 24) is amended by adding at the end the following:

"(c) The Commission shall exercise its authority to ensure that securities held in a portfolio margining account carried as a futures account are customer property and the owners of those accounts are customers for the purposes of subchapter IV of chapter 7 of title 11 of the United States Code.".

SEC. 714. ABUSIVE SWAPS.

The Commodity Futures Trading Commission or the Securities and Exchange Commission, or both, individually may, by rule or order—

(1) collect information as may be necessary concerning the markets for any types of—

(A) swap (as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a)); or

(B) security-based swap (as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a)); and

(2) issue a report with respect to any types of swaps or security-based swaps that the Commodity Futures Trading Commission or the Securities and Exchange Commission determines to be detrimental to—

(A) the stability of a financial market; or

(B) participants in a financial market.

SEC. 715. AUTHORITY TO PROHIBIT PARTICIPATION IN SWAP ACTIVITIES.

Except as provided in section 4 of the Commodity Exchange Act (7 U.S.C. 6), if the Commodity Futures Trading Commission or the Securities and Exchange Commission determines that the regulation of swaps or security-based swaps markets in a foreign country undermines the stability of the United States financial system, either Commission, in consultation with the Secretary of the Treasury, may prohibit an entity domiciled in the foreign country from participating in the United States in any swap or security-based swap activities.

SEC. 716. PROHIBITION AGAINST FEDERAL GOVERNMENT BAILOUTS OF SWAPS ENTITIES.

(a) PROHIBITION ON FEDERAL ASSISTANCE.—Notwithstanding any other provision of law (including regulations), no Federal assistance may be provided to any swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity.

(b) DEFINITIONS.—In this section:

(1) FEDERAL ASSISTANCE.—The term "Federal assistance" means the use of any advances from any Federal Reserve credit facility or discount window that is not part of a program or facility with broad-based eligibility under section 13(3)(A) of the Federal Reserve Act, Federal Deposit Insurance Corporation insurance or guarantees for the purpose of—

(A) making any loan to, or purchasing any stock, equity interest, or debt obligation of, any swaps entity;

(B) purchasing the assets of any swaps entity;

(C) guaranteeing any loan or debt issuance of any swaps entity; or

(D) entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity.

(2) SWAPS ENTITY.—

(A) IN GENERAL.—The term "swaps entity" means any swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, that is registered under—

(i) the Commodity Exchange Act (7 U.S.C. 1 et seq.); or

(ii) the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(B) EXCLUSION.—The term "swaps entity" does not include any major swap participant or major security-based swap participant that is an insured depository institution.

(c) AFFILIATES OF INSURED DEPOSITORY INSTITUTIONS.—The prohibition on Federal assistance contained in subsection (a) does not apply to and shall not prevent an insured depository institution from having or establishing an affiliate which is a swaps entity, as long as such insured depository institution is part of a bank holding company, or savings and loan holding company, that is supervised by the Federal Reserve and such swaps entity affiliate complies with sections 23A and 23B of the Federal Reserve Act and such other requirements as the Commodity Futures Trading Commission or the Securities Exchange Commission, as appropriate, and the Board of Governors of the Federal Reserve System, may determine to be necessary and appropriate.

(d) ONLY BONA FIDE HEDGING AND TRADITIONAL BANK ACTIVITIES PERMITTED.—The prohibition in subsection (a) shall apply to any insured depository institution unless the insured depository institution limits its swap or security-based swap activities to:

(1) Hedging and other similar risk mitigating activities directly related to the insured depository institution's activities.

(2) Acting as a swaps entity for swaps or security-based swaps involving rates or reference assets that are permissible for investment by a national bank under the paragraph designated as "Seventh." of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), other than as described in paragraph (3).

(3) LIMITATION ON CREDIT DEFAULT SWAPS.—Acting as a swaps entity for credit default swaps, including swaps or security-based swaps referencing the credit risk of asset-backed securities as defined in section 3(a)(77) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77)) (as amended by this Act) shall not be considered a bank permissible activity for purposes of subsection (d)(2) unless such swaps or security-based swaps are cleared by a derivatives clearing organization (as such term is defined in section la of the Commodity Exchange Act (7 U.S.C. la)) or a clearing agency (as such term is defined in section 3 of the Securities Exchange Act (15 U.S.C. 78c)) that is registered, or exempt from registration, as a derivatives clearing organization under the Commodity Exchange Act or as a clearing agency under the Securities Exchange Act, respectively.

(e) EXISTING SWAPS AND SECURITY-BASED SWAPS.—The prohibition in subsection (a) shall only apply to swaps or security-based swaps entered into by an insured depository institution after the end of the transition period described in subsection (f).

(f) TRANSITION PERIOD.—To the extent an insured depository institution qualifies as a "swaps entity" and would be subject to the Federal assistance prohibition in subsection (a), the appropriate Federal banking agency, after consulting with and considering the views of the Commodity Futures Trading Commission or the Securities Exchange Commission, as appropriate, shall permit the insured depository institution up to 24 months to divest the swaps entity or cease the activities that require registration as a swaps entity. In establishing the appropriate transition period to effect such divestiture or cessation of activities, which may include making the swaps entity an affiliate of the insured depository institution, the appropriate Federal banking agency shall take into account and make written findings regarding the potential impact of such divestiture or cessation of activities on the insured depository institution's (1) mortgage lending, (2) small business lending, (3) job creation, and (4) capital formation versus the potential negative impact on insured depositors and the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. The appropriate Federal banking agency may consider such other factors as may be appropriate. The appropriate Federal banking agency may place such conditions on the insured depository institution's divestiture or ceasing of activities of the swaps entity as it deems necessary and appropriate. The transition period under this subsection may be extended by the appropriate Federal banking agency, after consultation with the Commodity Futures Trading Commission and the Securities and Exchange Commission, for a period of up to 1 additional year.

(g) EXCLUDED ENTITIES.—For purposes of this section, the term "swaps entity" shall not include any insured depository institution under the Federal Deposit Insurance Act or a covered financial company under title II which is in a conservatorship, receivership, or a bridge bank operated by the Federal Deposit Insurance Corporation.

(h) EFFECTIVE DATE.—The prohibition in subsection (a) shall be effective 2 years following the date on which this Act is effective.

(i) LIQUIDATION REQUIRED.—

(1) IN GENERAL.—

(A) FDIC INSURED INSTITUTIONS.—All swaps entities that are FDIC insured institutions that are put into receivership or declared insolvent as a result of swap or security-based swap activity of the swaps entities shall be subject to the termination or transfer of that swap or security-based swap activity in accordance with applicable law prescribing the treatment of those contracts. No taxpayer funds shall be used to prevent the receivership of any swap entity resulting from swap or security-based swap activity of the swaps entity.

(B) INSTITUTIONS THAT POSE A SYSTEMIC RISK AND ARE SUBJECT TO HEIGHTENED PRUDENTIAL SUPERVISION AS REGULATED UNDER SECTION 113.—All swaps entities that are institutions that pose a systemic risk and are subject to heightened prudential supervision as regulated under section 113, that are put into receivership or declared insolvent as a result of swap or security-based swap activity of the swaps entities shall be subject to the termination or transfer of that swap or security-based swap activity in accordance with applicable law prescribing the treatment of those contracts. No taxpayer funds shall be used to prevent the receivership of any swap entity resulting from swap or security-based swap activity of the swaps entity.

(C) NON-FDIC INSURED, NON-SYSTEMICALLY SIGNIFICANT INSTITUTIONS NOT SUBJECT TO HEIGHTENED PRUDENTIAL SUPERVISION AS REGULATED UNDER SECTION 113.—No taxpayer resources shall be used for the orderly liquidation of any swaps entities that are non-FDIC insured, non-systemically significant institutions not subject to heightened prudential supervision as regulated under section 113.

(2) RECOVERY OF FUNDS.—All funds expended on the termination or transfer of the swap or security-based swap activity of the swaps entity shall be recovered in accordance with applicable law from the disposition of assets of such swap entity or through assessments, including on the financial sector as provided under applicable law.

(3) NO LOSSES TO TAXPAYERS.—Taxpayers shall bear no losses from the exercise of any authority under this title.

(j) PROHIBITION ON UNREGULATED COMBINATION OF SWAPS ENTITIES AND BANKING.—At no time following adoption of the rules in subsection (k) may a bank or bank holding company be permitted to be or become a swap entity unless it conducts its swap or security-based swap activity in compliance with such minimum standards set by its prudential regulator as are reasonably calculated to permit the swaps entity to conduct its swap or security-based swap activities in a safe and sound manner and mitigate systemic risk.

(k) RULES.—In prescribing rules, the prudential regulator for a swaps entity shall consider the following factors:

(1) The expertise and managerial strength of the swaps entity, including systems for effective oversight.

(2) The financial strength of the swaps entity.

(3) Systems for identifying, measuring and controlling risks arising from the swaps entity's operations.

(4) Systems for identifying, measuring and controlling the swaps entity's participation in existing markets.

(5) Systems for controlling the swaps entity's participation or entry into in new markets and products.

(l) AUTHORITY OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL.—The Financial Stability Oversight Council may determine that, when other provisions established by this Act are insufficient to effectively mitigate systemic risk and protect taxpayers, that swaps entities may no longer access Federal assistance with respect to any swap, security-based swap, or other activity of the swaps entity. Any such determination by the Financial Stability Oversight Council of a prohibition of federal assistance shall be made on an institution-by-institution basis, and shall require the vote of not fewer than two-thirds of the members of the Financial Stability Oversight Council, which must include the vote by the Chairman of the Council, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairperson of the Federal Deposit Insurance Corporation. Notice and hearing requirements for such determinations shall be consistent with the standards provided in title I.

(m) BAN ON PROPRIETARY TRADING IN DERIVATIVES.—An insured depository institution shall comply with the prohibition on proprietary trading in derivatives as required by section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

SEC. 717. NEW PRODUCT APPROVAL CFTC—SEC PROCESS.

(a) AMENDMENTS TO THE COMMODITY EXCHANGE ACT.—Section 2(a)(1)(C) of the Commodity Exchange Act (7 U.S.C. 2(a)(1)(C)) is amended—

(1) in clause (i) by striking "This" and inserting "(I) Except as provided in subclause (II), this"; and

(2) by adding at the end of clause (i) the following:

"(II) This Act shall apply to and the Commission shall have jurisdiction with respect to accounts, agreements, and transactions involving, and may permit the listing for trading pursuant to section 5c(c) of, a put, call, or other option on 1 or more securities (as defined in section 2(a)(1) of the Securities Act of 1933 or section 3(a)(10) of the Securities Exchange Act of 1934 on the date of enactment of the Futures Trading Act of 1982), including any group or index of such securities, or any interest therein or based on the value thereof, that is exempted by the Securities and Exchange Commission pursuant to section 36(a)(1) of the Securities Exchange Act of 1934 with the condition that the Commission exercise concurrent jurisdiction over such put, call, or other option; provided, however, that nothing in this paragraph shall be construed to affect the jurisdiction and authority of the Securities and Exchange Commission over such put, call, or other option.".

(b) AMENDMENTS TO THE SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 is amended by adding the following section after section 3A (15 U.S.C. 78c–1):

"SEC. 3B. SECURITIES-RELATED DERIVATIVES.

"(a) Any agreement, contract, or transaction (or class thereof) that is exempted by the Commodity Futures Trading Commission pursuant to section 4(c)(1) of the Commodity Exchange Act (7 U.S.C. 6(c)(1)) with the condition that the Commission exercise concurrent jurisdiction over such agreement, contract, or transaction (or class thereof) shall be deemed a security for purposes of the securities laws.

"(b) With respect to any agreement, contract, or transaction (or class thereof) that is exempted by the Commodity Futures Trading Commission pursuant to section 4(c)(1) of the Commodity Exchange Act (7 U.S.C. 6(c)(1)) with the condition that the Commission exercise concurrent jurisdiction over such agreement, contract, or transaction (or class thereof), references in the securities laws to the 'purchase' or 'sale' of a security shall be deemed to include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under such agreement, contract, or transaction, as the context may require.".

(c) AMENDMENT TO SECURITIES EXCHANGE ACT OF 1934.—Section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) is amended by adding at the end the following:

"(10) Notwithstanding paragraph (2), the time period within which the Commission is required by order to approve a proposed rule change or institute proceedings to determine whether the proposed rule change should be disapproved is stayed pending a determination by the Commission upon the request of the Commodity Futures Trading Commission or its Chairman that the Commission issue a determination as to whether a product that is the subject of such proposed rule change is a security pursuant to section 718 of the Wall Street Transparency and Accountability Act of 2010.".

(d) AMENDMENT TO COMMODITY EXCHANGE ACT.—Section 5c(c)(1) of the Commodity Exchange Act (7 U.S.C. 7a–2(c)(1)) is amended—

(1) by striking "Subject to paragraph (2)" and inserting the following:

"(A) ELECTION.—Subject to paragraph (2)"; and

(2) by adding at the end the following:

"(B) CERTIFICATION.—The certification of a product pursuant to this paragraph shall be stayed pending a determination by the Commission upon the request of the Securities and Exchange Commission or its Chairman that the Commission issue a determination as to whether the product that is the subject of such certification is a contract of sale of a commodity for future delivery, an option on such a contract, or an option on a commodity pursuant to section 718 of the Wall Street Transparency and Accountability Act of 2010.".

SEC. 718. DETERMINING STATUS OF NOVEL DERIVATIVE PRODUCTS.

(a) PROCESS FOR DETERMINING THE STATUS OF A NOVEL DERIVATIVE PRODUCT.—

(1) NOTICE.—

(A) IN GENERAL.—Any person filing a proposal to list or trade a novel derivative product that may have elements of both securities and contracts of sale of a commodity for future delivery (or options on such contracts or options on commodities) may concurrently provide notice and furnish a copy of such filing with the Securities and Exchange

Commission and the Commodity Futures Trading Commission. Any such notice shall state that notice has been made with both Commissions.

(B) NOTIFICATION.—If no concurrent notice is made pursuant to subparagraph (A), within 5 business days after determining that a proposal that seeks to list or trade a novel derivative product may have elements of both securities and contracts of sale of a commodity for future delivery (or options on such contracts or options on commodities), the Securities and Exchange Commission or the Commodity Futures Trading Commission, as applicable, shall notify the other Commission and provide a copy of such filing to the other Commission.

(2) REQUEST FOR DETERMINATION.—

(A) IN GENERAL.—No later than 21 days after receipt of a notice under paragraph (1), or upon its own initiative if no such notice is received, the Commodity Futures Trading Commission may request that the Securities and Exchange Commission issue a determination as to whether a product is a security, as defined in section 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(10)).

(B) REQUEST.—No later than 21 days after receipt of a notice under paragraph (1), or upon its own initiative if no such notice is received, the Securities and Exchange Commission may request that the Commodity Futures Trading Commission issue a determination as to whether a product is a contract of sale of a commodity for future delivery, an option on such a contract, or an option on a commodity subject to the Commodity Futures Trading Commission's exclusive jurisdiction under section 2(a)(1)(A) of the Commodity Exchange Act (7 U.S.C. 2(a)(1)(A)).

(C) REQUIREMENT RELATING TO REQUEST.—A request under subparagraph (A) or (B) shall be made by submitting such request, in writing, to the Securities and Exchange Commission or the Commodity Futures Trading Commission, as applicable.

(D) EFFECT.—Nothing in this paragraph shall be construed to prevent—

(i) the Commodity Futures Trading Commission from requesting that the Securities and Exchange Commission grant an exemption pursuant to section 36(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78mm(a)(1)) with respect to a product that is the subject of a filing under paragraph (1); or

(ii) the Securities and Exchange Commission from requesting that the Commodity Futures Trading Commission grant an exemption pursuant to section 4(c)(1) of the Commodity Exchange Act (7 U.S.C. 6(c)(1)) with respect to a product that is the subject of a filing under paragraph (1),

Provided, however, that nothing in this subparagraph shall be construed to require the Commodity Futures Trading Commission or the Securities and Exchange Commission to issue an exemption requested pursuant to this subparagraph; *provided further*, That an order granting or denying an exemption described in this subparagraph and issued under paragraph (3)(B) shall not be subject to judicial review pursuant to subsection (b).

(E) WITHDRAWAL OF REQUEST.—A request under subparagraph (A) or (B) may be withdrawn by the Commission making the request at any time prior to a determination being made pursuant to paragraph (3) for any reason by providing written notice to the head of the other Commission.

(3) DETERMINATION.—Notwithstanding any other provision of law, no later than 120 days after the date of receipt of a request—

(A) under subparagraph (A) or (B) of paragraph (2), unless such request has been withdrawn pursuant to paragraph (2)(E), the Securities and Exchange Commission or the Commodity Futures Trading Commission, as applicable, shall, by order, issue the determination requested in subparagraph (A) or (B) of paragraph (2), as applicable, and the reasons therefor; or

(B) under paragraph (2)(D), unless such request has been withdrawn, the Securities and Exchange Commission or the Commodity Futures Trading Commission, as applicable, shall grant an exemption or provide reasons for not granting such exemption, provided that any decision by the Securities and Exchange Commission not to grant such exemption shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y).

(b) JUDICIAL RESOLUTION.—

(1) IN GENERAL.—The Commodity Futures Trading Commission or the Securities and Exchange Commission may petition the United States Court of Appeals for the District of Columbia Circuit for review of a final order of the other Commission issued pursuant to subsection (a)(3)(A), with respect to a novel derivative product that may have elements of both securities and contracts of sale of a commodity for future delivery (or options on such contracts or options on commodities) that it believes affects its statutory jurisdiction within 60 days after the date of entry of such order, a written petition requesting a review of the order. Any such proceeding shall be expedited by the Court of Appeals.

(2) TRANSMITTAL OF PETITION AND RECORD.—A copy of a petition described in paragraph (1) shall be transmitted not later than 1 business day after filing by the complaining Commission to the responding Commission. On receipt of the petition, the responding Commission shall file with the court a copy of the order under review and any documents referred to therein, and any other materials prescribed by the court.

(3) STANDARD OF REVIEW.—The court, in considering a petition filed pursuant to paragraph (1), shall give no deference to, or presumption in favor of, the views of either Commission.

(4) JUDICIAL STAY.—The filing of a petition by the complaining Commission pursuant to paragraph (1) shall operate as a stay of the order, until the date on which the determination of the court is final (including any appeal of the determination).

SEC. 719. STUDIES.

(a) STUDY ON EFFECTS OF POSITION LIMITS ON TRADING ON EXCHANGES IN THE UNITED STATES.—

(1) STUDY.—The Commodity Futures Trading Commission, in consultation with each entity that is a designated contract market under the Commodity Exchange Act, shall conduct a study of the effects (if any) of the position limits imposed pursuant to the other provisions of this title on excessive speculation and on the movement of transactions from exchanges in the United States to trading venues outside the United States.

(2) REPORT TO THE CONGRESS.—Within 12 months after the imposition of position limits pursuant to the other provisions of this title, the Commodity Futures Trading Commission, in consultation with each entity that is a designated contract market under the Commodity Exchange Act, shall submit to the Congress a report on the matters described in paragraph (1).

(3) REQUIRED HEARING.—Within 30 legislative days after the submission to the Congress of the report described in paragraph (2), the Committee on Agriculture of the House of Representatives shall hold a hearing examining the findings of the report.

(4) BIENNIAL REPORTING.—In addition to the study required in paragraph (1), the Chairman of the Commodity Futures Trading Commission shall prepare and submit to the Congress biennial reports on the growth or decline of the derivatives markets in the United States and abroad, which shall include assessments of the causes of any such growth or decline, the effectiveness of regulatory regimes in managing systemic risk, a comparison of the costs of compliance at the time of the report for market participants subject to regulation by the United States with the costs of compliance in December 2008 for the market participants, and the quality of the available data. In preparing the report, the Chairman shall solicit the views of, consult with, and address the concerns raised by, market participants, regulators, legislators, and other interested parties.

(b) STUDY ON FEASIBILITY OF REQUIRING USE OF STANDARDIZED ALGORITHMIC DESCRIPTIONS FOR FINANCIAL DERIVATIVES.—

(1) IN GENERAL.—The Securities and Exchange Commission and the Commodity Futures Trading Commission shall conduct a joint study of the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions which may be used to describe complex and standardized financial derivatives.

(2) GOALS.—The algorithmic descriptions defined in the study shall be designed to facilitate computerized analysis of individual derivative contracts and to calculate net exposures to complex derivatives. The algorithmic descriptions shall be optimized for simultaneous use by—

(A) commercial users and traders of derivatives;

(B) derivative clearing houses, exchanges and electronic trading platforms;

(C) trade repositories and regulator investigations of market activities; and

(D) systemic risk regulators.

The study will also examine the extent to which the algorithmic description, together with standardized and extensible legal definitions, may serve as the binding legal definition of derivative contracts. The study will examine the logistics of possible implementations of standardized algorithmic descriptions for derivatives contracts. The study shall be limited to electronic formats for exchange of derivative contract descriptions and will not contemplate disclosure of proprietary valuation models.

(3) INTERNATIONAL COORDINATION.—In conducting the study, the Securities and Exchange Commission and the Commodity Futures Trading Commission shall coordinate the study with international financial institutions and regulators as appropriate and practical.

(4) REPORT.—Within 8 months after the date of the enactment of this Act, the Securities and Exchange Commission and the Commodity Futures Trading Commission shall jointly submit to the Committees on Agriculture and on Financial Services of the House of Representatives and the Committees on Agriculture, Nutrition, and Forestry and on Banking, Housing, and Urban Affairs of the Senate a written report which contains the results of the study required by paragraphs (1) through (3).

(c) INTERNATIONAL SWAP REGULATION.—

(1) IN GENERAL.—The Commodity Futures Trading Commission and the Securities and Exchange Commission shall jointly conduct a study—

(A) relating to—

(i) swap regulation in the United States, Asia, and Europe; and

(ii) clearing house and clearing agency regulation in the United States, Asia, and Europe; and

(B) that identifies areas of regulation that are similar in the United States, Asia and Europe and other areas of regulation that could be harmonized

(2) REPORT.—Not later than 18 months after the date of enactment of this Act, the Commodity Futures Trading Commission and the Securities and Exchange Commission shall submit to the Committee on Agriculture, Nutrition, and Forestry and the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Agriculture and the Committee on Financial Services of the House of Representatives a report that includes a description of the results of the study under subsection (a), including—

(A) identification of the major exchanges and their regulator in each geographic area for the trading of swaps and security-based swaps including a listing of the major contracts and their trading volumes and notional values as well as identification of the major swap dealers participating in such markets;

(B) identification of the major clearing houses and clearing agencies and their regulator in each geographic area for the clearing of swaps and security-based swaps, including a listing of the major contracts and the clearing volumes and notional values as well as identification of the major clearing members of such clearing houses and clearing agencies in such markets;

(C) a description of the comparative methods of clearing swaps in the United States, Asia, and Europe; and

(D) a description of the various systems used for establishing margin on individual swaps, security-based swaps, and swap portfolios.

(d) STABLE VALUE CONTRACTS.—

(1) DETERMINATION.—

(A) STATUS.—Not later than 15 months after the date of the enactment of this Act, the Securities and Exchange Commission and the Commodity Futures Trading Commission shall, jointly, conduct a study to determine whether stable value contracts fall within the definition of a swap. In making the determination required under this subparagraph, the Commissions jointly shall consult with the Department of Labor, the Department of the Treasury, and the State entities that regulate the issuers of stable value contracts.

(B) REGULATIONS.—If the Commissions determine that stable value contracts fall within the definition of a swap, the Commissions jointly shall determine if an exemption for stable value contracts from the definition of swap is appropriate and in the public interest. The Commissions shall issue regulations implementing the determinations required under this paragraph. Until the effective date of such regulations, and notwithstanding any other provision of this title, the requirements of this title shall not apply to stable value contracts.

(C) LEGAL CERTAINTY.—Stable value contracts in effect prior to the effective date of the regulations described in subparagraph (B) shall not be considered swaps.

(2) DEFINITION.—For purposes of this subsection, the term "stable value contract" means any contract, agreement, or transaction that provides a crediting interest rate and guaranty or financial assurance of liquidity at contract or book value prior to maturity offered by a bank, insurance company, or other State or federally regulated financial institution for the benefit of any individual or commingled fund available as an investment in an employee benefit plan (as defined in section 3(3) of the Employee Retirement Income Security Act of 1974, including plans described in section 3(32) of such Act) subject to participant direction, an eligible deferred compensation plan (as defined in section 457(b) of the Internal Revenue Code of 1986) that is maintained by an eligible employer described in section 457(e)(1)(A) of such Code, an arrangement described in section 403(b) of such Code, or a qualified tuition program (as defined in section 529 of such Code).

SEC. 720. MEMORANDUM.

(a)(1) The Commodity Futures Trading Commission and the Federal Energy Regulatory Commission shall, not later than 180 days after the date of the enactment of this Act, negotiate a memorandum of understanding to establish procedures for—

(A) applying their respective authorities in a manner so as to ensure effective and efficient regulation in the public interest;

(B) resolving conflicts concerning overlapping jurisdiction between the 2 agencies; and

(C) avoiding, to the extent possible, conflicting or duplicative regulation.

(2) Such memorandum and any subsequent amendments to the memorandum shall be promptly submitted to the appropriate committees of Congress.

(b) The Commodity Futures Trading Commission and the Federal Energy Regulatory Commission shall, not later than 180 days after the date of the enactment of this section, negotiate a memorandum of understanding to share information that may be requested where either Commission is conducting an investigation into potential manipulation, fraud, or market power abuse in markets subject to such Commission's regulation or oversight. Shared information shall remain subject to the same restrictions on disclosure applicable to the Commission initially holding the information.

PART II—REGULATION OF SWAP MARKETS

SEC. 721. DEFINITIONS.

(a) IN GENERAL.—Section 1a of the Commodity Exchange Act (7 U.S.C. 1a) is amended—

(1) by redesignating paragraphs (2), (3) and (4), (5) through (17), (18) through (23), (24) through (28), (29), (30), (31) through (33), and (34) as paragraphs (6), (8) and (9), (11) through (23), (26) through (31), (34) through (38), (40), (41), (44) through (46), and (51), respectively;

(2) by inserting after paragraph (1) the following:

"(2) APPROPRIATE FEDERAL BANKING AGENCY.—The term 'appropriate Federal banking agency'—

"(A) has the meaning given the term in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

"(B) means the Board in the case of a noninsured State bank; and

"(C) is the Farm Credit Administration for farm credit system institutions.

"(3) ASSOCIATED PERSON OF A SECURITY-BASED SWAP DEALER OR MAJOR SECURITY-BASED SWAP PARTICIPANT.—The term 'associated person of a security-based swap dealer or major security-based swap participant' has the meaning given the term in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

"(4) ASSOCIATED PERSON OF A SWAP DEALER OR MAJOR SWAP PARTICIPANT.—

"(A) IN GENERAL.—The term 'associated person of a swap dealer or major swap participant' means a person who is associated with a swap dealer or major swap participant as a partner, officer, employee, or agent (or any person occupying a similar status or performing similar functions), in any capacity that involves—

"(i) the solicitation or acceptance of swaps; or

"(ii) the supervision of any person or persons so engaged.

"(B) EXCLUSION.—Other than for purposes of section 4s(b)(6), the term 'associated person of a swap dealer or major swap participant' does not include any person associated with a swap dealer or major swap participant the functions of which are solely clerical or ministerial.

"(5) BOARD.—The term 'Board' means the Board of Governors of the Federal Reserve System.";

(3) by inserting after paragraph (6) (as redesignated by paragraph (1)) the following:

"(7) CLEARED SWAP.—The term 'cleared swap' means any swap that is, directly or indirectly, submitted to and cleared by a derivatives clearing organization registered with the Commission.";

(4) in paragraph (9) (as redesignated by paragraph (1)), by striking "except onions" and all that follows through the period at the end and inserting the following: "except onions (as provided by the first section of Public Law 85–839 (7 U.S.C. 13–1)) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.";

(5) by inserting after paragraph (9) (as redesignated by paragraph (1)) the following:

"(10) COMMODITY POOL.—

"(A) IN GENERAL.—The term 'commodity pool' means any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests, including any—

"(i) commodity for future delivery, security futures product, or swap;

"(ii) agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i);

"(iii) commodity option authorized under section 4c; or

"(iv) leverage transaction authorized under section 19.

"(B) FURTHER DEFINITION.—The Commission, by rule or regulation, may include within, or exclude from, the term 'commodity pool' any investment trust, syndicate, or similar form of enterprise if the Commission determines that the rule or regulation will effectuate the purposes of this Act.";

(6) by striking paragraph (11) (as redesignated by paragraph (1)) and inserting the following:

"(11) COMMODITY POOL OPERATOR.—

"(A) IN GENERAL.—The term 'commodity pool operator' means any person—

"(i) engaged in a business that is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in commodity interests, including any—

"(I) commodity for future delivery, security futures product, or swap;

"(II) agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i);

"(III) commodity option authorized under section 4c; or

"(IV) leverage transaction authorized under section 19; or

"(ii) who is registered with the Commission as a commodity pool operator.

"(B) FURTHER DEFINITION.—The Commission, by rule or regulation, may include within, or exclude from, the term 'commodity pool operator' any person engaged in a business that is of the nature of a commodity pool, investment trust, syndicate, or similar form of enterprise if the Commission determines that the rule or regulation will effectuate the purposes of this Act.";

(7) in paragraph (12) (as redesignated by paragraph (1)), in subparagraph (A)—

(A) in clause (i)—

(i) in subclause (I), by striking "made or to be made on or subject to the rules of a contract market or derivatives transaction execution facility" and inserting ", security futures product, or swap";

(ii) by redesignating subclauses (II) and (III) as subclauses (III) and (IV);

(iii) by inserting after subclause (I) the following:

"(II) any agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i)"; and

(iv) in subclause (IV) (as so redesignated), by striking "or";

(B) in clause (ii), by striking the period at the end and inserting a semicolon; and

(C) by adding at the end the following:

"(iii) is registered with the Commission as a commodity trading advisor; or

"(iv) the Commission, by rule or regulation, may include if the Commission determines that the rule or regulation will effectuate the purposes of this Act.";

(8) in paragraph (17) (as redesignated by paragraph (1)), in subparagraph (A), in the matter preceding clause (i), by striking "paragraph (12)(A)" and inserting "paragraph (18)(A)";

(9) in paragraph (18) (as redesignated by paragraph (1))—

(A) in subparagraph (A)—

(i) in the matter following clause (vii)(III)—

(I) by striking "section 1a (11)(A)" and inserting "paragraph (17)(A)"; and

(II) by striking "$25,000,000" and inserting "$50,000,000"; and

(ii) in clause (xi), in the matter preceding subclause (I), by striking "total assets in an amount" and inserting "amounts invested on a discretionary basis, the aggregate of which is";

(10) by striking paragraph (22) (as redesignated by paragraph (1)) and inserting the following:

"(22) FLOOR BROKER.—

"(A) IN GENERAL.—The term 'floor broker' means any person—

"(i) who, in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person—

"(I) any commodity for future delivery, security futures product, or swap; or

"(II) any commodity option authorized under section 4c; or

"(ii) who is registered with the Commission as a floor broker.

"(B) FURTHER DEFINITION.—The Commission, by rule or regulation, may include within, or exclude from, the term 'floor broker' any person in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged who trades for any other person if the Commission determines that the rule or regulation will effectuate the purposes of this Act.";

(11) by striking paragraph (23) (as redesignated by paragraph (1)) and inserting the following:

"(23) FLOOR TRADER.—

"(A) IN GENERAL.—The term 'floor trader' means any person—

"(i) who, in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged, purchases, or sells solely for such person's own account—

"(I) any commodity for future delivery, security futures product, or swap; or

"(II) any commodity option authorized under section 4c; or

"(ii) who is registered with the Commission as a floor trader.

"(B) FURTHER DEFINITION.—The Commission, by rule or regulation, may include within, or exclude from, the term 'floor trader' any person in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged who trades solely for such person's own account if the Commission determines that the rule or regulation will effectuate the purposes of this Act.";

(12) by inserting after paragraph (23) (as redesignated by paragraph (1)) the following:

"(24) FOREIGN EXCHANGE FORWARD.—The term 'foreign exchange forward' means a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.

"(25) FOREIGN EXCHANGE SWAP.—The term 'foreign exchange swap' means a transaction that solely involves—

"(A) an exchange of 2 different currencies on a specific date at a fixed rate that is agreed upon on the inception of the contract covering the exchange; and

"(B) a reverse exchange of the 2 currencies described in subparagraph (A) at a later date and at a fixed rate that is agreed upon on the inception of the contract covering the exchange.";

(13) by striking paragraph (28) (as redesignated by paragraph (1)) and inserting the following:

"(28) FUTURES COMMISSION MERCHANT.—

"(A) IN GENERAL.—The term 'futures commission merchant' means an individual, association, partnership, corporation, or trust—

"(i) that—

"(I) is—

"(aa) engaged in soliciting or in accepting orders for—

"(AA) the purchase or sale of a commodity for future delivery;

"(BB) a security futures product;

"(CC) a swap;

"(DD) any agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i);

"(EE) any commodity option authorized under section 4c; or

"(FF) any leverage transaction authorized under section 19; or

"(bb) acting as a counterparty in any agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i); and

"(II) in or in connection with the activities described in items (aa) or (bb) of subclause (I), accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom; or

"(ii) that is registered with the Commission as a futures commission merchant.

"(B) FURTHER DEFINITION.—The Commission, by rule or regulation, may include within, or exclude from, the term 'futures commission merchant' any person who engages in soliciting or accepting orders for, or acting as a counterparty in, any agreement, contract, or transaction subject to this Act, and who accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom, if the Commission determines that the rule or regulation will effectuate the purposes of this Act.";

(14) in paragraph (30) (as redesignated by paragraph (1)), in subparagraph (B), by striking "state" and inserting "State";

(15) by striking paragraph (31) (as redesignated by paragraph (1)) and inserting the following:

"(31) INTRODUCING BROKER.—

"(A) IN GENERAL.—The term 'introducing broker' means any person (except an individual who elects to be and is registered as an associated person of a futures commission merchant)—

"(i) who—

"(I) is engaged in soliciting or in accepting orders for—

"(aa) the purchase or sale of any commodity for future delivery, security futures product, or swap;

"(bb) any agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i);

"(cc) any commodity option authorized under section 4c; or

"(dd) any leverage transaction authorized under section 19; and

"(II) does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom; or

"(ii) who is registered with the Commission as an introducing broker.

"(B) FURTHER DEFINITION.—The Commission, by rule or regulation, may include within, or exclude from, the term 'introducing broker' any person who engages in soliciting or accepting orders for any agreement, contract, or transaction subject to this Act, and who does not accept any money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom, if the Commission determines that the rule or regulation will effectuate the purposes of this Act.";

(16) by inserting after paragraph (31) (as redesignated by paragraph (1)) the following:

"(32) MAJOR SECURITY-BASED SWAP PARTICIPANT.—The term 'major security-based swap participant' has the meaning given the term in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

"(33) MAJOR SWAP PARTICIPANT.—

"(A) IN GENERAL.—The term 'major swap participant' means any person who is not a swap dealer, and—

"(i) maintains a substantial position in swaps for any of the major swap categories as determined by the Commission, excluding—

"(I) positions held for hedging or mitigating commercial risk; and

"(II) positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;

"(ii) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or

"(iii)(I) is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and

"(II) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission.

"(B) DEFINITION OF SUBSTANTIAL POSITION.—For purposes of subparagraph (A), the Commission shall define by rule or regulation the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person's relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures.

"(C) SCOPE OF DESIGNATION.—For purposes of subparagraph (A), a person may be designated as a major swap participant for 1 or more categories of swaps without being classified as a major swap participant for all classes of swaps.

"(D) EXCLUSIONS.—The definition under this paragraph shall not include an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company.";

(17) by inserting after paragraph (38) (as redesignated by paragraph (1)) the following:

"(39) PRUDENTIAL REGULATOR.—The term 'prudential regulator' means—

"(A) the Board in the case of a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant that is—

"(i) a State-chartered bank that is a member of the Federal Reserve System;

"(ii) a State-chartered branch or agency of a foreign bank;

"(iii) any foreign bank which does not operate an insured branch;

"(iv) any organization operating under section 25A of the Federal Reserve Act or having an agreement with the Board under section 225 of the Federal Reserve Act;

"(v) any bank holding company (as defined in section 2 of the Bank Holding Company Act of 1965 (12 U.S.C. 1841)), any foreign bank (as defined in section 1(b)(7) of the International Banking Act of 1978 (12 U.S.C. 3101(b)(7)) that is treated as a bank holding company under section 8(a) of the International Banking Act of 1978 (12 U.S.C. 3106(a)), and any subsidiary of such a company or foreign bank (other than a subsidiary that is described in subparagraph (A) or (B) or that is required to be registered with the Commission as a swap dealer or major swap participant under this Act or with the Securities and Exchange Commission as a security-based swap dealer or major security-based swap participant);

"(vi) after the transfer date (as defined in section 311 of the Dodd-Frank Wall Street Reform and Consumer Protection Act), any savings and loan holding company (as defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1467a)) and any subsidiary of such company (other than a subsidiary that is described in subparagraph (A) or (B) or that is required to be registered as a swap dealer or major swap participant with the Commission under this Act or with the Securities and Exchange Commission as a security-based swap dealer or major security-based swap participant); or

"(vii) any organization operating under section 25A of the Federal Reserve Act (12U.S.C. 611 et seq.) or having an agreement with the Board under section 25 of the Federal Reserve Act (12 U.S.C. 601 et seq.);

"(B) the Office of the Comptroller of the Currency in the case of a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant that is—

"(i) a national bank;

"(ii) a federally chartered branch or agency of a foreign bank; or

"(iii) any Federal savings association;

"(C) the Federal Deposit Insurance Corporation in the case of a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant that is—

"(i) a State-chartered bank that is not a member of the Federal Reserve System; or

"(ii) any State savings association;

"(D) the Farm Credit Administration, in the case of a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant that is an institution chartered under the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.); and

"(E) the Federal Housing Finance Agency in the case of a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant that is a regulated entity (as such term is defined in section 1303 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992).";

(18) in paragraph (40) (as redesignated by paragraph (1))—

(A) by striking subparagraph (B);

(B) by redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (F), respectively;

(C) in subparagraph (C) (as so redesignated), by striking "and"; and

(D) by inserting after subparagraph (C) (as so redesignated) the following:

"(D) a swap execution facility registered under section 5h;

"(E) a swap data repository registered under section 21; and";

(19) by inserting after paragraph (41) (as redesignated by paragraph (1)) the following:

"(42) SECURITY-BASED SWAP.—The term 'security-based swap' has the meaning given the term in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

"(43) SECURITY-BASED SWAP DEALER.—The term 'security-based swap dealer' has the meaning given the term in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).";

(20) in paragraph (46) (as redesignated by paragraph (1)), by striking "subject to section 2(h)(7)" and inserting "subject to section 2(h)(5)";

(21) by inserting after paragraph (46) (as redesignated by paragraph (1)) the following:

"(47) SWAP.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'swap' means any agreement, contract, or transaction—

"(i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind;

"(ii) that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence;

"(iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred, including any agreement, contract, or transaction commonly known as—

"(I) an interest rate swap;

"(II) a rate floor;

"(III) a rate cap;

"(IV) a rate collar;

"(V) a cross-currency rate swap;

"(VI) a basis swap;

"(VII) a currency swap;

"(VIII) a foreign exchange swap;

"(IX) a total return swap;

"(X) an equity index swap;

"(XI) an equity swap;

"(XII) a debt index swap;

"(XIII) a debt swap;

"(XIV) a credit spread;
"(XV) a credit default swap;
"(XVI) a credit swap;
"(XVII) a weather swap;
"(XVIII) an energy swap;
"(XIX) a metal swap;
"(XX) an agricultural swap;
"(XXI) an emissions swap; and
"(XXII) a commodity swap;

"(iv) that is an agreement, contract, or transaction that is, or in the future becomes, commonly known to the trade as a swap;

"(v) including any security-based swap agreement which meets the definition of 'swap agreement' as defined in section 206A of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note) of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein; or

"(vi) that is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of clauses (i) through (v).

"(B) EXCLUSIONS.—The term 'swap' does not include—

"(i) any contract of sale of a commodity for future delivery (or option on such a contract), leverage contract authorized under section 19, security futures product, or agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i);

"(ii) any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled;

"(iii) any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof, that is subject to—

"(I) the Securities Act of 1933 (15 U.S.C. 77a et seq.); and

"(II) the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.);

"(iv) any put, call, straddle, option, or privilege relating to a foreign currency entered into on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a));

"(v) any agreement, contract, or transaction providing for the purchase or sale of 1 or more securities on a fixed basis that is subject to—

"(I) the Securities Act of 1933 (15 U.S.C. 77a et seq.); and

"(II) the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.);

"(vi) any agreement, contract, or transaction providing for the purchase or sale of 1 or more securities on a contingent basis that is subject to the Securities Act of 1933 (15 U.S.C. 77a et seq.) and the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), unless the agreement, contract, or transaction predicates the purchase or sale on the occurrence of a bona fide contingency that might reasonably be expected to affect or be affected by the creditworthiness of a party other than a party to the agreement, contract, or transaction;

"(vii) any note, bond, or evidence of indebtedness that is a security, as defined in section 2(a)(1) of the Securities Act of 1933 (15 U.S.C. 77b(a)(1));

"(viii) any agreement, contract, or transaction that is—

"(I) based on a security; and

"(II) entered into directly or through an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933 (15 U.S.C. 77b(a)(11)) by the issuer of such security for the purposes of raising capital, unless the agreement, contract, or transaction is entered into to manage a risk associated with capital raising;

"(ix) any agreement, contract, or transaction a counterparty of which is a Federal Reserve bank, the Federal Government, or a Federal agency that is expressly backed by the full faith and credit of the United States; and

"(x) any security-based swap, other than a security-based swap as described in subparagraph (D).

"(C) RULE OF CONSTRUCTION REGARDING MASTER AGREEMENTS.—

"(i) IN GENERAL.—Except as provided in clause (ii), the term 'swap' includes a master agreement that provides for an agreement, contract, or transaction that is a swap under subparagraph (A), together with each supplement to any master agreement, without regard to whether the master agreement contains an agreement, contract, or transaction that is not a swap pursuant to subparagraph (A).

"(ii) EXCEPTION.—For purposes of clause (i), the master agreement shall be considered to be a swap only with respect to each agreement, contract, or transaction covered by the master agreement that is a swap pursuant to subparagraph (A).

"(D) MIXED SWAP.—The term 'security-based swap' includes any agreement, contract, or transaction that is as described in section 3(a)(68)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)(A)) and also is based on the value of 1 or more interest or other rates, currencies, commodities, instruments of indebtedness, indices, quantitative measures, other financial or economic interest or property of any kind (other than a single security or a narrow-based security index), or the occurrence, non-occurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence (other than an event described in subparagraph (A)(iii)).

"(E) TREATMENT OF FOREIGN EXCHANGE SWAPS AND FORWARDS.—

"(i) IN GENERAL.—Foreign exchange swaps and foreign exchange forwards shall be considered swaps under this paragraph unless the Secretary makes a written determination under section 1b that either foreign exchange swaps or foreign exchange forwards or both—

"(I) should be not be regulated as swaps under this Act; and

"(II) are not structured to evade the Dodd-Frank Wall Street Reform and Consumer Protection Act in violation of any rule promulgated by the Commission pursuant to section 721(c) of that Act.

"(ii) CONGRESSIONAL NOTICE; EFFECTIVENESS.—The Secretary shall submit any written determination under clause (i) to the appropriate committees of Congress, including the Committee on Agriculture, Nutrition, and Forestry of the Senate and the Committee on Agriculture of the House of Representatives. Any such written determination by the Secretary shall not be effective until it is submitted to the appropriate committees of Congress.

"(iii) REPORTING.—Notwithstanding a written determination by the Secretary under clause (i), all foreign exchange swaps and foreign exchange forwards shall be reported to either a swap data repository, or, if there is no swap data repository that would accept such swaps or forwards, to the Commission pursuant to section 4r within such time period as the Commission may by rule or regulation prescribe.

"(iv) BUSINESS STANDARDS.—Notwithstanding a written determination by the Secretary pursuant to clause (i), any party to a foreign exchange swap or forward that is a swap dealer or major swap participant shall conform to the business conduct standards contained in section 4s(h).

"(v) SECRETARY.—For purposes of this subparagraph, the term 'Secretary' means the Secretary of the Treasury.

"(F) EXCEPTION FOR CERTAIN FOREIGN EXCHANGE SWAPS AND FORWARDS.—

"(i) REGISTERED ENTITIES.—Any foreign exchange swap and any foreign exchange forward that is listed and traded on or subject to the rules of a designated contract market or a swap execution facility, or that is cleared by a derivatives clearing organization, shall not be exempt from any provision of this Act or amendments made by the Wall Street Transparency and Accountability Act of 2010 prohibiting fraud or manipulation.

"(ii) RETAIL TRANSACTIONS.—Nothing in subparagraph (E) shall affect, or be construed to affect, the applicability of this Act or the jurisdiction of the Commission with respect to agreements, contracts, or transactions in foreign currency pursuant to section 2(c)(2).

"(48) SWAP DATA REPOSITORY.—The term 'swap data repository' means any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps.

"(49) SWAP DEALER.—

"(A) IN GENERAL.—The term 'swap dealer' means any person who—

"(i) holds itself out as a dealer in swaps;

"(ii) makes a market in swaps;

"(iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

"(iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps,

provided however, in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.

"(B) INCLUSION.—A person may be designated as a swap dealer for a single type or single class or category of swap or activities and considered not to be a swap dealer for other types, classes, or categories of swaps or activities.

"(C) EXCEPTION.—The term 'swap dealer' does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business.

"(D) DE MINIMIS EXCEPTION.—The Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of this determination to exempt.

"(50) SWAP EXECUTION FACILITY.—The term 'swap execution facility' means a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—

"(A) facilitates the execution of swaps between persons; and

"(B) is not a designated contract market.".

(22) in paragraph (51) (as redesignated by paragraph (1)), in subparagraph (A)(i), by striking "partipants" and inserting "participants".

(b) AUTHORITY TO DEFINE TERMS.—The Commodity Futures Trading Commission may adopt a rule to define—

(1) the term "commercial risk"; and

(2) any other term included in an amendment to the Commodity Exchange Act (7 U.S.C. 1 et seq.) made by this subtitle.

(c) MODIFICATION OF DEFINITIONS.—To include transactions and entities that have been structured to evade this subtitle (or an amendment made by this subtitle), the Commodity Futures Trading Commission shall adopt a rule to further define the terms "swap", "swap dealer", "major swap participant", and "eligible contract participant".

(d) EXEMPTIONS.—Section 4(c)(1) of the Commodity Exchange Act (7 U.S.C. 6(c)(1)) is amended by striking "except that" and all that follows through the period at the end and inserting the following: "except that—

"(A) unless the Commission is expressly authorized by any provision described in this subparagraph to grant exemptions, with respect to amendments made by subtitle A of the Wall Street Transparency and Accountability Act of 2010—

"(i) with respect to—

"(I) paragraphs (2), (3), (4), (5), and (7), paragraph (18)(A)(vii)(III), paragraphs (23), (24), (31), (32), (38), (39), (41), (42), (46), (47), (48), and (49) of section 1a, and sections 2(a)(13), 2(c)(1)(D), 4a(a), 4a(b), 4d(c), 4d(d), 4r, 4s, 5b(a), 5b(b), 5(d), 5(g), 5(h), 5b(c), 5b(i), 8e, and 21; and

"(II) section 206(e) of the Gramm-Leach-Bliley Act (Public Law 106–102; 15 U.S.C. 78c note); and

"(ii) in sections 721(c) and 742 of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and

"(B) the Commission and the Securities and Exchange Commission may by rule, regulation, or order jointly exclude any agreement, contract, or transaction from section 2(a)(1)(D)) if the Commissions determine that the exemption would be consistent with the public interest.".

(e) CONFORMING AMENDMENTS.—

(1) Section 2(c)(2)(B)(i)(II) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(B)(i)(II)) is amended—

(A) in item (cc)—

(i) in subitem (AA), by striking "section 1a(20)" and inserting "section 1a"; and

(ii) in subitem (BB), by striking "section 1a(20)" and inserting "section 1a"; and

(B) in item (dd), by striking "section 1a(12)(A)(ii)" and inserting "section 1a(18)(A)(ii)".

(2) Section 4m(3) of the Commodity Exchange Act (7 U.S.C. 6m(3)) is amended by striking "section 1a(6)" and inserting "section 1a".

(3) Section 4q(a)(1) of the Commodity Exchange Act (7 U.S.C. 6o–1(a)(1)) is amended by striking "section 1a(4)" and inserting "section 1a(9)".

(4) Section 5(e)(1) of the Commodity Exchange Act (7 U.S.C. 7(e)(1)) is amended by striking "section 1a(4)" and inserting "section 1a(9)".

(5) Section 5a(b)(2)(F) of the Commodity Exchange Act (7 U.S.C. 7a(b)(2)(F)) is amended by striking "section 1a(4)" and inserting "section 1a(9)".

(6) Section 5b(a) of the Commodity Exchange Act (7 U.S.C. 7a–1(a)) is amended, in the matter preceding paragraph (1), by striking "section 1a(9)" and inserting "section 1a".

(7) Section 5c(c)(2)(B) of the Commodity Exchange Act (7 U.S.C. 7a–2(c)(2)(B)) is amended by striking "section 1a(4)" and inserting "section 1a(9)".

(8) Section 6(g)(5)(B)(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(g)(5)(B)(i)) is amended—

(A) in subclause (I), by striking "section 1a(12)(B)(ii)" and inserting "section 1a(18)(B)(ii)"; and

(B) in subclause (II), by striking "section 1a(12)" and inserting "section 1a(18)".

(9) Section 402 of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27 et seq.) is amended—

(A) in subsection (a)(7), by striking "section 1a(20)" and inserting "section 1a";

(B) in subsection (b)(2), by striking "section 1a(12)" and inserting "section 1a"; and

(C) in subsection (c), by striking "section 1a(4)" and inserting "section 1a".

(10) The first section of Public Law 85–839 (7 U.S.C. 13–1) is amended in subsection (a), in the first sentence, by inserting "motion picture box office receipts (or any index, measure, value, or data related to such receipts) or" after "sale of".

(f) EFFECTIVE DATE.—Notwithstanding any other provision of this Act, the amendments made by subsection (a)(4) shall take effect on June 1, 2010.

SEC. 722. JURISDICTION.

(a) EXCLUSIVE JURISDICTION.—Section 2(a)(1) of the Commodity Exchange Act (7 U.S.C. 2(a)(1)) is amended—

(1) in subparagraph (A), in the first sentence—

(A) by inserting "the Wall Street Transparency and Accountability Act of 2010 (including an amendment made by that Act) and" after "otherwise provided in";

(B) by striking "(C) and (D)" and inserting "(C), (D), and (I)";

(C) by striking "(c) through (i) of this section" and inserting "(c) and (f)";

(D) by striking "contracts of sale" and inserting "swaps or contracts of sale"; and

(E) by striking "or derivatives transaction execution facility registered pursuant to section 5 or 5a" and inserting "pursuant to section 5 or a swap execution facility pursuant to section 5h"; and

(2) by adding at the end the following:

"(G)(i) Nothing in this paragraph shall limit the jurisdiction conferred on the Securities and Exchange Commission by the Wall Street Transparency and Accountability Act of 2010 with regard to security-based swap agreements as defined pursuant to section 3(a)(78) of the Securities Exchange Act of 1934, and security-based swaps.

"(ii) In addition to the authority of the Securities and Exchange Commission described in clause (i), nothing in this subparagraph shall limit or affect any statutory authority of the Commission with respect to an agreement, contract, or transaction described in clause (i).

"(H) Notwithstanding any other provision of law, the Wall Street Transparency and Accountability Act of 2010 shall not apply to, and the Commodity Futures Trading Commission shall have no jurisdiction under such Act (or any amendments to the Commodity Exchange Act made by such Act) with respect to, any security other than a security-based swap.".

(b) REGULATION OF SWAPS UNDER FEDERAL AND STATE LAW.—Section 12 of the Commodity Exchange Act (7 U.S.C. 16) is amended by adding at the end the following:

"(h) REGULATION OF SWAPS AS INSURANCE UNDER STATE LAW.—A swap—

"(1) shall not be considered to be insurance; and

"(2) may not be regulated as an insurance contract under the law of any State.".

(c) AGREEMENTS, CONTRACTS, AND TRANSACTIONS TRADED ON AN ORGANIZED EXCHANGE.—Section 2(c)(2)(A) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(A)) is amended—

(1) in clause (i), by striking "or" at the end;

(2) by redesignating clause (ii) as clause (iii); and

(3) by inserting after clause (i) the following:

"(ii) a swap; or".

(d) APPLICABILITY.—Section 2 of the Commodity Exchange Act (7 U.S.C. 2) (as amended by section 723(a)(3)) is amended by adding at the end the following:

"(i) APPLICABILITY.—The provisions of this Act relating to swaps that were enacted by the Wall Street Transparency and Accountability Act of 2010 (including any rule prescribed or regulation promulgated under that Act), shall not apply to activities outside the United States unless those activities—

"(1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or

"(2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act that was enacted by the Wall Street Transparency and Accountability Act of 2010.".

(e) FEDERAL ENERGY REGULATORY COMMISSION.—Section 2(a)(1) of the Commodity Exchange Act (7 U.S.C. 2(a)(1)) is amended by adding at the end the following:

"(I)(i) Nothing in this Act shall limit or affect any statutory authority of the Federal Energy Regulatory Commission or a State regulatory authority (as defined in section 3(21) of the Federal Power Act (16 U.S.C. 796(21)) with respect to an agreement, contract, or transaction that is entered into pursuant to a tariff or rate schedule approved by the Federal Energy Regulatory Commission or a State regulatory authority and is—

"(I) not executed, traded, or cleared on a registered entity or trading facility; or

"(II) executed, traded, or cleared on a registered entity or trading facility owned or operated by a regional transmission organization or independent system operator.

"(ii) In addition to the authority of the Federal Energy Regulatory Commission or a State regulatory authority described in clause (i), nothing in this subparagraph shall limit or affect—

"(I) any statutory authority of the Commission with respect to an agreement, contract, or transaction described in clause (i); or

"(II) the jurisdiction of the Commission under subparagraph (A) with respect to an agreement, contract, or transaction that is executed, traded, or cleared on a registered entity or trading facility that is not owned or operated by a regional transmission organization or independent system operator (as defined by sections 3(27) and (28) of the Federal Power Act (16 U.S.C. 796(27), 796(28)).".

(f) PUBLIC INTEREST WAIVER.—Section 4(c) of the Commodity Exchange Act (7 U.S.C. 6(c)) (as amended by section 721(d)) is amended by adding at the end the following:

"(6) If the Commission determines that the exemption would be consistent with the public interest and the purposes of this Act, the Commission shall, in accordance with paragraphs (1) and (2), exempt from the requirements of this Act an agreement, contract, or transaction that is entered into—

"(A) pursuant to a tariff or rate schedule approved or permitted to take effect by the Federal Energy Regulatory Commission;

"(B) pursuant to a tariff or rate schedule establishing rates or charges for, or protocols governing, the sale of electric energy approved or permitted to take effect by the regulatory authority of the State or municipality having jurisdiction to regulate rates and charges for the sale of electric energy within the State or municipality; or

"(C) between entities described in section 201(f) of the Federal Power Act (16 U.S.C. 824(f)).".

(g) AUTHORITY OF FERC.—Nothing in the Wall Street Transparency and Accountability Act of 2010 or the amendments to the Commodity Exchange Act made by such Act shall limit or affect any statutory enforcement authority of the Federal Energy Regulatory Commission pursuant to section 222 of the Federal Power Act and section 4A of the Natural Gas Act that existed prior to the date of enactment of the Wall Street Transparency and Accountability Act of 2010.

(h) DETERMINATION.—The Commodity Exchange Act is amended by inserting after section 1a (7 U.S.C. 1a) the following:

"SEC. 1b. REQUIREMENTS OF SECRETARY OF THE TREASURY REGARDING EXEMPTION OF FOREIGN EXCHANGE SWAPS AND FOREIGN EXCHANGE FORWARDS FROM DEFINITION OF THE TERM 'SWAP'.

"(a) REQUIRED CONSIDERATIONS.—In determining whether to exempt foreign exchange swaps and foreign exchange forwards from the definition of the term 'swap', the Secretary of the Treasury (referred to in this section as the 'Secretary') shall consider—

"(1) whether the required trading and clearing of foreign exchange swaps and foreign exchange forwards would create systemic risk, lower transparency, or threaten the financial stability of the United States;

"(2) whether foreign exchange swaps and foreign exchange forwards are already subject to a regulatory scheme that is materially comparable to that established by this Act for other classes of swaps;

"(3) the extent to which bank regulators of participants in the foreign exchange market provide adequate supervision, including capital and margin requirements;

"(4) the extent of adequate payment and settlement systems; and

"(5) the use of a potential exemption of foreign exchange swaps and foreign exchange forwards to evade otherwise applicable regulatory requirements.

"(b) DETERMINATION.—If the Secretary makes a determination to exempt foreign exchange swaps and foreign exchange forwards from the definition of the term 'swap', the Secretary shall submit to the appropriate committees of Congress a determination that contains—

"(1) an explanation regarding why foreign exchange swaps and foreign exchange forwards are qualitatively different from other classes of swaps in a way that would make the foreign exchange swaps and foreign exchange forwards ill-suited for regulation as swaps; and

"(2) an identification of the objective differences of foreign exchange swaps and foreign exchange forwards with respect to standard swaps that warrant an exempted status.

"(c) EFFECT OF DETERMINATION.—A determination by the Secretary under subsection (b) shall not exempt any foreign exchange swaps and foreign exchange forwards traded on a designated contract market or swap execution facility from any applicable antifraud and antimanipulation provision under this title.".

SEC. 723. CLEARING.

(a) CLEARING REQUIREMENT.—

(1) IN GENERAL.—Section 2 of the Commodity Exchange Act (7 U.S.C. 2) is amended—

(A) by striking subsections (d), (e), (g), and (h); and

(B) by redesignating subsection (i) as subsection (g).

(2) SWAPS; LIMITATION ON PARTICIPATION.—Section 2 of the Commodity Exchange Act (7 U.S.C. 2) (as amended by paragraph (1)) is amended by inserting after subsection (c) the following:

"(d) SWAPS.—Nothing in this Act (other than subparagraphs (A), (B), (C), (D), (G), and (H) of subsection (a)(1), subsections (f) and (g), sections 1a, 2(a)(13), 2(c)(2)(A)(ii), 2(e), 2(h), 4(c), 4a, 4b, and 4b–1, subsections (a), (b), and (g) of section 4c, sections 4d, 4e, 4f, 4g, 4h, 4i, 4j, 4k, 4l, 4m, 4n, 4o, 4p, 4r, 4s, 4t, 5, 5b, 5c, 5e, and 5h, subsections (c) and (d) of section 6, sections 6c, 6d, 8, 8a, and 9, subsections (e)(2), (f), and (h) of section 12, subsections (a) and (b) of section 13, sections 17, 20, 21, and 22(a)(4), and any other provision of this Act that is applicable to registered entities or Commission registrants) governs or applies to a swap.

"(e) LIMITATION ON PARTICIPATION.—It shall be unlawful for any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a board of trade designated as a contract market under section 5.".

(3) MANDATORY CLEARING OF SWAPS.—Section 2 of the Commodity Exchange Act (7 U.S.C. 2) is amended by inserting after subsection (g) (as redesignated by paragraph (1)(B)) the following:

"(h) CLEARING REQUIREMENT.—

"(1) IN GENERAL.—

"(A) STANDARD FOR CLEARING.—It shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization that is registered under this Act or a derivatives clearing organization that is exempt from registration under this Act if the swap is required to be cleared.

"(B) OPEN ACCESS.—The rules of a derivatives clearing organization described in subparagraph (A) shall—

"(i) prescribe that all swaps (but not contracts of sale of a commodity for future delivery or options on such contracts) submitted to the derivatives clearing organization with the same terms and conditions are economically equivalent within the derivatives clearing organization and may be offset with each other within the derivatives clearing organization; and

"(ii) provide for non-discriminatory clearing of a swap (but not a contract of sale of a commodity for future delivery or option on such contract) executed bilaterally or on or through the rules of an unaffiliated designated contract market or swap execution facility.

"(2) COMMISSION REVIEW.—

"(A) COMMISSION-INITIATED REVIEW.—

"(i) The Commission on an ongoing basis shall review each swap, or any group, category, type, or class of swaps to make a determination as to whether the swap or group, category, type, or class of swaps should be required to be cleared.

"(ii) The Commission shall provide at least a 30-day public comment period regarding any determination made under clause (i).

"(B) SWAP SUBMISSIONS.—

"(i) A derivatives clearing organization shall submit to the Commission each swap, or any group, category, type, or class of swaps that it plans to accept for clearing, and provide notice to its members (in a manner to be determined by the Commission) of the submission.

"(ii) Any swap or group, category, type, or class of swaps listed for clearing by a derivative clearing organization as of the date of enactment of this subsection shall be considered submitted to the Commission.

"(iii) The Commission shall—

"(I) make available to the public submissions received under clauses (i) and (ii);

"(II) review each submission made under clauses (i) and (ii), and determine whether the swap, or group, category, type, or class of swaps described in the submission is required to be cleared; and

"(III) provide at least a 30-day public comment period regarding its determination as to whether the clearing requirement under paragraph (1)(A) shall apply to the submission.

"(C) DEADLINE.—The Commission shall make its determination under subparagraph (B)(iii) not later than 90 days after receiving a submission made under subparagraphs (B)(i) and (B)(ii), unless the submitting derivatives clearing organization agrees to an extension for the time limitation established under this subparagraph.

"(D) DETERMINATION.—

"(i) In reviewing a submission made under subparagraph (B), the Commission shall review whether the submission is consistent with section 5b(c)(2).

"(ii) In reviewing a swap, group of swaps, or class of swaps pursuant to subparagraph (A) or a submission made under subparagraph (B), the Commission shall take into account the following factors:

"(I) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data.

"(II) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

"(III) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract.

"(IV) The effect on competition, including appropriate fees and charges applied to clearing.

"(V) The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or 1 or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

"(iii) In making a determination under subparagraph (A) or (B)(iii) that the clearing requirement shall apply, the Commission may require such terms and conditions to the requirement as the Commission determines to be appropriate.

"(E) RULES.—Not later than 1 year after the date of the enactment of this subsection, the Commission shall adopt rules for a derivatives clearing organization's submission for review, pursuant to this paragraph, of a swap, or a group, category, type, or class of swaps, that it seeks to accept for clearing. Nothing in this subparagraph limits the Commission from making a determination under subparagraph (B)(iii) for swaps described in subparagraph (B)(ii).

"(3) STAY OF CLEARING REQUIREMENT.—

"(A) IN GENERAL.—After making a determination pursuant to paragraph (2)(B), the Commission, on application of a counterparty to a swap or on its own initiative, may stay the clearing requirement of paragraph (1) until the Commission completes a review of the terms of the swap (or the group, category, type, or class of swaps) and the clearing arrangement.

"(B) DEADLINE.—The Commission shall complete a review undertaken pursuant to subparagraph (A) not later than 90 days after issuance of the stay, unless the derivatives clearing organization that clears the swap, or group, category, type, or class of swaps agrees to an extension of the time limitation established under this subparagraph.

"(C) DETERMINATION.—Upon completion of the review undertaken pursuant to subparagraph (A), the Commission may—

"(i) determine, unconditionally or subject to such terms and conditions as the Commission determines to be appropriate, that the swap, or group, category, type, or class of swaps must be cleared pursuant to this subsection if it finds that such clearing is consistent with paragraph (2)(D); or

"(ii) determine that the clearing requirement of paragraph (1) shall not apply to the swap, or group, category, type, or class of swaps.

"(D) RULES.—Not later than 1 year after the date of the enactment of the Wall Street Transparency and Accountability Act of 2010, the Commission shall adopt rules for reviewing, pursuant to this paragraph, a derivatives clearing organization's clearing of a swap, or a group, category, type, or class of swaps, that it has accepted for clearing.

"(4) PREVENTION OF EVASION.—

"(A) IN GENERAL.—The Commission shall prescribe rules under this subsection (and issue interpretations of rules prescribed under this subsection) as determined by the Commission to be necessary to prevent evasions of the mandatory clearing requirements under this Act.

"(B) DUTY OF COMMISSION TO INVESTIGATE AND TAKE CERTAIN ACTIONS.—To the extent the Commission finds that a particular swap, group, category, type, or class of swaps would otherwise be subject to mandatory clearing but no derivatives clearing organization has listed the swap, group, category, type, or class of swaps for clearing, the Commission shall—

"(i) investigate the relevant facts and circumstances;

"(ii) within 30 days issue a public report containing the results of the investigation; and

"(iii) take such actions as the Commission determines to be necessary and in the public interest, which may include requiring the retaining of adequate margin or capital by parties to the swap, group, category, type, or class of swaps.

"(C) EFFECT ON AUTHORITY.—Nothing in this paragraph—

"(i) authorizes the Commission to adopt rules requiring a derivatives clearing organization to list for clearing a swap, group, category, type, or class of swaps if the clearing of the swap, group, category, type, or class of swaps would threaten the financial integrity of the derivatives clearing organization; and

"(ii) affects the authority of the Commission to enforce the open access provisions of paragraph (1)(B) with respect to a swap, group, category, type, or class of swaps that is listed for clearing by a derivatives clearing organization.

"(5) REPORTING TRANSITION RULES.—Rules adopted by the Commission under this section shall provide for the reporting of data, as follows:

"(A) Swaps entered into before the date of the enactment of this subsection shall be reported to a registered swap data repository or the Commission no later than 180 days after the effective date of this subsection.

"(B) Swaps entered into on or after such date of enactment shall be reported to a registered swap data repository or the Commission no later than the later of—

"(i) 90 days after such effective date; or

"(ii) such other time after entering into the swap as the Commission may prescribe by rule or regulation.

"(6) CLEARING TRANSITION RULES.—

"(A) Swaps entered into before the date of the enactment of this subsection are exempt from the clearing requirements of this subsection if reported pursuant to paragraph (5)(A).

"(B) Swaps entered into before application of the clearing requirement pursuant to this subsection are exempt from the clearing requirements of this subsection if reported pursuant to paragraph (5)(B).

"(7) EXCEPTIONS.—

"(A) IN GENERAL.—The requirements of paragraph (1)(A) shall not apply to a swap if 1 of the counterparties to the swap—

"(i) is not a financial entity;

"(ii) is using swaps to hedge or mitigate commercial risk; and

"(iii) notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared swaps.

"(B) OPTION TO CLEAR.—The application of the clearing exception in subparagraph (A) is solely at the discretion of the counterparty to the swap that meets the conditions of clauses (i) through (iii) of subparagraph (A).

"(C) FINANCIAL ENTITY DEFINITION.—

"(i) IN GENERAL.—For the purposes of this paragraph, the term 'financial entity' means—

"(I) a swap dealer;

"(II) a security-based swap dealer;

"(III) a major swap participant;

"(IV) a major security-based swap participant;

"(V) a commodity pool;

"(VI) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80-b-2(a));

"(VII) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002);

"(VIII) a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956.

"(ii) EXCLUSION.—The Commission shall consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions, including—

"(I) depository institutions with total assets of $10,000,000,000 or less;

"(II) farm credit system institutions with total assets of $10,000,000,000 or less; or

"(III) credit unions with total assets of $10,000,000,000 or less.

"(iii) LIMITATION.—Such definition shall not include an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company.

"(D) TREATMENT OF AFFILIATES.—

"(i) IN GENERAL.—An affiliate of a person that qualifies for an exception under subparagraph (A) (including affiliate entities predominantly engaged in providing financing for the purchase of the merchandise or manufactured goods of the person) may qualify for the exception only if the affiliate, acting on behalf of the person and as an agent, uses the swap to hedge or mitigate the commercial risk of the person or other affiliate of the person that is not a financial entity.

"(ii) PROHIBITION RELATING TO CERTAIN AFFILIATES.—The exception in clause (i) shall not apply if the affiliate is—

"(I) a swap dealer;

"(II) a security-based swap dealer;

"(III) a major swap participant;

"(IV) a major security-based swap participant;

"(V) an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3), but for paragraph (1) or (7) of subsection (c) of that Act (15 U.S.C. 80a–3(c));

"(VI) a commodity pool; or

"(VII) a bank holding company with over $50,000,000,000 in consolidated assets.

"(iii) TRANSITION RULE FOR AFFILIATES.—An affiliate, subsidiary, or a wholly owned entity of a person that qualifies for an exception under subparagraph (A) and is predominantly engaged in providing financing for the purchase or lease of merchandise or manufactured goods of the person shall be exempt from the margin requirement described in section 4s(e) and the clearing requirement described in paragraph (1) with regard to swaps entered into to mitigate the risk of the financing activities for not less than a 2-year period beginning on the date of enactment of this clause.

"(E) ELECTION OF COUNTERPARTY.—

"(i) SWAPS REQUIRED TO BE CLEARED.—With respect to any swap that is subject to the mandatory clearing requirement under this subsection and entered into by a swap dealer or a major swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant, the counterparty shall have the sole right to select the derivatives clearing organization at which the swap will be cleared.

"(ii) SWAPS NOT REQUIRED TO BE CLEARED.—With respect to any swap that is not subject to the mandatory clearing requirement under this subsection and entered into by a swap dealer or a major swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant, the counterparty—

"(I) may elect to require clearing of the swap; and

"(II) shall have the sole right to select the derivatives clearing organization at which the swap will be cleared.

"(F) ABUSE OF EXCEPTION.—The Commission may prescribe such rules or issue interpretations of the rules as the Commission determines to be necessary to prevent abuse of the exceptions described in this paragraph. The Commission may also request information from those persons claiming the clearing exception as necessary to prevent abuse of the exceptions described in this paragraph.

"(8) TRADE EXECUTION.—

"(A) IN GENERAL.—With respect to transactions involving swaps subject to the clearing requirement of paragraph (1), counterparties shall—

"(i) execute the transaction on a board of trade designated as a contract market under section 5; or

"(ii) execute the transaction on a swap execution facility registered under 5h or a swap execution facility that is exempt from registration under section 5h(f) of this Act.

"(B) EXCEPTION.—The requirements of clauses (i) and (ii) of subparagraph (A) shall not apply if no board of trade or swap execution facility makes the swap available to trade or for swap transactions subject to the clearing exception under paragraph (7).".

(b) COMMODITY EXCHANGE ACT.—Section 2 of the Commodity Exchange Act (7 U.S.C. 2) is amended by adding at the end the following:

"(j) COMMITTEE APPROVAL BY BOARD.—Exemptions from the requirements of subsection (h)(1) to clear a swap and subsection (h)(8) to execute a swap through a board of trade or swap execution facility shall be available to a counterparty that is an issuer of securities that are registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports pursuant to section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o) only if an appropriate committee of the issuer's board or governing body has reviewed and approved its decision to enter into swaps that are subject to such exemptions.".

(c) GRANDFATHER PROVISIONS.—

(1) LEGAL CERTAINTY FOR CERTAIN TRANSACTIONS IN EXEMPT COMMODITIES.—Not later than 60 days after the date of enactment of this Act, a person may submit to the Commodity Futures Trading Commission a petition to remain subject to section 2(h) of the Commodity Exchange Act (7 U.S.C. 2(h)) (as in effect on the day before the date of enactment of this Act).

(2) CONSIDERATION; AUTHORITY OF COMMODITY FUTURES TRADING COMMISSION.—The Commodity Futures Trading Commission—

(A) shall consider any petition submitted under subparagraph (A) in a prompt manner; and

(B) may allow a person to continue operating subject to section 2(h) of the Commodity Exchange Act (7 U.S.C. 2(h)) (as in effect on the day before the date of enactment of this Act) for not longer than a 1-year period.

(3) AGRICULTURAL SWAPS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), no person shall offer to enter into, enter into, or confirm the execution of, any swap in an agricultural commodity (as defined by the Commodity Futures Trading Commission).

(B) EXCEPTION.—Notwithstanding subparagraph (A), a person may offer to enter into, enter into, or confirm the execution of, any swap in an agricultural commodity pursuant to section 4(c) of the Commodity Exchange Act (7 U.S.C. 6(c)) or any rule, regulation, or order issued thereunder (including any rule, regulation, or order in effect as of the date of enactment of this Act) by the Commodity Futures Trading Commission to allow swaps under such terms and conditions as the Commission shall prescribe.

(4) REQUIRED REPORTING.—If the exception described in section 2(h)(8)(B) of the Commodity Exchange Act applies, the counterparties shall comply with any recordkeeping and transaction reporting requirements that may be prescribed by the Commission with respect to swaps subject to section 2(h)(8)(B) of the Commodity Exchange Act.

SEC. 724. SWAPS; SEGREGATION AND BANKRUPTCY TREATMENT.

(a) SEGREGATION REQUIREMENTS FOR CLEARED SWAPS.—Section 4d of the Commodity Exchange Act (7 U.S.C. 6d) (as amended by section 732) is amended by adding at the end the following:

"(f) SWAPS.—

"(1) REGISTRATION REQUIREMENT.—It shall be unlawful for any person to accept any money, securities, or property (or to extend any credit in lieu of money, securities, or property) from, for, or on behalf of a swaps customer to margin, guarantee, or secure a swap cleared by or through a derivatives clearing organization (including money, securities, or property accruing to the customer as the result of such a swap), unless the person shall have registered under this Act with the Commission as a futures commission merchant, and the registration shall not have expired nor been suspended nor revoked.

"(2) CLEARED SWAPS.—

"(A) SEGREGATION REQUIRED.—A futures commission merchant shall treat and deal with all money, securities, and property of any swaps customer received to margin, guarantee, or secure a swap cleared by or though a derivatives clearing organization (including money, securities, or property accruing to the swaps customer as the result of such a swap) as belonging to the swaps customer.

"(B) COMMINGLING PROHIBITED.—Money, securities, and property of a swaps customer described in subparagraph (A) shall be separately accounted for and shall not be commingled with the funds of the futures commission merchant or be used to margin, secure, or guarantee any trades or contracts of any swaps customer or person other than the person for whom the same are held.

"(3) EXCEPTIONS.—

"(A) USE OF FUNDS.—

"(i) IN GENERAL.—Notwithstanding paragraph (2), money, securities, and property of swap customers of a futures commission merchant described in paragraph (2) may, for convenience, be commingled and deposited in the same account or accounts with any bank or trust company or with a derivatives clearing organization.

"(ii) WITHDRAWAL.—Notwithstanding paragraph (2), such share of the money, securities, and property described in clause (i) as in the normal course of business shall be necessary to margin, guarantee, secure, transfer, adjust, or settle a cleared swap with a derivatives clearing organization, or with any member of the derivatives clearing organization, may be withdrawn and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage, and other charges, lawfully accruing in connection with the cleared swap.

"(B) COMMISSION ACTION.—Notwithstanding paragraph (2), in accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the swaps customers of a futures commission merchant described in paragraph (2) may be commingled and deposited in customer accounts with any other money, securities, or property received by the futures commission merchant and required by the Commission to be separately accounted for and treated and dealt with as belonging to the swaps customer of the futures commission merchant.

"(4) PERMITTED INVESTMENTS.—Money described in paragraph (2) may be invested in obligations of the United States, in general obligations of any State or of any political subdivision of a State, and in obligations fully guaranteed as to principal and interest by the United States, or in any other investment that the Commission may by rule or regulation prescribe, and such investments shall be made in accordance with such rules and regulations and subject to such conditions as the Commission may prescribe.

"(5) COMMODITY CONTRACT.—A swap cleared by or through a derivatives clearing organization shall be considered to be a commodity contract as such term is defined in section 761 of title 11, United States Code, with regard to all money, securities, and property of any swaps customer received by a futures commission merchant or a derivatives clearing organization to margin, guarantee, or secure the swap (including money, securities, or property accruing to the customer as the result of the swap).

"(6) PROHIBITION.—It shall be unlawful for any person, including any derivatives clearing organization and any depository institution, that has received any money, securities, or property for deposit in a separate account or accounts as provided in paragraph (2) to hold, dispose of, or use any such money, securities, or property as belonging to the depositing futures commission merchant or any person other than the swaps customer of the futures commission merchant.".

(b) BANKRUPTCY TREATMENT OF CLEARED SWAPS.—Section 761 of title 11, United States Code, is amended—

(1) in paragraph (4), by striking subparagraph (F) and inserting the following:

"(F)(i) any other contract, option, agreement, or transaction that is similar to a contract, option, agreement, or transaction referred to in this paragraph; and

"(ii) with respect to a futures commission merchant or a clearing organization, any other contract, option, agreement, or transaction, in each case, that is cleared by a clearing organization;"; and

(2) in paragraph (9)(A)(i), by striking "the commodity futures account" and inserting "a commodity contract account".

(c) SEGREGATION REQUIREMENTS FOR UNCLEARED SWAPS.—Section 4s of the Commodity Exchange Act (as added by section 731) is amended by adding at the end the following:

"(l) SEGREGATION REQUIREMENTS.—

"(1) SEGREGATION OF ASSETS HELD AS COLLATERAL IN UNCLEARED SWAP TRANSACTIONS.—

"(A) NOTIFICATION.—A swap dealer or major swap participant shall be required to notify the counterparty of the swap dealer or major swap participant at the beginning of a swap transaction that the counterparty has the right to require segregation of the funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty.

"(B) SEGREGATION AND MAINTENANCE OF FUNDS.—At the request of a counterparty to a swap that provides funds or other property to a swap dealer or major swap participant to margin, guarantee, or secure the obligations of the counterparty, the swap dealer or major swap participant shall—

"(i) segregate the funds or other property for the benefit of the counterparty; and

"(ii) in accordance with such rules and regulations as the Commission may promulgate, maintain the funds or other property in a segregated account separate from the assets and other interests of the swap dealer or major swap participant.

"(2) APPLICABILITY.—The requirements described in paragraph (1) shall—

"(A) apply only to a swap between a counterparty and a swap dealer or major swap participant that is not submitted for clearing to a derivatives clearing organization; and

"(B)(i) not apply to variation margin payments; or

"(ii) not preclude any commercial arrangement regarding—

"(I) the investment of segregated funds or other property that may only be invested in such investments as the Commission may permit by rule or regulation; and

"(II) the related allocation of gains and losses resulting from any investment of the segregated funds or other property.

"(3) USE OF INDEPENDENT THIRD-PARTY CUSTODIANS.—The segregated account described in paragraph (1) shall be—

"(A) carried by an independent third-party custodian; and

"(B) designated as a segregated account for and on behalf of the counterparty.

"(4) REPORTING REQUIREMENT.—If the counterparty does not choose to require segregation of the funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty, the swap dealer or major swap participant shall report to the counterparty of the swap dealer or major swap participant on a quarterly basis that the back office procedures of the swap dealer or major swap participant relating to margin and collateral requirements are in compliance with the agreement of the counterparties.".

SEC. 725. DERIVATIVES CLEARING ORGANIZATIONS.

(a) REGISTRATION REQUIREMENT.—Section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1) is amended by striking subsections (a) and (b) and inserting the following:

"(a) REGISTRATION REQUIREMENT.—

"(1) IN GENERAL.—Except as provided in paragraph (2), it shall be unlawful for a derivatives clearing organization, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a derivatives clearing organization with respect to—

"(A) a contract of sale of a commodity for future delivery (or an option on the contract of sale) or option on a commodity, in each case, unless the contract or option is—

"(i) excluded from this Act by subsection (a)(1)(C)(i), (c), or (f) of section 2; or

"(ii) a security futures product cleared by a clearing agency registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.); or

"(B) a swap.

"(2) EXCEPTION.—Paragraph (1) shall not apply to a derivatives clearing organization that is registered with the Commission.

"(b) VOLUNTARY REGISTRATION.—A person that clears 1 or more agreements, contracts, or transactions that are not required to be cleared under this Act may register with the Commission as a derivatives clearing organization.''.

(b) REGISTRATION FOR DEPOSITORY INSTITUTIONS AND CLEARING AGENCIES; EXEMPTIONS; COMPLIANCE OFFICER; ANNUAL REPORTS.—Section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1) is amended by adding at the end the following:

''(g) EXISTING DEPOSITORY INSTITUTIONS AND CLEARING AGENCIES.—

''(1) IN GENERAL.—A depository institution or clearing agency registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) that is required to be registered as a derivatives clearing organization under this section is deemed to be registered under this section to the extent that, before the date of enactment of this subsection—

''(A) the depository institution cleared swaps as a multilateral clearing organization; or

''(B) the clearing agency cleared swaps.

''(2) CONVERSION OF DEPOSITORY INSTITUTIONS.—A depository institution to which this subsection applies may, by the vote of the shareholders owning not less than 51 percent of the voting interests of the depository institution, be converted into a State corporation, partnership, limited liability company, or similar legal form pursuant to a plan of conversion, if the conversion is not in contravention of applicable State law.

''(3) SHARING OF INFORMATION.—The Securities and Exchange Commission shall make available to the Commission, upon request, all information determined to be relevant by the Securities and Exchange Commission regarding a clearing agency deemed to be registered with the Commission under paragraph (1).

''(h) EXEMPTIONS.—The Commission may exempt, conditionally or unconditionally, a derivatives clearing organization from registration under this section for the clearing of swaps if the Commission determines that the derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by the Securities and Exchange Commission or the appropriate government authorities in the home country of the organization. Such conditions may include, but are not limited to, requiring that the derivatives clearing organization be available for inspection by the Commission and make available all information requested by the Commission.

''(i) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

''(1) IN GENERAL.—Each derivatives clearing organization shall designate an individual to serve as a chief compliance officer.

''(2) DUTIES.—The chief compliance officer shall—

''(A) report directly to the board or to the senior officer of the derivatives clearing organization;

''(B) review the compliance of the derivatives clearing organization with respect to the core principles described in subsection (c)(2);

''(C) in consultation with the board of the derivatives clearing organization, a body performing a function similar to the board of the derivatives clearing organization, or the senior officer of the derivatives clearing organization, resolve any conflicts of interest that may arise;

“(D) be responsible for administering each policy and procedure that is required to be established pursuant to this section;

“(E) ensure compliance with this Act (including regulations) relating to agreements, contracts, or transactions, including each rule prescribed by the Commission under this section;

“(F) establish procedures for the remediation of noncompliance issues identified by the compliance officer through any—

“(i) compliance office review;

“(ii) look-back;

“(iii) internal or external audit finding;

“(iv) self-reported error; or

“(v) validated complaint; and

“(G) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

“(3) ANNUAL REPORTS.—

“(A) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

“(i) the compliance of the derivatives clearing organization of the compliance officer with respect to this Act (including regulations); and

“(ii) each policy and procedure of the derivatives clearing organization of the compliance officer (including the code of ethics and conflict of interest policies of the derivatives clearing organization).

“(B) REQUIREMENTS.—A compliance report under subparagraph (A) shall—

“(i) accompany each appropriate financial report of the derivatives clearing organization that is required to be furnished to the Commission pursuant to this section; and

“(ii) include a certification that, under penalty of law, the compliance report is accurate and complete.”.

(c) CORE PRINCIPLES FOR DERIVATIVES CLEARING ORGANIZATIONS.—Section 5b(c) of the Commodity Exchange Act (7 U.S.C. 7a–1(c)) is amended by striking paragraph (2) and inserting the following:

“(2) CORE PRINCIPLES FOR DERIVATIVES CLEARING ORGANIZATIONS.—

“(A) COMPLIANCE.—

“(i) IN GENERAL.—To be registered and to maintain registration as a derivatives clearing organization, a derivatives clearing organization shall comply with each core principle described in this paragraph and any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5).

“(ii) DISCRETION OF DERIVATIVES CLEARING ORGANIZATION.—Subject to any rule or regulation prescribed by the Commission, a derivatives clearing organization shall have reasonable discretion in establishing the manner by which the derivatives clearing organization complies with each core principle described in this paragraph.

"(B) FINANCIAL RESOURCES.—

"(i) IN GENERAL.—Each derivatives clearing organization shall have adequate financial, operational, and managerial resources, as determined by the Commission, to discharge each responsibility of the derivatives clearing organization.

"(ii) MINIMUM AMOUNT OF FINANCIAL RESOURCES.—Each derivatives clearing organization shall possess financial resources that, at a minimum, exceed the total amount that would—

"(I) enable the organization to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure for that organization in extreme but plausible market conditions; and

"(II) enable the derivatives clearing organization to cover the operating costs of the derivatives clearing organization for a period of 1 year (as calculated on a rolling basis).

"(C) PARTICIPANT AND PRODUCT ELIGIBILITY.—

"(i) IN GENERAL.—Each derivatives clearing organization shall establish—

"(I) appropriate admission and continuing eligibility standards (including sufficient financial resources and operational capacity to meet obligations arising from participation in the derivatives clearing organization) for members of, and participants in, the derivatives clearing organization; and

"(II) appropriate standards for determining the eligibility of agreements, contracts, or transactions submitted to the derivatives clearing organization for clearing.

"(ii) REQUIRED PROCEDURES.—Each derivatives clearing organization shall establish and implement procedures to verify, on an ongoing basis, the compliance of each participation and membership requirement of the derivatives clearing organization.

"(iii) REQUIREMENTS.—The participation and membership requirements of each derivatives clearing organization shall—

"(I) be objective;

"(II) be publicly disclosed; and

"(III) permit fair and open access.

"(D) RISK MANAGEMENT.—

"(i) IN GENERAL.—Each derivatives clearing organization shall ensure that the derivatives clearing organization possesses the ability to manage the risks associated with discharging the responsibilities of the derivatives clearing organization through the use of appropriate tools and procedures.

"(ii) MEASUREMENT OF CREDIT EXPOSURE.—Each derivatives clearing organization shall—

"(I) not less than once during each business day of the derivatives clearing organization, measure the credit exposures of the derivatives clearing organization to each member and participant of the derivatives clearing organization; and

"(II) monitor each exposure described in subclause (I) periodically during the business day of the derivatives clearing organization.

"(iii) LIMITATION OF EXPOSURE TO POTENTIAL LOSSES FROM DEFAULTS.—Each derivatives clearing organization, through margin requirements and other risk control mechanisms, shall limit the exposure of the derivatives clearing organization to potential losses from defaults by members and participants of the derivatives clearing organization to ensure that—

"(I) the operations of the derivatives clearing organization would not be disrupted; and

"(II) nondefaulting members or participants would not be exposed to losses that nondefaulting members or participants cannot anticipate or control.

"(iv) MARGIN REQUIREMENTS.—The margin required from each member and participant of a derivatives clearing organization shall be sufficient to cover potential exposures in normal market conditions.

"(v) REQUIREMENTS REGARDING MODELS AND PARAMETERS.—Each model and parameter used in setting margin requirements under clause (iv) shall be—

"(I) risk-based; and

"(II) reviewed on a regular basis.

"(E) SETTLEMENT PROCEDURES.—Each derivatives clearing organization shall—

"(i) complete money settlements on a timely basis (but not less frequently than once each business day);

"(ii) employ money settlement arrangements to eliminate or strictly limit the exposure of the derivatives clearing organization to settlement bank risks (including credit and liquidity risks from the use of banks to effect money settlements);

"(iii) ensure that money settlements are final when effected;

"(iv) maintain an accurate record of the flow of funds associated with each money settlement;

"(v) possess the ability to comply with each term and condition of any permitted netting or offset arrangement with any other clearing organization;

"(vi) regarding physical settlements, establish rules that clearly state each obligation of the derivatives clearing organization with respect to physical deliveries; and

"(vii) ensure that each risk arising from an obligation described in clause (vi) is identified and managed.

"(F) TREATMENT OF FUNDS.—

"(i) REQUIRED STANDARDS AND PROCEDURES.—Each derivatives clearing organization shall establish standards and procedures that are designed to protect and ensure the safety of member and participant funds and assets.

"(ii) HOLDING OF FUNDS AND ASSETS.—Each derivatives clearing organization shall hold member and participant funds and assets in a manner by which to minimize the risk of loss or of delay in the access by the derivatives clearing organization to the assets and funds.

"(iii) PERMISSIBLE INVESTMENTS.—Funds and assets invested by a derivatives clearing organization shall be held in instruments with minimal credit, market, and liquidity risks.

"(G) DEFAULT RULES AND PROCEDURES.—

"(i) IN GENERAL.—Each derivatives clearing organization shall have rules and procedures designed to allow for the efficient, fair, and safe management of events during which members or participants—

"(I) become insolvent; or

"(II) otherwise default on the obligations of the members or participants to the derivatives clearing organization.

"(ii) DEFAULT PROCEDURES.—Each derivatives clearing organization shall—

"(I) clearly state the default procedures of the derivatives clearing organization;

"(II) make publicly available the default rules of the derivatives clearing organization; and

"(III) ensure that the derivatives clearing organization may take timely action—

"(aa) to contain losses and liquidity pressures; and

"(bb) to continue meeting each obligation of the derivatives clearing organization.

"(H) RULE ENFORCEMENT.—Each derivatives clearing organization shall—

"(i) maintain adequate arrangements and resources for—

"(I) the effective monitoring and enforcement of compliance with the rules of the derivatives clearing organization; and

"(II) the resolution of disputes;

"(ii) have the authority and ability to discipline, limit, suspend, or terminate the activities of a member or participant due to a violation by the member or participant of any rule of the derivatives clearing organization; and

"(iii) report to the Commission regarding rule enforcement activities and sanctions imposed against members and participants as provided in clause (ii).

"(I) SYSTEM SAFEGUARDS.—Each derivatives clearing organization shall—

"(i) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk through the development of appropriate controls and procedures, and automated systems, that are reliable, secure, and have adequate scalable capacity;

"(ii) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allows for—

"(I) the timely recovery and resumption of operations of the derivatives clearing organization; and

"(II) the fulfillment of each obligation and responsibility of the derivatives clearing organization; and

"(iii) periodically conduct tests to verify that the backup resources of the derivatives clearing organization are sufficient to ensure daily processing, clearing, and settlement.

"(J) REPORTING.—Each derivatives clearing organization shall provide to the Commission all information that the Commission determines to be necessary to conduct oversight of the derivatives clearing organization.

"(K) RECORDKEEPING.—Each derivatives clearing organization shall maintain records of all activities related to the business of the derivatives clearing organization as a derivatives clearing organization—

"(i) in a form and manner that is acceptable to the Commission; and

"(ii) for a period of not less than 5 years.

"(L) PUBLIC INFORMATION.—

"(i) IN GENERAL.—Each derivatives clearing organization shall provide to market participants sufficient information to enable the market participants to identify and evaluate accurately the risks and costs associated with using the services of the derivatives clearing organization.

"(ii) AVAILABILITY OF INFORMATION.—Each derivatives clearing organization shall make information concerning the rules and operating and default procedures governing the clearing and settlement systems of the derivatives clearing organization available to market participants.

"(iii) PUBLIC DISCLOSURE.—Each derivatives clearing organization shall disclose publicly and to the Commission information concerning—

"(I) the terms and conditions of each contract, agreement, and transaction cleared and settled by the derivatives clearing organization;

"(II) each clearing and other fee that the derivatives clearing organization charges the members and participants of the derivatives clearing organization;

"(III) the margin-setting methodology, and the size and composition, of the financial resource package of the derivatives clearing organization;

"(IV) daily settlement prices, volume, and open interest for each contract settled or cleared by the derivatives clearing organization; and

"(V) any other matter relevant to participation in the settlement and clearing activities of the derivatives clearing organization.

"(M) INFORMATION-SHARING.—Each derivatives clearing organization shall—

"(i) enter into, and abide by the terms of, each appropriate and applicable domestic and international information-sharing agreement; and

"(ii) use relevant information obtained from each agreement described in clause (i) in carrying out the risk management program of the derivatives clearing organization.

"(N) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this Act, a derivatives clearing organization shall not—

"(i) adopt any rule or take any action that results in any unreasonable restraint of trade; or

"(ii) impose any material anticompetitive burden.

"(O) GOVERNANCE FITNESS STANDARDS.—

"(i) GOVERNANCE ARRANGEMENTS.—Each derivatives clearing organization shall establish governance arrangements that are transparent—

"(I) to fulfill public interest requirements; and

"(II) to permit the consideration of the views of owners and participants.

"(ii) FITNESS STANDARDS.—Each derivatives clearing organization shall establish and enforce appropriate fitness standards for—

"(I) directors;

"(II) members of any disciplinary committee;

"(III) members of the derivatives clearing organization;

"(IV) any other individual or entity with direct access to the settlement or clearing activities of the derivatives clearing organization; and

"(V) any party affiliated with any individual or entity described in this clause.

"(P) CONFLICTS OF INTEREST.—Each derivatives clearing organization shall—

"(i) establish and enforce rules to minimize conflicts of interest in the decision-making process of the derivatives clearing organization; and

"(ii) establish a process for resolving conflicts of interest described in clause (i).

"(Q) COMPOSITION OF GOVERNING BOARDS.—Each derivatives clearing organization shall ensure that the composition of the governing board or committee of the derivatives clearing organization includes market participants.

"(R) LEGAL RISK.—Each derivatives clearing organization shall have a well-founded, transparent, and enforceable legal framework for each aspect of the activities of the derivatives clearing organization.".

(d) CONFLICTS OF INTEREST.—The Commodity Futures Trading Commission shall adopt rules mitigating conflicts of interest in connection with the conduct of business by a swap dealer or a major swap participant with a derivatives clearing organization, board of trade, or a swap execution facility that clears or trades swaps in which the swap dealer or major swap participant has a material debt or material equity investment.

(e) REPORTING REQUIREMENTS.—Section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1) (as amended by subsection (b)) is amended by adding at the end the following:

"(k) REPORTING REQUIREMENTS.—

"(1) DUTY OF DERIVATIVES CLEARING ORGANIZATIONS.—Each derivatives clearing organization that clears swaps shall provide to the Commission all information that is determined by the Commission to be necessary to perform each responsibility of the Commission under this Act.

"(2) DATA COLLECTION AND MAINTENANCE REQUIREMENTS.—The Commission shall adopt data collection and maintenance requirements for swaps cleared by derivatives clearing organizations that are comparable to the corresponding requirements for—

"(A) swaps data reported to swap data repositories; and

"(B) swaps traded on swap execution facilities.

"(3) REPORTS ON SECURITY-BASED SWAP AGREEMENTS TO BE SHARED WITH THE SECURITIES AND EXCHANGE COMMISSION.—

"(A) IN GENERAL.—A derivatives clearing organization that clears security-based swap agreements (as defined in section 1a(47)(A)(v)) shall, upon request, open to inspection and examination to the Securities and Exchange Commission all books and records relating to such security-based swap agreements, consistent with the confidentiality and disclosure requirements of section 8.

"(B) JURISDICTION.—Nothing in this paragraph shall affect the exclusive jurisdiction of the Commission to prescribe recordkeeping and reporting requirements for a derivatives clearing organization that is registered with the Commission.

"(4) INFORMATION SHARING.—Subject to section 8, and upon request, the Commission shall share information collected under paragraph (2) with—

"(A) the Board;

"(B) the Securities and Exchange Commission;

"(C) each appropriate prudential regulator;

"(D) the Financial Stability Oversight Council;

"(E) the Department of Justice; and

"(F) any other person that the Commission determines to be appropriate, including—

"(i) foreign financial supervisors (including foreign futures authorities);

"(ii) foreign central banks; and

"(iii) foreign ministries.

"(5) CONFIDENTIALITY AND INDEMNIFICATION AGREEMENT.—Before the Commission may share information with any entity described in paragraph (4)—

"(A) the Commission shall receive a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in section 8 relating to the information on swap transactions that is provided; and

"(B) each entity shall agree to indemnify the Commission for any expenses arising from litigation relating to the information provided under section 8.

"(6) PUBLIC INFORMATION.—Each derivatives clearing organization that clears swaps shall provide to the Commission (including any designee of the Commission) information under paragraph (2) in such form and at such frequency as is required by the Commission to comply with the public reporting requirements contained in section 2(a)(13).".

(f) PUBLIC DISCLOSURE.—Section 8(e) of the Commodity Exchange Act (7 U.S.C. 12(e)) is amended in the last sentence—

(1) by inserting ", central bank and ministries," after "department" each place it appears; and

(2) by striking ". is a party." and inserting ", is a party.".

(g) LEGAL CERTAINTY FOR IDENTIFIED BANKING PRODUCTS.—

(1) REPEALS.—The Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27 et seq.) is amended—

(A) by striking sections 404 and 407 (7 U.S.C. 27b, 27e);

(B) in section 402 (7 U.S.C. 27), by striking subsection (d); and

(C) in section 408 (7 U.S.C. 27f)—

(i) in subsection (c)—

(I) by striking "in the case" and all that follows through "a hybrid" and inserting "in the case of a hybrid";

(II) by striking "; or" and inserting a period; and

(III) by striking paragraph (2);

(ii) by striking subsection (b); and

(iii) by redesignating subsection (c) as subsection (b).

(2) LEGAL CERTAINTY FOR BANK PRODUCTS ACT OF 2000.—Section 403 of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27a) is amended to read as follows:

"SEC. 403. EXCLUSION OF IDENTIFIED BANKING PRODUCT.

"(a) EXCLUSION.—Except as provided in subsection (b) or (c)—

"(1) the Commodity Exchange Act (7 U.S.C. 1 et seq.) shall not apply to, and the Commodity Futures Trading Commission shall not exercise regulatory authority under the Commodity Exchange Act (7 U.S.C. 1 et seq.) with respect to, an identified banking product; and

"(2) the definitions of 'security-based swap' in section 3(a)(68) of the Securities Exchange Act of 1934 and 'security-based swap agreement' in section 1a(47)(A)(v) of the Commodity Exchange Act and section 3(a)(78) of the Securities Exchange Act of 1934 do not include any identified bank product.

"(b) EXCEPTION.—An appropriate Federal banking agency may except an identified banking product of a bank under its regulatory jurisdiction from the exclusion in subsection (a) if the agency determines, in consultation with the Commodity Futures Trading Commission and the Securities and Exchange Commission, that the product—

"(1) would meet the definition of a 'swap' under section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a) or a 'security-based swap' under that section 3(a)(68) of the Securities Exchange Act of 1934; and

"(2) has become known to the trade as a swap or security-based swap, or otherwise has been structured as an identified banking product for the purpose of evading the provisions of the Commodity Exchange Act (7 U.S.C. 1 et seq.), the Securities Act of 1933 (15 U.S.C. 77a et seq.), or the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

"(c) EXCEPTION.—The exclusions in subsection (a) shall not apply to an identified bank product that—

"(1) is a product of a bank that is not under the regulatory jurisdiction of an appropriate Federal banking agency;

"(2) meets the definition of swap in section 1a(47) of the Commodity Exchange Act or security-based swap in section 3(a)(68) of the Securities Exchange Act of 1934; and

"(3) has become known to the trade as a swap or security-based swap, or otherwise has been structured as an identified banking product for the purpose of evading the provisions of the Commodity Exchange Act (7 U.S.C. 1 et seq.), the Securities Act of 1933 (15 U.S.C. 77a et seq.), or the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).".

(h) REDUCING CLEARING SYSTEMIC RISK.—Section 5b(f)(1) of the Commodity Exchange Act (7 U.S.C. 7a-1(F)(i)) is amended by adding at the end the following: "In order to minimize systemic risk, under no circumstances shall a derivatives clearing organization be compelled to accept the counterparty credit risk of another clearing organization.".

SEC. 726. RULEMAKING ON CONFLICT OF INTEREST.

(a) IN GENERAL.—In order to mitigate conflicts of interest, not later than 180 days after the date of enactment of the Wall Street Transparency and Accountability Act of 2010, the Commodity Futures Trading Commission shall adopt rules which may include numerical limits on the control of, or the voting rights with respect to, any derivatives clearing organization that clears swaps, or swap execution facility or board of trade designated as a contract market that posts swaps or makes swaps available for trading, by a bank holding company (as defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841)) with total consolidated assets of $50,000,000,000 or more, a nonbank financial company (as defined in section 102) supervised by the Board, an affiliate of such a bank holding company or nonbank financial company, a swap dealer, major swap participant, or associated person of a swap dealer or major swap participant.

(b) PURPOSES.—The Commission shall adopt rules if it determines, after the review described in subsection (a), that such rules are necessary or appropriate to improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a swap dealer or major swap participant's conduct of business with, a derivatives clearing organization, contract market, or swap execution facility that clears or posts swaps or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity investment.

(c) CONSIDERATIONS.—In adopting rules pursuant to this section, the Commodity Futures Trading Commission shall consider any conflicts of interest arising from the amount of equity owned by a single investor, the ability to vote, cause the vote of, or withhold votes entitled to be cast on any matters by the holders of the ownership interest, and the governance arrangements of any derivatives clearing organization that clears swaps, or swap execution facility or board of trade designated as a contract market that posts swaps or makes swaps available for trading.

SEC. 727. PUBLIC REPORTING OF SWAP TRANSACTION DATA.

Section 2(a) of the Commodity Exchange Act (7 U.S.C. 2(a)) is amended by adding at the end the following:

"(13) PUBLIC AVAILABILITY OF SWAP TRANSACTION DATA.—

"(A) DEFINITION OF REAL-TIME PUBLIC REPORTING.— In this paragraph, the term 'real-time public reporting' means to report data relating to a swap transaction, including price and volume, as soon as technologically practicable after the time at which the swap transaction has been executed.

"(B) PURPOSE.—The purpose of this section is to authorize the Commission to make swap transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery.

"(C) GENERAL RULE.—The Commission is authorized and required to provide by rule for the public availability of swap transaction and pricing data as follows:

"(i) With respect to those swaps that are subject to the mandatory clearing requirement described in subsection (h)(1) (including those swaps that are excepted from the requirement pursuant to subsection (h)(7)), the Commission shall require real-time public reporting for such transactions.

"(ii) With respect to those swaps that are not subject to the mandatory clearing requirement described in subsection (h)(1), but are cleared at a registered derivatives clearing organization, the Commission shall require real-time public reporting for such transactions.

"(iii) With respect to swaps that are not cleared at a registered derivatives clearing organization and which are reported to a swap data repository or the Commission under subsection (h)(6), the Commission shall require real-time public reporting for such transactions, in a manner that does not disclose the business transactions and market positions of any person.

"(iv) With respect to swaps that are determined to be required to be cleared under subsection (h)(2) but are not cleared, the Commission shall require real-time public reporting for such transactions.

"(D) REGISTERED ENTITIES AND PUBLIC REPORTING.— The Commission may require registered entities to publicly disseminate the swap transaction and pricing data required to be reported under this paragraph.

"(E) RULEMAKING REQUIRED.—With respect to the rule providing for the public availability of transaction and pricing data for swaps described in clauses (i) and (ii) of subparagraph (C), the rule promulgated by the Commission shall contain provisions—

"(i) to ensure such information does not identify the participants;

"(ii) to specify the criteria for determining what constitutes a large notional swap transaction (block trade) for particular markets and contracts;

"(iii) to specify the appropriate time delay for reporting large notional swap transactions (block trades) to the public; and

"(iv) that take into account whether the public disclosure will materially reduce market liquidity.

"(F) TIMELINESS OF REPORTING.—Parties to a swap (including agents of the parties to a swap) shall be responsible for reporting swap transaction information to the appropriate registered entity in a timely manner as may be prescribed by the Commission.

"(G) REPORTING OF SWAPS TO REGISTERED SWAP DATA REPOSITORIES.—Each swap (whether cleared or uncleared) shall be reported to a registered swap data repository.

"(14) SEMIANNUAL AND ANNUAL PUBLIC REPORTING OF AGGREGATE SWAP DATA.—

"(A) IN GENERAL.—In accordance with subparagraph (B), the Commission shall issue a written report on a semiannual and annual basis to make available to the public information relating to—

"(i) the trading and clearing in the major swap categories; and

"(ii) the market participants and developments in new products.

"(B) USE; CONSULTATION.—In preparing a report under subparagraph (A), the Commission shall—

"(i) use information from swap data repositories and derivatives clearing organizations; and

"(ii) consult with the Office of the Comptroller of the Currency, the Bank for International Settlements, and such other regulatory bodies as may be necessary.

"(C) AUTHORITY OF THE COMMISSION.—The Commission may, by rule, regulation, or order, delegate the public reporting responsibilities of the Commission under this paragraph in accordance with such terms and conditions as the Commission determines to be appropriate and in the public interest.".

SEC. 728. SWAP DATA REPOSITORIES.

The Commodity Exchange Act is amended by inserting after section 20 (7 U.S.C. 24) the following:

"SEC. 21. SWAP DATA REPOSITORIES.

"(a) REGISTRATION REQUIREMENT.—

"(1) REQUIREMENT; AUTHORITY OF DERIVATIVES CLEARING ORGANIZATION.—

"(A) IN GENERAL.—It shall be unlawful for any person, unless registered with the Commission, directly or indirectly to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a swap data repository.

"(B) REGISTRATION OF DERIVATIVES CLEARING ORGANIZATIONS.—A derivatives clearing organization may register as a swap data repository.

"(2) INSPECTION AND EXAMINATION.—Each registered swap data repository shall be subject to inspection and examination by any representative of the Commission.

"(3) COMPLIANCE WITH CORE PRINCIPLES.—

"(A) IN GENERAL.—To be registered, and maintain registration, as a swap data repository, the swap data repository shall comply with—

"(i) the requirements and core principles described in this section; and

"(ii) any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5).

"(B) REASONABLE DISCRETION OF SWAP DATA REPOSITORY.—Unless otherwise determined by the Commission by rule or regulation, a swap data repository described in subparagraph (A) shall have reasonable discretion in establishing the manner in which the swap data repository complies with the core principles described in this section.

"(b) STANDARD SETTING.—

"(1) DATA IDENTIFICATION.—

"(A) IN GENERAL.—In accordance with subparagraph (B), the Commission shall prescribe standards that specify the data elements for each swap that shall be collected and maintained by each registered swap data repository.

"(B) REQUIREMENT.—In carrying out subparagraph (A), the Commission shall prescribe consistent data element standards applicable to registered entities and reporting counterparties.

"(2) DATA COLLECTION AND MAINTENANCE.—The Commission shall prescribe data collection and data maintenance standards for swap data repositories.

"(3) COMPARABILITY.—The standards prescribed by the Commission under this subsection shall be comparable to the data standards imposed by the Commission on derivatives clearing organizations in connection with their clearing of swaps.

"(c) DUTIES.—A swap data repository shall—

"(1) accept data prescribed by the Commission for each swap under subsection (b);

"(2) confirm with both counterparties to the swap the accuracy of the data that was submitted;

"(3) maintain the data described in paragraph (1) in such form, in such manner, and for such period as may be required by the Commission;

"(4)(A) provide direct electronic access to the Commission (or any designee of the Commission, including another registered entity); and

"(B) provide the information described in paragraph (1) in such form and at such frequency as the Commission may require to comply with the public reporting requirements contained in section 2(a)(13);

"(5) at the direction of the Commission, establish automated systems for monitoring, screening, and analyzing swap data, including compliance and frequency of end user clearing exemption claims by individual and affiliated entities;

"(6) maintain the privacy of any and all swap transaction information that the swap data repository receives from a swap dealer, counterparty, or any other registered entity; and

"(7) on a confidential basis pursuant to section 8, upon request, and after notifying the Commission of the request, make available all data obtained by the swap data repository, including individual counterparty trade and position data, to—

"(A) each appropriate prudential regulator;

"(B) the Financial Stability Oversight Council;

"(C) the Securities and Exchange Commission;

"(D) the Department of Justice; and

"(E) any other person that the Commission determines to be appropriate, including—

"(i) foreign financial supervisors (including foreign futures authorities);

"(ii) foreign central banks; and

"(iii) foreign ministries; and

"(8) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allows for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the organization.

"(d) CONFIDENTIALITY AND INDEMNIFICATION AGREEMENT.—Before the swap data repository may share information with any entity described in subsection (c)(7)—

"(1) the swap data repository shall receive a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in section 8 relating to the information on swap transactions that is provided; and

"(2) each entity shall agree to indemnify the swap data repository and the Commission for any expenses arising from litigation relating to the information provided under section 8.

"(e) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(1) IN GENERAL.—Each swap data repository shall designate an individual to serve as a chief compliance officer.

"(2) DUTIES.—The chief compliance officer shall—

"(A) report directly to the board or to the senior officer of the swap data repository;

"(B) review the compliance of the swap data repository with respect to the requirements and core principles described in this section;

"(C) in consultation with the board of the swap data repository, a body performing a function similar to the board of the swap data repository, or the senior officer of the swap data repository, resolve any conflicts of interest that may arise;

"(D) be responsible for administering each policy and procedure that is required to be established pursuant to this section;

"(E) ensure compliance with this Act (including regulations) relating to agreements, contracts, or transactions, including each rule prescribed by the Commission under this section;

"(F) establish procedures for the remediation of noncompliance issues identified by the chief compliance officer through any—

"(i) compliance office review;

"(ii) look-back;

"(iii) internal or external audit finding;

"(iv) self-reported error; or

"(v) validated complaint; and

"(G) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

"(3) ANNUAL REPORTS.—

"(A) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

"(i) the compliance of the swap data repository of the chief compliance officer with respect to this Act (including regulations); and

"(ii) each policy and procedure of the swap data repository of the chief compliance officer (including the code of ethics and conflict of interest policies of the swap data repository).

"(B) REQUIREMENTS.—A compliance report under subparagraph (A) shall—

"(i) accompany each appropriate financial report of the swap data repository that is required to be furnished to the Commission pursuant to this section; and

"(ii) include a certification that, under penalty of law, the compliance report is accurate and complete.

"(f) CORE PRINCIPLES APPLICABLE TO SWAP DATA REPOSITORIES.—

"(1) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this Act, a swap data repository shall not—

"(A) adopt any rule or take any action that results in any unreasonable restraint of trade; or

"(B) impose any material anticompetitive burden on the trading, clearing, or reporting of transactions.

"(2) GOVERNANCE ARRANGEMENTS.—Each swap data repository shall establish governance arrangements that are transparent—

"(A) to fulfill public interest requirements; and

"(B) to support the objectives of the Federal Government, owners, and participants.

"(3) CONFLICTS OF INTEREST.—Each swap data repository shall—

"(A) establish and enforce rules to minimize conflicts of interest in the decision-making process of the swap data repository; and

"(B) establish a process for resolving conflicts of interest described in subparagraph (A).

"(4) ADDITIONAL DUTIES DEVELOPED BY COMMISSION.—

"(A) IN GENERAL.—The Commission may develop 1 or more additional duties applicable to swap data repositories.

"(B) CONSIDERATION OF EVOLVING STANDARDS.—In developing additional duties under subparagraph (A), the Commission may take into consideration any evolving standard of the United States or the international community.

"(C) ADDITIONAL DUTIES FOR COMMISSION DESIGNEES.—The Commission shall establish additional duties for any registrant described in section 1a(48) in order to minimize conflicts of interest, protect data, ensure compliance, and guarantee the safety and security of the swap data repository.

"(g) REQUIRED REGISTRATION FOR SWAP DATA REPOSITORIES.—Any person that is required to be registered as a swap data repository under this section shall register with the Commission regardless of whether that person is also licensed as a bank or registered with the Securities and Exchange Commission as a swap data repository.

"(h) RULES.—The Commission shall adopt rules governing persons that are registered under this section.".

SEC. 729. REPORTING AND RECORDKEEPING.

The Commodity Exchange Act is amended by inserting after section 4q (7 U.S.C. 6o–1) the following:

"SEC. 4r. REPORTING AND RECORDKEEPING FOR UNCLEARED SWAPS.

"(a) REQUIRED REPORTING OF SWAPS NOT ACCEPTED BY ANY DERIVATIVES CLEARING ORGANIZATION.—

"(1) IN GENERAL.—Each swap that is not accepted for clearing by any derivatives clearing organization shall be reported to—

"(A) a swap data repository described in section 21; or

"(B) in the case in which there is no swap data repository that would accept the swap, to the Commission pursuant to this section within such time period as the Commission may by rule or regulation prescribe.

"(2) TRANSITION RULE FOR PREENACTMENT SWAPS.—

"(A) SWAPS ENTERED INTO BEFORE THE DATE OF ENACTMENT OF THE WALL STREET TRANSPARENCY AND ACCOUNTABILITY ACT OF 2010.—Each swap entered into before the date of enactment of the Wall Street Transparency and Accountability Act of 2010, the terms of which have not expired as of the date of enactment of that Act, shall be reported to a registered swap data repository or the Commission by a date that is not later than—

"(i) 30 days after issuance of the interim final rule; or

"(ii) such other period as the Commission determines to be appropriate.

"(B) COMMISSION RULEMAKING.—The Commission shall promulgate an interim final rule within 90 days of the date of enactment of this section providing for the reporting of each swap entered into before the date of enactment as referenced in subparagraph (A).

"(C) EFFECTIVE DATE.—The reporting provisions described in this section shall be effective upon the enactment of this section.

"(3) REPORTING OBLIGATIONS.—

"(A) SWAPS IN WHICH ONLY 1 COUNTERPARTY IS A SWAP DEALER OR MAJOR SWAP PARTICIPANT.—With respect to a swap in which only 1 counterparty is a swap dealer or major swap participant, the swap dealer or major swap participant shall report the swap as required under paragraphs (1) and (2).

"(B) SWAPS IN WHICH 1 COUNTERPARTY IS A SWAP DEALER AND THE OTHER A MAJOR SWAP PARTICIPANT.—With respect to a swap in which 1 counterparty is a swap dealer and the other a major swap participant, the swap dealer shall report the swap as required under paragraphs (1) and (2).

"(C) OTHER SWAPS.—With respect to any other swap not described in subparagraph (A) or (B), the counterparties to the swap shall select a counterparty to report the swap as required under paragraphs (1) and (2).

"(b) DUTIES OF CERTAIN INDIVIDUALS.—Any individual or entity that enters into a swap shall meet each requirement described in subsection (c) if the individual or entity did not—

"(1) clear the swap in accordance with section 2(h)(1); or

"(2) have the data regarding the swap accepted by a swap data repository in accordance with rules (including timeframes) adopted by the Commission under section 21.

"(c) REQUIREMENTS.—An individual or entity described in subsection (b) shall—

"(1) upon written request from the Commission, provide reports regarding the swaps held by the individual or entity to the Commission in such form and in such manner as the Commission may request; and

"(2) maintain books and records pertaining to the swaps held by the individual or entity in such form, in such manner, and for such period as the Commission may require, which shall be open to inspection by—

"(A) any representative of the Commission;

"(B) an appropriate prudential regulator;

"(C) the Securities and Exchange Commission;

"(D) the Financial Stability Oversight Council; and

"(E) the Department of Justice.

"(d) IDENTICAL DATA.—In prescribing rules under this section, the Commission shall require individuals and entities described in subsection (b) to submit to the Commission a report that contains data that is not less comprehensive than the data required to be collected by swap data repositories under section 21.".

SEC. 730. LARGE SWAP TRADER REPORTING.

The Commodity Exchange Act (7 U.S.C. 1 et seq.) is amended by adding after section 4s (as added by section 731) the following:

"SEC. 4t. LARGE SWAP TRADER REPORTING.

"(a) PROHIBITION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), it shall be unlawful for any person to enter into any swap that the Commission determines to perform a significant price discovery function with respect to registered entities if—

"(A) the person directly or indirectly enters into the swap during any 1 day in an amount equal to or in excess of such amount as shall be established periodically by the Commission; and

"(B) the person directly or indirectly has or obtains a position in the swap equal to or in excess of such amount as shall be established periodically by the Commission.

"(2) EXCEPTION.—Paragraph (1) shall not apply if—

"(A) the person files or causes to be filed with the properly designated officer of the Commission such reports regarding any transactions or positions described in subparagraphs (A) and (B) of paragraph (1) as the Commission may require by rule or regulation; and

"(B) in accordance with the rules and regulations of the Commission, the person keeps books and records of all such swaps and any transactions and positions in any related commodity traded on or subject to the rules of any designated contract market or swap execution facility, and of cash or spot transactions in, inventories of, and purchase and sale commitments of, such a commodity.

"(b) REQUIREMENTS.—

"(1) IN GENERAL.—Books and records described in subsection (a)(2)(B) shall—

"(A) show such complete details concerning all transactions and positions as the Commission may prescribe by rule or regulation;

"(B) be open at all times to inspection and examination by any representative of the Commission; and

"(C) be open at all times to inspection and examination by the Securities and Exchange Commission, to the extent such books and records relate to transactions in swaps (as that term is defined in section 1a(47)(A)(v)), and consistent with the confidentiality and disclosure requirements of section 8.

"(2) JURISDICTION.—Nothing in paragraph (1) shall affect the exclusive jurisdiction of the Commission to prescribe recordkeeping and reporting requirements for large swap traders under this section.

"(c) APPLICABILITY.—For purposes of this section, the swaps, futures, and cash or spot transactions and positions of any person shall include the swaps, futures, and cash or spot transactions and positions of any persons directly or indirectly controlled by the person.

"(d) SIGNIFICANT PRICE DISCOVERY FUNCTION.—In making a determination as to whether a swap performs or affects a significant price discovery function with respect to registered entities, the Commission shall consider the factors described in section 4a(a)(3).".

SEC. 731. REGISTRATION AND REGULATION OF SWAP DEALERS AND MAJOR SWAP PARTICIPANTS.

The Commodity Exchange Act (7 U.S.C. 1 et seq.) is amended by inserting after section 4r (as added by section 729) the following:

"SEC. 4s. REGISTRATION AND REGULATION OF SWAP DEALERS AND MAJOR SWAP PARTICIPANTS.

"(a) REGISTRATION.—

"(1) SWAP DEALERS.—It shall be unlawful for any person to act as a swap dealer unless the person is registered as a swap dealer with the Commission.

"(2) MAJOR SWAP PARTICIPANTS.—It shall be unlawful for any person to act as a major swap participant unless the person is registered as a major swap participant with the Commission.

"(b) REQUIREMENTS.—

"(1) IN GENERAL.—A person shall register as a swap dealer or major swap participant by filing a registration application with the Commission.

"(2) CONTENTS.—

"(A) IN GENERAL.—The application shall be made in such form and manner as prescribed by the Commission, and shall contain such information, as the Commission considers necessary concerning the business in which the applicant is or will be engaged.

"(B) CONTINUAL REPORTING.—A person that is registered as a swap dealer or major swap participant shall continue to submit to the Commission reports that contain such information pertaining to the business of the person as the Commission may require.

"(3) EXPIRATION.—Each registration under this section shall expire at such time as the Commission may prescribe by rule or regulation.

"(4) RULES.—Except as provided in subsections (d) and (e), the Commission may prescribe rules applicable to swap dealers and major swap participants, including rules that limit the activities of swap dealers and major swap participants.

"(5) TRANSITION.—Rules under this section shall provide for the registration of swap dealers and major swap participants not later than 1 year after the date of enactment of the Wall Street Transparency and Accountability Act of 2010.

"(6) STATUTORY DISQUALIFICATION.—Except to the extent otherwise specifically provided by rule, regulation, or order, it shall be unlawful for a swap dealer or a major swap participant to permit any person associated with a swap dealer or a major swap participant who is subject to a statutory disqualification to effect or be involved in effecting swaps on behalf of the swap dealer or major swap participant, if the swap dealer or major swap participant knew, or in the exercise of reasonable care should have known, of the statutory disqualification.

"(c) DUAL REGISTRATION.—

"(1) SWAP DEALER.—Any person that is required to be registered as a swap dealer under this section shall register with the Commission regardless of whether the person also is a depository institution or is registered with the Securities and Exchange Commission as a security-based swap dealer.

"(2) MAJOR SWAP PARTICIPANT.—Any person that is required to be registered as a major swap participant under this section shall register with the Commission regardless of whether the person also is a depository institution or is registered with the Securities and Exchange Commission as a major security-based swap participant.

"(d) RULEMAKINGS.—

"(1) IN GENERAL.—The Commission shall adopt rules for persons that are registered as swap dealers or major swap participants under this section.

"(2) EXCEPTION FOR PRUDENTIAL REQUIREMENTS.—

"(A) IN GENERAL.—The Commission may not prescribe rules imposing prudential requirements on swap dealers or major swap participants for which there is a prudential regulator.

"(B) APPLICABILITY.—Subparagraph (A) does not limit the authority of the Commission to prescribe rules as directed under this section.

"(e) CAPITAL AND MARGIN REQUIREMENTS.—

"(1) IN GENERAL.—

"(A) SWAP DEALERS AND MAJOR SWAP PARTICIPANTS THAT ARE BANKS.—Each registered swap dealer and major swap participant for which there is a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the prudential regulator shall by rule or regulation prescribe under paragraph (2)(A).

"(B) SWAP DEALERS AND MAJOR SWAP PARTICIPANTS THAT ARE NOT BANKS.—Each registered swap dealer and major swap participant for which there is not a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the Commission shall by rule or regulation prescribe under paragraph (2)(B).

"(2) RULES.—

"(A) SWAP DEALERS AND MAJOR SWAP PARTICIPANTS THAT ARE BANKS.—The prudential regulators, in consultation with the Commission and the Securities and Exchange Commission, shall jointly adopt rules for swap dealers and major swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is a prudential regulator imposing—

"(i) capital requirements; and

"(ii) both initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization.

"(B) SWAP DEALERS AND MAJOR SWAP PARTICIPANTS THAT ARE NOT BANKS.—The Commission shall adopt rules for swap dealers and major swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is not a prudential regulator imposing—

"(i) capital requirements; and

"(ii) both initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization.

"(C) CAPITAL.—In setting capital requirements for a person that is designated as a swap dealer or a major swap participant for a single type or single class or category of swap or activities, the prudential regulator and the Commission shall take into account the risks associated with other types of swaps or classes of swaps or categories of swaps engaged in and the other activities conducted by that person that are not otherwise subject to regulation applicable to that person by virtue of the status of the person as a swap dealer or a major swap participant.

"(3) STANDARDS FOR CAPITAL AND MARGIN.—

"(A) IN GENERAL.—To offset the greater risk to the swap dealer or major swap participant and the financial system arising from the use of swaps that are not cleared, the requirements imposed under paragraph (2) shall—

"(i) help ensure the safety and soundness of the swap dealer or major swap participant; and

"(ii) be appropriate for the risk associated with the non-cleared swaps held as a swap dealer or major swap participant.

"(B) RULE OF CONSTRUCTION.—

"(i) IN GENERAL.—Nothing in this section shall limit, or be construed to limit, the authority—

"(I) of the Commission to set financial responsibility rules for a futures commission merchant or introducing broker registered pursuant to section 4f(a) (except for section 4f(a)(3)) in accordance with section 4f(b); or

"(II) of the Securities and Exchange Commission to set financial responsibility rules for a broker or dealer registered pursuant to section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)) (except for section 15(b)(11) of that Act (15 U.S.C. 78o(b)(11)) in accordance with section 15(c)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)(3)).

"(ii) FUTURES COMMISSION MERCHANTS AND OTHER DEALERS.—A futures commission merchant, introducing broker, broker, or dealer shall maintain sufficient capital to comply with the stricter of any applicable capital requirements to which such futures commission merchant, introducing broker, broker, or dealer is subject to under this Act or the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

"(C) MARGIN REQUIREMENTS.—In prescribing margin requirements under this subsection, the prudential regulator with respect to swap dealers and major swap participants for which it is the prudential regulator and the Commission with respect to swap dealers and major swap participants for which there is no prudential regulator shall permit the use of noncash collateral, as the regulator or the Commission determines to be consistent with—

"(i) preserving the financial integrity of markets trading swaps; and

"(ii) preserving the stability of the United States financial system.

"(D) COMPARABILITY OF CAPITAL AND MARGIN REQUIREMENTS.—

"(i) IN GENERAL.—The prudential regulators, the Commission, and the Securities and Exchange Commission shall periodically (but not less frequently than annually) consult on minimum capital requirements and minimum initial and variation margin requirements.

"(ii) COMPARABILITY.—The entities described in clause (i) shall, to the maximum extent practicable, establish and maintain comparable minimum capital requirements and minimum initial and variation margin requirements, including the use of non cash collateral, for—

"(I) swap dealers; and

"(II) major swap participants.

"(f) REPORTING AND RECORDKEEPING.—

"(1) IN GENERAL.—Each registered swap dealer and major swap participant—

"(A) shall make such reports as are required by the Commission by rule or regulation regarding the transactions and positions and financial condition of the registered swap dealer or major swap participant;

"(B)(i) for which there is a prudential regulator, shall keep books and records of all activities related to the business as a swap dealer or major swap participant in such form and manner and for such period as may be prescribed by the Commission by rule or regulation; and

"(ii) for which there is no prudential regulator, shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation;

"(C) shall keep books and records described in subparagraph (B) open to inspection and examination by any representative of the Commission; and

"(D) shall keep any such books and records relating to swaps defined in section 1a(47)(A)(v) open to inspection and examination by the Securities and Exchange Commission.

"(2) RULES.—The Commission shall adopt rules governing reporting and recordkeeping for swap dealers and major swap participants.

"(g) DAILY TRADING RECORDS.—

"(1) IN GENERAL.—Each registered swap dealer and major swap participant shall maintain daily trading records of the swaps of the registered swap dealer and major swap participant and all related records (including related cash or forward transactions) and recorded communications, including electronic mail, instant messages, and recordings of telephone calls, for such period as may be required by the Commission by rule or regulation.

"(2) INFORMATION REQUIREMENTS.—The daily trading records shall include such information as the Commission shall require by rule or regulation.

"(3) COUNTERPARTY RECORDS.—Each registered swap dealer and major swap participant shall maintain daily trading records for each counterparty in a manner and form that is identifiable with each swap transaction.

"(4) AUDIT TRAIL.—Each registered swap dealer and major swap participant shall maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions.

"(5) RULES.—The Commission shall adopt rules governing daily trading records for swap dealers and major swap participants.

"(h) BUSINESS CONDUCT STANDARDS.—

"(1) IN GENERAL.—Each registered swap dealer and major swap participant shall conform with such business conduct standards as prescribed in paragraph (3) and as may be prescribed by the Commission by rule or regulation that relate to—

"(A) fraud, manipulation, and other abusive practices involving swaps (including swaps that are offered but not entered into);

"(B) diligent supervision of the business of the registered swap dealer and major swap participant;

"(C) adherence to all applicable position limits; and

"(D) such other matters as the Commission determines to be appropriate.

"(2) RESPONSIBILITIES WITH RESPECT TO SPECIAL ENTITIES.—

"(A) ADVISING SPECIAL ENTITIES.—A swap dealer or major swap participant that acts as an advisor to a special entity regarding a swap shall comply with the requirements of subparagraph (4) with respect to such Special Entity.

"(B) ENTERING OF SWAPS WITH RESPECT TO SPECIAL ENTITIES.—A swap dealer that enters into or offers to enter into swap with a Special Entity shall comply with the requirements of subparagraph (5) with respect to such Special Entity.

"(C) SPECIAL ENTITY DEFINED.—For purposes of this subsection, the term 'special entity' means—

"(i) a Federal agency;

"(ii) a State, State agency, city, county, municipality, or other political subdivision of a State;

"(iii) any employee benefit plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002);

"(iv) any governmental plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); or

"(v) any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986.

"(3) BUSINESS CONDUCT REQUIREMENTS.—Business conduct requirements adopted by the Commission shall—

"(A) establish a duty for a swap dealer or major swap participant to verify that any counterparty meets the eligibility standards for an eligible contract participant;

"(B) require disclosure by the swap dealer or major swap participant to any counterparty to the transaction (other than a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant) of—

"(i) information about the material risks and characteristics of the swap;

"(ii) any material incentives or conflicts of interest that the swap dealer or major swap participant may have in connection with the swap; and

"(iii)(I) for cleared swaps, upon the request of the counterparty, receipt of the daily mark of the transaction from the appropriate derivatives clearing organization; and

"(II) for uncleared swaps, receipt of the daily mark of the transaction from the swap dealer or the major swap participant;

"(C) establish a duty for a swap dealer or major swap participant to communicate in a fair and balanced manner based on principles of fair dealing and good faith; and

"(D) establish such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act.

"(4) SPECIAL REQUIREMENTS FOR SWAP DEALERS ACTING AS ADVISORS.—

"(A) IN GENERAL.—It shall be unlawful for a swap dealer or major swap participant—

"(i) to employ any device, scheme, or artifice to defraud any Special Entity or prospective customer who is a Special Entity;

"(ii) to engage in any transaction, practice, or course of business that operates as a fraud or deceit on any Special Entity or prospective customer who is a Special Entity; or

"(iii) to engage in any act, practice, or course of business that is fraudulent, deceptive or manipulative.

"(B) DUTY.—Any swap dealer that acts as an advisor to a Special Entity shall have a duty to act in the best interests of the Special Entity.

"(C) REASONABLE EFFORTS.—Any swap dealer that acts as an advisor to a Special Entity shall make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any swap recommended by the swap dealer is in the best interests of the Special Entity, including information relating to—

"(i) the financial status of the Special Entity;

"(ii) the tax status of the Special Entity;

"(iii) the investment or financing objectives of the Special Entity; and

"(iv) any other information that the Commission may prescribe by rule or regulation.

"(5) SPECIAL REQUIREMENTS FOR SWAP DEALERS AS COUNTERPARTIES TO SPECIAL ENTITIES.—

"(A) Any swap dealer or major swap participant that offers to enter or enters into a swap with a Special Entity shall—

"(i) comply with any duty established by the Commission for a swap dealer or major swap participant, with respect to a counterparty that is an eligible contract participant within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18) of this Act, that requires the swap dealer or major swap participant to have a reasonable basis to believe that the counterparty that is a Special Entity has an independent representative that—

"(I) has sufficient knowledge to evaluate the transaction and risks;

"(II) is not subject to a statutory disqualification;

"(III) is independent of the swap dealer or major swap participant;

"(IV) undertakes a duty to act in the best interests of the counterparty it represents;

"(V) makes appropriate disclosures;

"(VI) will provide written representations to the Special Entity regarding fair pricing and the appropriateness of the transaction; and

"(VII) in the case of employee benefit plans subject to the Employee Retirement Income Security act of 1974, is a fiduciary as defined in section 3 of that Act (29 U.S.C. 1002); and "(ii) before the initiation of the transaction, disclose to the Special Entity in writing the capacity in which the swap dealer is acting; and

"(B) the Commission may establish such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act.

"(6) RULES.—The Commission shall prescribe rules under this subsection governing business conduct standards for swap dealers and major swap participants.

"(7) APPLICABILITY.—This section shall not apply with respect to a transaction that is—

"(A) initiated by a Special Entity on an exchange or swap execution facility; and

"(B) one in which the swap dealer or major swap participant does not know the identity of the counterparty to the transaction.

"(i) DOCUMENTATION STANDARDS.—

"(1) IN GENERAL.—Each registered swap dealer and major swap participant shall conform with such standards as may be prescribed by the Commission by rule or regulation that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps.

"(2) RULES.—The Commission shall adopt rules governing documentation standards for swap dealers and major swap participants.

"(j) DUTIES.—Each registered swap dealer and major swap participant at all times shall comply with the following requirements:

"(1) MONITORING OF TRADING.—The swap dealer or major swap participant shall monitor its trading in swaps to prevent violations of applicable position limits.

"(2) RISK MANAGEMENT PROCEDURES.—The swap dealer or major swap participant shall establish robust and professional risk management systems adequate for managing the day-to-day business of the swap dealer or major swap participant.

"(3) DISCLOSURE OF GENERAL INFORMATION.—The swap dealer or major swap participant shall disclose to the Commission and to the prudential regulator for the swap dealer or major swap participant, as applicable, information concerning—

"(A) terms and conditions of its swaps;

"(B) swap trading operations, mechanisms, and practices;

"(C) financial integrity protections relating to swaps; and

"(D) other information relevant to its trading in swaps.

"(4) ABILITY TO OBTAIN INFORMATION.—The swap dealer or major swap participant shall—

"(A) establish and enforce internal systems and procedures to obtain any necessary information to perform any of the functions described in this section; and

"(B) provide the information to the Commission and to the prudential regulator for the swap dealer or major swap participant, as applicable, on request.

"(5) CONFLICTS OF INTEREST.—The swap dealer and major swap participant shall implement conflict-of-interest systems and procedures that—

"(A) establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any commodity or swap or acting in a role of providing clearing activities or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards described in this Act; and

"(B) address such other issues as the Commission determines to be appropriate.

"(6) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this Act, a swap dealer or major swap participant shall not—

"(A) adopt any process or take any action that results in any unreasonable restraint of trade; or

"(B) impose any material anticompetitive burden on trading or clearing.

"(7) RULES.—The Commission shall prescribe rules under this subsection governing duties of swap dealers and major swap participants.

"(k) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(1) IN GENERAL.—Each swap dealer and major swap participant shall designate an individual to serve as a chief compliance officer.

"(2) DUTIES.—The chief compliance officer shall—

"(A) report directly to the board or to the senior officer of the swap dealer or major swap participant;

"(B) review the compliance of the swap dealer or major swap participant with respect to the swap dealer and major swap participant requirements described in this section;

"(C) in consultation with the board of directors, a body performing a function similar to the board, or the senior officer of the organization, resolve any conflicts of interest that may arise;

"(D) be responsible for administering each policy and procedure that is required to be established pursuant to this section;

"(E) ensure compliance with this Act (including regulations) relating to swaps, including each rule prescribed by the Commission under this section;

"(F) establish procedures for the remediation of noncompliance issues identified by the chief compliance officer through any—

"(i) compliance office review;

"(ii) look-back;

"(iii) internal or external audit finding;

"(iv) self-reported error; or

"(v) validated complaint; and

"(G) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

"(3) ANNUAL REPORTS.—

"(A) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

"(i) the compliance of the swap dealer or major swap participant with respect to this Act (including regulations); and

"(ii) each policy and procedure of the swap dealer or major swap participant of the chief compliance officer (including the code of ethics and conflict of interest policies).

"(B) REQUIREMENTS.—A compliance report under subparagraph (A) shall—

"(i) accompany each appropriate financial report of the swap dealer or major swap participant that is required to be furnished to the Commission pursuant to this section; and

"(ii) include a certification that, under penalty of law, the compliance report is accurate and complete.".

SEC. 732. CONFLICTS OF INTEREST.

Section 4d of the Commodity Exchange Act (7 U.S.C. 6d) is amended—

(1) by redesignating subsection (c) as subsection (e); and

(2) by inserting after subsection (b) the following:

"(c) CONFLICTS OF INTEREST.—The Commission shall require that futures commission merchants and introducing brokers implement conflict-of-interest systems and procedures that—

"(1) establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any commodity are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in trading or clearing activities might potentially bias the judgment or supervision of the persons; and

"(2) address such other issues as the Commission determines to be appropriate.

"(d) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—Each futures commission merchant shall designate an individual to serve as its Chief Compliance Officer and perform such duties and responsibilities as shall be set forth in regulations to be adopted by the Commission or rules to be adopted by a futures association registered under section 17.".

SEC. 733. SWAP EXECUTION FACILITIES.

The Commodity Exchange Act is amended by inserting after section 5g (7 U.S.C. 7b–2) the following:

"SEC. 5h. SWAP EXECUTION FACILITIES.

"(a) REGISTRATION.—

"(1) IN GENERAL.—No person may operate a facility for the trading or processing of swaps unless the facility is registered as a swap execution facility or as a designated contract market under this section.

"(2) DUAL REGISTRATION.—Any person that is registered as a swap execution facility under this section shall register with the Commission regardless of whether the person also is registered with the Securities and Exchange Commission as a swap execution facility.

"(b) TRADING AND TRADE PROCESSING.—

"(1) IN GENERAL.—Except as specified in paragraph (2), a swap execution facility that is registered under subsection (a) may—

"(A) make available for trading any swap; and

"(B) facilitate trade processing of any swap.

"(2) AGRICULTURAL SWAPS.—A swap execution facility may not list for trading or confirm the execution of any swap in an agricultural commodity (as defined by the Commission) except pursuant to a rule or regulation of the Commission allowing the swap under such terms and conditions as the Commission shall prescribe.

"(c) IDENTIFICATION OF FACILITY USED TO TRADE SWAPS BY CONTRACT MARKETS.—A board of trade that operates a contract market shall, to the extent that the board of trade also operates a swap execution facility and uses the same electronic trade execution system for listing and executing trades of swaps on or through the contract market and the swap execution facility, identify whether the electronic trading of such swaps is taking place on or through the contract market or the swap execution facility.

"(d) RULE-WRITING.—

"(1) The Securities and Exchange Commission and Commodity Futures Trading Commission may promulgate rules defining the universe of swaps that can be executed on a swap execution facility. These rules shall take into account the price and nonprice requirements of the counterparties to a swap and the goal of this section as set forth in subsection (e).

"(2) For all swaps that are not required to be executed through a swap execution facility as defined in paragraph (1), such trades may be executed through any other available means of interstate commerce.

"(3) The Securities and Exchange Commission and Commodity Futures Trading Commission shall update these rules as necessary to account for technological and other innovation.

"(e) RULE OF CONSTRUCTION.—The goal of this section is to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market.

"(f) CORE PRINCIPLES FOR SWAP EXECUTION FACILITIES.—

"(1) COMPLIANCE WITH CORE PRINCIPLES.—

"(A) IN GENERAL.—To be registered, and maintain registration, as a swap execution facility, the swap execution facility shall comply with—

"(i) the core principles described in this subsection; and

"(ii) any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5).

"(B) REASONABLE DISCRETION OF SWAP EXECUTION FACILITY.—Unless otherwise determined by the Commission by rule or regulation, a swap execution facility described in subparagraph (A) shall have reasonable discretion in establishing the manner in which the swap execution facility complies with the core principles described in this subsection.

"(2) COMPLIANCE WITH RULES.—A swap execution facility shall—

"(A) establish and enforce compliance with any rule of the swap execution facility, including—

"(i) the terms and conditions of the swaps traded or processed on or through the swap execution facility; and

"(ii) any limitation on access to the swap execution facility;

"(B) establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means—

"(i) to provide market participants with impartial access to the market; and

"(ii) to capture information that may be used in establishing whether rule violations have occurred;

"(C) establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades; and

"(D) provide by its rules that when a swap dealer or major swap participant enters into or facilitates a swap that is subject to the mandatory clearing requirement of section 2(h), the swap dealer or major swap participant shall be responsible for compliance with the mandatory trading requirement under section 2(h)(8).

"(3) SWAPS NOT READILY SUSCEPTIBLE TO MANIPULATION.—The swap execution facility shall permit trading only in swaps that are not readily susceptible to manipulation.

"(4) MONITORING OF TRADING AND TRADE PROCESSING.—The swap execution facility shall—

"(A) establish and enforce rules or terms and conditions defining, or specifications detailing—

"(i) trading procedures to be used in entering and executing orders traded on or through the facilities of the swap execution facility; and

"(ii) procedures for trade processing of swaps on or through the facilities of the swap execution facility; and

"(B) monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

"(5) ABILITY TO OBTAIN INFORMATION.—The swap execution facility shall—

"(A) establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in this section;

"(B) provide the information to the Commission on request; and

"(C) have the capacity to carry out such international information-sharing agreements as the Commission may require.

"(6) POSITION LIMITS OR ACCOUNTABILITY.—

"(A) IN GENERAL.—To reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month, a swap execution facility that is a trading facility shall adopt for each of the contracts of the facility, as is necessary and appropriate, position limitations or position accountability for speculators.

"(B) POSITION LIMITS.—For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a), the swap execution facility shall—

"(i) set its position limitation at a level no higher than the Commission limitation; and

"(ii) monitor positions established on or through the swap execution facility for compliance with the limit set by the Commission and the limit, if any, set by the swap execution facility.

"(7) FINANCIAL INTEGRITY OF TRANSACTIONS.—The swap execution facility shall establish and enforce rules and procedures for ensuring the financial integrity of swaps entered on or through the facilities of the swap execution facility, including the clearance and settlement of the swaps pursuant to section 2(h)(1).

"(8) EMERGENCY AUTHORITY.—The swap execution facility shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any swap or to suspend or curtail trading in a swap.

"(9) TIMELY PUBLICATION OF TRADING INFORMATION.—

"(A) IN GENERAL.—The swap execution facility shall make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.

"(B) CAPACITY OF SWAP EXECUTION FACILITY.—The swap execution facility shall be required to have the capacity to electronically capture and transmit trade information with respect to transactions executed on the facility.

"(10) RECORDKEEPING AND REPORTING.—

"(A) IN GENERAL.—A swap execution facility shall—

"(i) maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of 5 years;

"(ii) report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under this Act; and

"(iii) shall keep any such records relating to swaps defined in section 1a(47)(A)(v) open to inspection and examination by the Securities and Exchange Commission."

"(B) REQUIREMENTS.—The Commission shall adopt data collection and reporting requirements for swap execution facilities that are comparable to corresponding requirements for derivatives clearing organizations and swap data repositories.

"(11) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this Act, the swap execution facility shall not—

"(A) adopt any rules or taking any actions that result in any unreasonable restraint of trade; or

"(B) impose any material anticompetitive burden on trading or clearing.

"(12) CONFLICTS OF INTEREST.—The swap execution facility shall—

"(A) establish and enforce rules to minimize conflicts of interest in its decision-making process; and

"(B) establish a process for resolving the conflicts of interest.

"(13) FINANCIAL RESOURCES.—

"(A) IN GENERAL.—The swap execution facility shall have adequate financial, operational, and managerial resources to discharge each responsibility of the swap execution facility.

"(B) DETERMINATION OF RESOURCE ADEQUACY.—The financial resources of a swap execution facility shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the swap execution facility to cover the operating costs of the swap execution facility for a 1-year period, as calculated on a rolling basis.

"(14) SYSTEM SAFEGUARDS.—The swap execution facility shall—

"(A) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems, that—

"(i) are reliable and secure; and

"(ii) have adequate scalable capacity;

"(B) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for—

"(i) the timely recovery and resumption of operations; and

"(ii) the fulfillment of the responsibilities and obligations of the swap execution facility; and

"(C) periodically conduct tests to verify that the backup resources of the swap execution facility are sufficient to ensure continued—

"(i) order processing and trade matching;

"(ii) price reporting;

"(iii) market surveillance and

"(iv) maintenance of a comprehensive and accurate audit trail.

"(15) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(A) IN GENERAL.—Each swap execution facility shall designate an individual to serve as a chief compliance officer.

"(B) DUTIES.—The chief compliance officer shall—

"(i) report directly to the board or to the senior officer of the facility;

"(ii) review compliance with the core principles in this subsection;

"(iii) in consultation with the board of the facility, a body performing a function similar to that of a board, or the senior officer of the facility, resolve any conflicts of interest that may arise;

"(iv) be responsible for establishing and administering the policies and procedures required to be established pursuant to this section;

"(v) ensure compliance with this Act and the rules and regulations issued under this Act, including rules prescribed by the Commission pursuant to this section; and

"(vi) establish procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

"(C) REQUIREMENTS FOR PROCEDURES.—In establishing procedures under subparagraph (B)(vi), the chief compliance officer shall design the procedures to establish the handling, management response, remediation, retesting, and closing of noncompliance issues.

"(D) ANNUAL REPORTS.—

"(i) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

"(I) the compliance of the swap execution facility with this Act; and

"(II) the policies and procedures, including the code of ethics and conflict of interest policies, of the swap execution facility.

"(ii) REQUIREMENTS.—The chief compliance officer shall—

"(I) submit each report described in clause (i) with the appropriate financial report of the swap execution facility that is required to be submitted to the Commission pursuant to this section; and

"(II) include in the report a certification that, under penalty of law, the report is accurate and complete.

"(g) EXEMPTIONS.—The Commission may exempt, conditionally or unconditionally, a swap execution facility from registration under this section if the Commission finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the Securities and Exchange Commission, a prudential regulator, or the appropriate governmental authorities in the home country of the facility.

"(h) RULES.—The Commission shall prescribe rules governing the regulation of alternative swap execution facilities under this section.".

SEC. 734. DERIVATIVES TRANSACTION EXECUTION FACILITIES AND EXEMPT BOARDS OF TRADE.

(a) IN GENERAL.—Sections 5a and 5d of the Commodity Exchange Act (7 U.S.C. 7a, 7a–3) are repealed.

(b) CONFORMING AMENDMENTS.—

(1) Section 2 of the Commodity Exchange Act (7 U.S.C. 2) is amended—

(A) in subsection (a)(1)(A), in the first sentence, by striking "or 5a"; and

(B) in paragraph (2) of subsection (g) (as redesignated by section 723(a)(1)(B)), by striking "section 5a of this Act" and all that follows through "5d of this Act" and inserting "section 5b of this Act".

(2) Section 6(g)(1)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(g)(1)(A)) is amended—

(A) by striking "that—" and all that follows through "(i) has been designated" and inserting "that has been designated";

(B) by striking "; or" and inserting "; and" and

(C) by striking clause (ii).

(c) ABILITY TO PETITION COMMISSION.—

(1) IN GENERAL.—Prior to the final effective dates in this title, a person may petition the Commodity Futures Trading Commission to remain subject to the provisions of section 5d of the Commodity Exchange Act, as such provisions existed prior to the effective date of this subtitle.

(2) CONSIDERATION OF PETITION.—The Commodity Futures Trading Commission shall consider any petition submitted under paragraph (1) in a prompt manner and may allow a person to continue operating subject to the provisions of section 5d of the Commodity Exchange Act for up to 1 year after the effective date of this subtitle.

SEC. 735. DESIGNATED CONTRACT MARKETS.

(a) CRITERIA FOR DESIGNATION.—Section 5 of the Commodity Exchange Act (7 U.S.C. 7) is amended by striking subsection (b).

(b) CORE PRINCIPLES FOR CONTRACT MARKETS.—Section 5 of the Commodity Exchange Act (7 U.S.C. 7) is amended by striking subsection (d) and inserting the following:

"(d) CORE PRINCIPLES FOR CONTRACT MARKETS.—

"(1) DESIGNATION AS CONTRACT MARKET.—

"(A) IN GENERAL.—To be designated, and maintain a designation, as a contract market, a board of trade shall comply with—

"(i) any core principle described in this subsection; and

"(ii) any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5).

"(B) REASONABLE DISCRETION OF CONTRACT MARKET.—Unless otherwise determined by the Commission by rule or regulation, a board of trade described in subparagraph (A) shall have reasonable discretion in establishing the manner in which the board of trade complies with the core principles described in this subsection.

"(2) COMPLIANCE WITH RULES.—

"(A) IN GENERAL.—The board of trade shall establish, monitor, and enforce compliance with the rules of the contract market, including—

"(i) access requirements;

"(ii) the terms and conditions of any contracts to be traded on the contract market; and

"(iii) rules prohibiting abusive trade practices on the contract market.

"(B) CAPACITY OF CONTRACT MARKET.—The board of trade shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market.

"(C) REQUIREMENT OF RULES.—The rules of the contract market shall provide the board of trade with the ability and authority to obtain any necessary information to perform any function described in this subsection, including the capacity to carry out such international information-sharing agreements as the Commission may require.

"(3) CONTRACTS NOT READILY SUBJECT TO MANIPULATION.—The board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation.

"(4) PREVENTION OF MARKET DISRUPTION.—The board of trade shall have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including—

"(A) methods for conducting real-time monitoring of trading; and

"(B) comprehensive and accurate trade reconstructions.

"(5) POSITION LIMITATIONS OR ACCOUNTABILITY.—

"(A) IN GENERAL.—To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators.

"(B) MAXIMUM ALLOWABLE POSITION LIMITATION.—For any contract that is subject to a position limitation established by the Commission pursuant to section 4a(a), the board of trade shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission.

"(6) EMERGENCY AUTHORITY.—The board of trade, in consultation or cooperation with the Commission, shall adopt rules to provide for the exercise of emergency authority, as is necessary and appropriate, including the authority—

"(A) to liquidate or transfer open positions in any contract;

"(B) to suspend or curtail trading in any contract; and

"(C) to require market participants in any contract to meet special margin requirements.

"(7) AVAILABILITY OF GENERAL INFORMATION.—The board of trade shall make available to market authorities, market participants, and the public accurate information concerning—

"(A) the terms and conditions of the contracts of the contract market; and

"(B)(i) the rules, regulations, and mechanisms for executing transactions on or through the facilities of the contract market; and

"(ii) the rules and specifications describing the operation of the contract market's—

"(I) electronic matching platform; or

"(II) trade execution facility.

"(8) DAILY PUBLICATION OF TRADING INFORMATION.—The board of trade shall make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market.

"(9) EXECUTION OF TRANSACTIONS.—

"(A) IN GENERAL.—The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade.

"(B) RULES.—The rules of the board of trade may authorize, for bona fide business purposes—

"(i) transfer trades or office trades;

"(ii) an exchange of—

"(I) futures in connection with a cash commodity transaction;

"(II) futures for cash commodities; or

"(III) futures for swaps; or

"(iii) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.

"(10) TRADE INFORMATION.—The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information—

"(A) to assist in the prevention of customer and market abuses; and

"(B) to provide evidence of any violations of the rules of the contract market.

"(11) FINANCIAL INTEGRITY OF TRANSACTIONS.—The board of trade shall establish and enforce—

"(A) rules and procedures for ensuring the financial integrity of transactions entered into on or through the facilities of the contract market (including the clearance and settlement of the transactions with a derivatives clearing organization); and

"(B) rules to ensure—

"(i) the financial integrity of any—

"(I) futures commission merchant; and

"(II) introducing broker; and

"(ii) the protection of customer funds.

"(12) PROTECTION OF MARKETS AND MARKET PARTICIPANTS.—The board of trade shall establish and enforce rules—

"(A) to protect markets and market participants from abusive practices committed by any party, including abusive practices committed by a party acting as an agent for a participant; and

"(B) to promote fair and equitable trading on the contract market.

"(13) DISCIPLINARY PROCEDURES.—The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.

"(14) DISPUTE RESOLUTION.—The board of trade shall establish and enforce rules regarding, and provide facilities for alternative dispute resolution as appropriate for, market participants and any market intermediaries.

"(15) GOVERNANCE FITNESS STANDARDS.—The board of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other person with direct access to the facility (including any party affiliated with any person described in this paragraph).

"(16) CONFLICTS OF INTEREST.—The board of trade shall establish and enforce rules—

"(A) to minimize conflicts of interest in the decision-making process of the contract market; and

"(B) to establish a process for resolving conflicts of interest described in subparagraph (A).

"(17) COMPOSITION OF GOVERNING BOARDS OF CONTRACT MARKETS.—The governance arrangements of the board of trade shall be designed to permit consideration of the views of market participants.

"(18) RECORDKEEPING.—The board of trade shall maintain records of all activities relating to the business of the contract market—

"(A) in a form and manner that is acceptable to the Commission; and

"(B) for a period of at least 5 years.

"(19) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this Act, the board of trade shall not—

"(A) adopt any rule or taking any action that results in any unreasonable restraint of trade; or

"(B) impose any material anticompetitive burden on trading on the contract market.

"(20) SYSTEM SAFEGUARDS.—The board of trade shall—

"(A) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and the development of automated systems, that are reliable, secure, and have adequate scalable capacity;

"(B) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the board of trade; and

"(C) periodically conduct tests to verify that backup resources are sufficient to ensure continued order processing and trade matching, price reporting, market surveillance, and maintenance of a comprehensive and accurate audit trail.

"(21) FINANCIAL RESOURCES.—

"(A) IN GENERAL.—The board of trade shall have adequate financial, operational, and managerial resources to discharge each responsibility of the board of trade.

"(B) DETERMINATION OF ADEQUACY.—The financial resources of the board of trade shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the contract market to cover the operating costs of the contract market for a 1-year period, as calculated on a rolling basis.

"(22) DIVERSITY OF BOARD OF DIRECTORS.—The board of trade, if a publicly traded company, shall endeavor to recruit individuals to serve on the board of directors and the other decision-making bodies (as determined by the Commission) of the board of trade from among, and to have the composition of the bodies reflect, a broad and culturally diverse pool of qualified candidates.

"(23) SECURITIES AND EXCHANGE COMMISSION.—The board of trade shall keep any such records relating to swaps defined in section 1a(47)(A)(v) open to inspection and examination by the Securities and Exchange Commission.".

SEC. 736. MARGIN.

Section 8a(7) of the Commodity Exchange Act (7 U.S.C. 12a(7)) is amended—

(1) in subparagraph (C), by striking ", excepting the setting of levels of margin";

(2) by redesignating subparagraphs (D) through (F) as subparagraphs (E) through (G), respectively; and

(3) by inserting after subparagraph (C) the following:

"(D) margin requirements, provided that the rules, regulations, or orders shall—

"(i) be limited to protecting the financial integrity of the derivatives clearing organization;

"(ii) be designed for risk management purposes to protect the financial integrity of transactions; and

"(iii) not set specific margin amounts;".

SEC. 737. POSITION LIMITS.

(a) AGGREGATE POSITION LIMITS.—Section 4a(a) of the Commodity Exchange Act (7 U.S.C. 6a(a)) is amended—

(1) by inserting after "(a)" the following:

"(1) IN GENERAL.—";

(2) in the first sentence, by striking "on electronic trading facilities with respect to a significant price discovery contract" and inserting "swaps that perform or affect a significant price discovery function with respect to registered entities";

(3) in the second sentence—

(A) by inserting ", including any group or class of traders," after "held by any person"; and

(B) by striking "on an electronic trading facility with respect to a significant price discovery contract," and inserting "swaps traded on or subject to the rules of a designated contract market or a swap execution facility, or swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs a significant price discovery function with respect to a registered entity,''; and

(4) by adding at the end the following:

''(2) ESTABLISHMENT OF LIMITATIONS.—

''(A) IN GENERAL.—In accordance with the standards set forth in paragraph (1) of this subsection and consistent with the good faith exception cited in subsection (b)(2), with respect to physical commodities other than excluded commodities as defined by the Commission, the Commission shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market.

''(B) TIMING.—

''(i) EXEMPT COMMODITIES.—For exempt commodities, the limits required under subparagraph (A) shall be established within 180 days after the date of the enactment of this paragraph.

''(ii) AGRICULTURAL COMMODITIES.—For agricultural commodities, the limits required under subparagraph (A) shall be established within 270 days after the date of the enactment of this paragraph.

''(C) GOAL.—In establishing the limits required under subparagraph (A), the Commission shall strive to ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade.

''(3) SPECIFIC LIMITATIONS.—In establishing the limits required in paragraph (2), the Commission, as appropriate, shall set limits—

''(A) on the number of positions that may be held by any person for the spot month, each other month, and the aggregate number of positions that may be held by any person for all months; and

''(B) to the maximum extent practicable, in its discretion—

''(i) to diminish, eliminate, or prevent excessive speculation as described under this section;

''(ii) to deter and prevent market manipulation, squeezes, and corners;

''(iii) to ensure sufficient market liquidity for bona fide hedgers; and

''(iv) to ensure that the price discovery function of the underlying market is not disrupted.

''(4) SIGNIFICANT PRICE DISCOVERY FUNCTION.—In making a determination whether a swap performs or affects a significant price discovery function with respect to regulated markets, the Commission shall consider, as appropriate:

"(A) PRICE LINKAGE.—The extent to which the swap uses or otherwise relies on a daily or final settlement price, or other major price parameter, of another contract traded on a regulated market based upon the same underlying commodity, to value a position, transfer or convert a position, financially settle a position, or close out a position.

"(B) ARBITRAGE.—The extent to which the price for the swap is sufficiently related to the price of another contract traded on a regulated market based upon the same underlying commodity so as to permit market participants to effectively arbitrage between the markets by simultaneously maintaining positions or executing trades in the swaps on a frequent and recurring basis.

"(C) MATERIAL PRICE REFERENCE.—The extent to which, on a frequent and recurring basis, bids, offers, or transactions in a contract traded on a regulated market are directly based on, or are determined by referencing, the price generated by the swap.

"(D) MATERIAL LIQUIDITY.—The extent to which the volume of swaps being traded in the commodity is sufficient to have a material effect on another contract traded on a regulated market.

"(E) OTHER MATERIAL FACTORS.—Such other material factors as the Commission specifies by rule or regulation as relevant to determine whether a swap serves a significant price discovery function with respect to a regulated market.

"(5) ECONOMICALLY EQUIVALENT CONTRACTS.—

"(A) Notwithstanding any other provision of this section, the Commission shall establish limits on the amount of positions, including aggregate position limits, as appropriate, other than bona fide hedge positions, that may be held by any person with respect to swaps that are economically equivalent to contracts of sale for future delivery or to options on the contracts or commodities traded on or subject to the rules of a designated contract market subject to paragraph (2).

"(B) In establishing limits pursuant to subparagraph (A), the Commission shall—

"(i) develop the limits concurrently with limits established under paragraph (2), and the limits shall have similar requirements as under paragraph (3)(B); and

"(ii) establish the limits simultaneously with limits established under paragraph (2).

"(6) AGGREGATE POSITION LIMITS.—The Commission shall, by rule or regulation, establish limits (including related hedge exemption provisions) on the aggregate number or amount of positions in contracts based upon the same underlying commodity (as defined by the Commission) that may be held by any person, including any group or class of traders, for each month across—

"(A) contracts listed by designated contract markets;

"(B) with respect to an agreement contract, or transaction that settles against any price (including the daily or final settlement price) of 1 or more contracts listed for trading on a registered entity, contracts traded on a foreign board of trade that provides members or other participants located in the United States with direct access to its electronic trading and order matching system; and

"(C) swap contracts that perform or affect a significant price discovery function with respect to regulated entities.

"(7) EXEMPTIONS.—The Commission, by rule, regulation, or order, may exempt, conditionally or unconditionally, any person or class of persons, any swap or class of swaps, any contract of sale of a commodity for future delivery or class of such contracts, any option or class of options, or any transaction or class of transactions from any requirement it may establish under this section with respect to position limits.".

(b) CONFORMING AMENDMENTS.—Section 4a(b) of the Commodity Exchange Act (7 U.S.C. 6a(b)) is amended—

(1) in paragraph (1), by striking "or derivatives transaction execution facility or facilities or electronic trading facility" and inserting "or swap execution facility or facilities"; and

(2) in paragraph (2), by striking "or derivatives transaction execution facility or facilities or electronic trading facility" and inserting "or swap execution facility".

(c) BONA FIDE HEDGING TRANSACTION.—Section 4a(c) of the Commodity Exchange Act is amended—

(1) by inserting "(1)" after "(c)"; and

(2) by adding at the end the following:

"(2) For the purposes of implementation of subsection (a)(2) for contracts of sale for future delivery or options on the contracts or commodities, the Commission shall define what constitutes a bona fide hedging transaction or position as a transaction or position that—

"(A)(i) represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel;

"(ii) is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and

"(iii) arises from the potential change in the value of—

"(I) assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

"(II) liabilities that a person owns or anticipates incurring; or

"(III) services that a person provides, purchases, or anticipates providing or purchasing; or

"(B) reduces risks attendant to a position resulting from a swap that—

"(i) was executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction pursuant to subparagraph (A); or

"(ii) meets the requirements of subparagraph (A).".

(d) EFFECTIVE DATE.—This section and the amendments made by this section shall become effective on the date of the enactment of this section.

SEC. 738. FOREIGN BOARDS OF TRADE.

(a) IN GENERAL.—Section 4(b) of the Commodity Exchange Act (7 U.S.C. 6(b)) is amended—

(1) in the first sentence, by striking "The Commission" and inserting the following:

"(2) PERSONS LOCATED IN THE UNITED STATES.—

"(A) IN GENERAL.—The Commission";

(2) in the second sentence, by striking "Such rules and regulations" and inserting the following:

"(B) DIFFERENT REQUIREMENTS.—Rules and regulations described in subparagraph (A)";

(3) in the third sentence—

(A) by striking "No rule or regulation" and inserting the following:

"(C) PROHIBITION.—Except as provided in paragraphs (1) and (2), no rule or regulation";

(B) by striking "that (1) requires" and inserting the following: "that—

"(i) requires"; and

(C) by striking "market, or (2) governs" and inserting the following: "market; or

"(ii) governs"; and

(4) by inserting before paragraph (2) (as designated by paragraph (1)) the following:

"(1) FOREIGN BOARDS OF TRADE.—

"(A) REGISTRATION.—The Commission may adopt rules and regulations requiring registration with the Commission for a foreign board of trade that provides the members of the foreign board of trade or other participants located in the United States with direct access to the electronic trading and order matching system of the foreign board of trade, including rules and regulations prescribing procedures and requirements applicable to the registration of such foreign boards of trade. For purposes of this paragraph, 'direct access' refers to an explicit grant of authority by a foreign board of trade to an identified member or other participant located in the United States to enter trades directly into the trade matching system of the foreign board of trade. In adopting such rules and regulations, the commission shall consider—

"(i) whether any such foreign board of trade is subject to comparable, comprehensive supervision and regulation by the appropriate governmental authorities in the foreign board of trade's home country; and

"(ii) any previous commission findings that the foreign board of trade is subject to comparable comprehensive supervision and regulation by the appropriate government authorities in the foreign board of trade's home country.

"(B) LINKED CONTRACTS.—The Commission may not permit a foreign board of trade to provide to the members of the foreign board of trade or other participants located in the United States direct access to the electronic trading and order-matching system of the foreign board of trade with respect to an agreement, contract, or transaction that settles against any price (including the daily or final settlement price) of 1 or more contracts listed for trading on a registered entity, unless the Commission determines that—

"(i) the foreign board of trade makes public daily trading information regarding the agreement, contract, or transaction that is comparable to the daily trading information published by the registered entity for the 1 or more contracts against which the agreement, contract, or transaction traded on the foreign board of trade settles; and

"(ii) the foreign board of trade (or the foreign futures authority that oversees the foreign board of trade)—

"(I) adopts position limits (including related hedge exemption provisions) for the agreement, contract, or transaction that are comparable to the position limits (including related hedge exemption provisions) adopted by the registered entity for the 1 or more contracts against which the agreement, contract, or transaction traded on the foreign board of trade settles;

"(II) has the authority to require or direct market participants to limit, reduce, or liquidate any position the foreign board of trade (or the foreign futures authority that oversees the foreign board of trade) determines to be necessary to prevent or reduce the threat of price manipulation, excessive speculation as described in section 4a, price distortion, or disruption of delivery or the cash settlement process;

"(III) agrees to promptly notify the Commission, with regard to the agreement, contract, or transaction that settles against any price (including the daily or final settlement price) of 1 or more contracts listed for trading on a registered entity, of any change regarding—

"(aa) the information that the foreign board of trade will make publicly available;

"(bb) the position limits that the foreign board of trade or foreign futures authority will adopt and enforce;

"(cc) the position reductions required to prevent manipulation, excessive speculation as described in section 4a, price distortion, or disruption of delivery or the cash settlement process; and

"(dd) any other area of interest expressed by the Commission to the foreign board of trade or foreign futures authority;

"(IV) provides information to the Commission regarding large trader positions in the agreement, contract, or transaction that is comparable to the large trader position information collected by the Commission for the 1 or more contracts against which the agreement, contract, or transaction traded on the foreign board of trade settles; and

"(V) provides the Commission such information as is necessary to publish reports on aggregate trader positions for the agreement, contract, or transaction traded on the foreign board of trade that are comparable to such reports on aggregate trader positions for the 1 or more contracts against which the agreement, contract, or transaction traded on the foreign board of trade settles.

"(C) EXISTING FOREIGN BOARDS OF TRADE.—Subparagraphs (A) and (B) shall not be effective with respect to any foreign board of trade to which, prior to the date of enactment of this paragraph, the Commission granted direct access permission until the date that is 180 days after that date of enactment.".

(b) LIABILITY OF REGISTERED PERSONS TRADING ON A FOREIGN BOARD OF TRADE.—Section 4 of the Commodity Exchange Act (7 U.S.C. 6) is amended—

(1) in subsection (a), in the matter preceding paragraph (1), by inserting "or by subsection (e)" after "Unless exempted by the Commission pursuant to subsection (c)"; and

(2) by adding at the end the following:

"(e) LIABILITY OF REGISTERED PERSONS TRADING ON A FOREIGN BOARD OF TRADE.—

"(1) IN GENERAL.—A person registered with the Commission, or exempt from registration by the Commission, under this Act may not be found to have violated subsection (a) with respect to a transaction in, or in connection with, a contract of sale of a commodity for future delivery if the person—

"(A) has reason to believe that the transaction and the contract is made on or subject to the rules of a foreign board of trade that is—

"(i) legally organized under the laws of a foreign country;

"(ii) authorized to act as a board of trade by a foreign futures authority; and

"(iii) subject to regulation by the foreign futures authority; and

"(B) has not been determined by the Commission to be operating in violation of subsection (a).

"(2) RULE OF CONSTRUCTION.—Nothing in this subsection shall be construed as implying or creating any presumption that a board of trade, exchange, or market is located outside the United States, or its territories or possessions, for purposes of subsection (a).".

(c) CONTRACT ENFORCEMENT FOR FOREIGN FUTURES CONTRACTS.—Section 22(a) of the Commodity Exchange Act (7 U.S.C. 25(a)) (as amended by section 739) is amended by adding at the end the following:

"(6) CONTRACT ENFORCEMENT FOR FOREIGN FUTURES CONTRACTS.—A contract of sale of a commodity for future delivery traded or executed on or through the facilities of a board of trade, exchange, or market located outside the United States for purposes of section 4(a) shall not be void, voidable, or unenforceable, and a party to such a contract shall not be entitled to rescind or recover any payment made with respect to the contract, based on the failure of the foreign board of trade to comply with any provision of this Act.".

SEC. 739. LEGAL CERTAINTY FOR SWAPS.

Section 22(a) of the Commodity Exchange Act (7 U.S.C. 25(a)) is amended by striking paragraph (4) and inserting the following:

"(4) CONTRACT ENFORCEMENT BETWEEN ELIGIBLE COUNTERPARTIES.—

"(A) IN GENERAL.—No hybrid instrument sold to any investor shall be void, voidable, or unenforceable, and no party to a hybrid instrument shall be entitled to rescind, or recover any payment made with respect to, the hybrid instrument under this section or any other provision of Federal or State law, based solely on the failure of the hybrid instrument to comply with the terms or conditions of section 2(f) or regulations of the Commission.

"(B) SWAPS.—No agreement, contract, or transaction between eligible contract participants or persons reasonably believed to be eligible contract participants shall be void, voidable, or unenforceable, and no party to such agreement, contract, or transaction shall be entitled to rescind, or recover any payment made with respect to, the agreement, contract, or transaction under this section or any other provision of Federal or State law, based solely on the failure of the agreement, contract, or transaction—

"(i) to meet the definition of a swap under section 1a; or

"(ii) to be cleared in accordance with section 2(h)(1).

"(5) LEGAL CERTAINTY FOR LONG-TERM SWAPS ENTERED INTO BEFORE THE DATE OF ENACTMENT OF THE WALL STREET TRANSPARENCY AND ACCOUNTABILITY ACT OF 2010.—

"(A) EFFECT ON SWAPS.—Unless specifically reserved in the applicable swap, neither the enactment of the Wall Street Transparency and Accountability Act of 2010, nor any requirement under that Act or an amendment made by that Act, shall constitute a termination event, force majeure, illegality, increased costs, regulatory change, or similar event under a swap (including any related credit support arrangement) that would permit a party to terminate, renegotiate, modify, amend, or supplement 1 or more transactions under the swap.

"(B) POSITION LIMITS.—Any position limit established under the Wall Street Transparency and Accountability Act of 2010 shall not apply to a position acquired in good faith prior to the effective date of any rule, regulation, or order under the Act that establishes the position limit; provided, however, that such positions shall be attributed to the trader if the trader's position is increased after the effective date of such position limit rule, regulation, or order.".

SEC. 740. MULTILATERAL CLEARING ORGANIZATIONS.

Sections 408 and 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4421, 4422) are repealed.

SEC. 741. ENFORCEMENT.

(a) ENFORCEMENT AUTHORITY.—The Commodity Exchange Act is amended by inserting after section 4b (7 U.S.C. 6b) the following:

"SEC. 4b–1. ENFORCEMENT AUTHORITY.

"(a) COMMODITY FUTURES TRADING COMMISSION.—Except as provided in subsections (b), (c), and (d), the Commission shall have exclusive authority to enforce the provisions of subtitle A of the

Wall Street Transparency and Accountability Act of 2010 with respect to any person.

"(b) PRUDENTIAL REGULATORS.—The prudential regulators shall have exclusive authority to enforce the provisions of section 4s(e) with respect to swap dealers or major swap participants for which they are the prudential regulator.

"(c) REFERRALS.—

"(1) PRUDENTIAL REGULATORS.—If the prudential regulator for a swap dealer or major swap participant has cause to believe that the swap dealer or major swap participant, or any affiliate or division of the swap dealer or major swap participant, may have engaged in conduct that constitutes a violation of the nonprudential requirements of this Act (including section 4s or rules adopted by the Commission under that section), the prudential regulator may promptly notify the Commission in a written report that includes—

"(A) a request that the Commission initiate an enforcement proceeding under this Act; and

"(B) an explanation of the facts and circumstances that led to the preparation of the written report.

"(2) COMMISSION.—If the Commission has cause to believe that a swap dealer or major swap participant that has a prudential regulator may have engaged in conduct that constitutes a violation of any prudential requirement of section 4s or rules adopted by the Commission under that section, the Commission may notify the prudential regulator of the conduct in a written report that includes—

"(A) a request that the prudential regulator initiate an enforcement proceeding under this Act or any other Federal law (including regulations); and

"(B) an explanation of the concerns of the Commission, and a description of the facts and circumstances, that led to the preparation of the written report.

"(d) BACKSTOP ENFORCEMENT AUTHORITY.—

"(1) INITIATION OF ENFORCEMENT PROCEEDING BY PRUDENTIAL REGULATOR.—If the Commission does not initiate an enforcement proceeding before the end of the 90-day period beginning on the date on which the Commission receives a written report under subsection (c)(1), the prudential regulator may initiate an enforcement proceeding.

"(2) INITIATION OF ENFORCEMENT PROCEEDING BY COMMISSION.—If the prudential regulator does not initiate an enforcement proceeding before the end of the 90-day period beginning on the date on which the prudential regulator receives a written report under subsection (c)(2), the Commission may initiate an enforcement proceeding.".

(b) CONFORMING AMENDMENTS.—

(1) Section 4b of the Commodity Exchange Act (7 U.S.C. 6b) is amended—

(A) in subsection (a)(2), by striking "or other agreement, contract, or transaction subject to paragraphs (1) and (2) of section 5a(g)," and inserting "or swap,";

(B) in subsection (b), by striking "or other agreement, contract or transaction subject to paragraphs (1) and (2) of section 5a(g)," and inserting "or swap,"; and

(C) by adding at the end the following:

"(e) It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any registered entity, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery (or option on such a contract), or any swap, on a group or index of securities (or any interest therein or based on the value thereof)—

"(1) to employ any device, scheme, or artifice to defraud;

"(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.".

(2) Section 4c(a)(1) of the Commodity Exchange Act (7 U.S.C. 6c(a)(1)) is amended by inserting "or swap" before "if the transaction is used or may be used".

(3) Section 6(c) of the Commodity Exchange Act (7 U.S.C. 9) is amended in the first sentence by inserting "or of any swap," before "or has willfully made".

(4) Section 6(d) of the Commodity Exchange Act (7 U.S.C. 13b) is amended in the first sentence, in the matter preceding the proviso, by inserting "or of any swap," before "or otherwise is violating".

(5) Section 6c(a) of the Commodity Exchange Act (7 U.S.C. 13a–1(a)) is amended in the matter preceding the proviso by inserting "or any swap" after "commodity for future delivery".

(6) Section 9 of the Commodity Exchange Act (7 U.S.C. 13) is amended—

(A) in subsection (a)—

(i) in paragraph (2), by inserting "or of any swap," before "or to corner"; and

(ii) in paragraph (4), by inserting "swap data repository," before "or futures association" and

(B) in subsection (e)(1)—

(i) by inserting "swap data repository," before "or registered futures association"; and

(ii) by inserting ", or swaps," before "on the basis".

(7) Section 9(a) of the Commodity Exchange Act (7 U.S.C. 13(a)) is amended by adding at the end the following:

"(6) Any person to abuse the end user clearing exemption under section 2(h)(4), as determined by the Commission.".

(8) Section 2(c)(2)(B) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(B)) is amended—

(A) by striking "(dd)," each place it appears;

(B) in clause (iii), by inserting ", and accounts or pooled investment vehicles described in clause (vi)," before "shall be subject to"; and

(C) by adding at the end the following:

"(vi) This Act applies to, and the Commission shall have jurisdiction over, an account or pooled investment vehicle that is offered for the purpose of trading, or that trades, any agreement, contract, or transaction in foreign currency described in clause (i).".

(9) Section 2(c)(2)(C) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)) is amended—

(A) by striking "(dd)," each place it appears;

(B) in clause (ii)(I), by inserting ", and accounts or pooled investment vehicles described in clause (vii)," before "shall be subject to"; and

(C) by adding at the end the following:

"(vii) This Act applies to, and the Commission shall have jurisdiction over, an account or pooled investment vehicle that is offered for the purpose of trading, or that trades, any agreement, contract, or transaction in foreign currency described in clause (i).".

(10) Section 1a(19)(A)(iv)(II) of the Commodity Exchange Act (7 U.S.C. 1a(19)(A)(iv)(II)) (as redesignated by section 721(a)(1)) is amended by inserting before the semicolon at the end the following: "provided, however, that for purposes of section 2(c)(2)(B)(vi) and section 2(c)(2)(C)(vii), the term 'eligible contract participant' shall not include a commodity pool in which any participant is not otherwise an eligible contract participant".

(11) Section 6(e) of the Commodity Exchange Act (7 U.S.C. 9a) is amended by adding at the end the following:

"(4) Any designated clearing organization that knowingly or recklessly evades or participates in or facilitates an evasion of the requirements of section 2(h) shall be liable for a civil money penalty in twice the amount otherwise available for a violation of section 2(h).

"(5) Any swap dealer or major swap participant that knowingly or recklessly evades or participates in or facilitates an evasion of the requirements of section 2(h) shall be liable for a civil money penalty in twice the amount otherwise available for a violation of section 2(h).".

(c) SAVINGS CLAUSE.—Notwithstanding any other provision of this title, nothing in this subtitle shall be construed as divesting any appropriate Federal banking agency of any authority it may have to establish or enforce, with respect to a person for which such agency is the appropriate Federal banking agency, prudential or other standards pursuant to authority granted by Federal law other than this title.

SEC. 742. RETAIL COMMODITY TRANSACTIONS.

(a) IN GENERAL.—Section 2(c) of the Commodity Exchange Act (7 U.S.C. 2(c)) is amended—

(1) in paragraph (1), by striking "5a (to the extent provided in section 5a(g)), 5b, 5d, or 12(e)(2)(B))" and inserting ", 5b, or 12(e)(2)(B))"; and

(2) in paragraph (2), by adding at the end the following:

"(D) RETAIL COMMODITY TRANSACTIONS.—

"(i) APPLICABILITY.—Except as provided in clause (ii), this subparagraph shall apply to any agreement, contract, or transaction in any commodity that is—

"(I) entered into with, or offered to (even if not entered into with), a person that is not an eligible contract participant or eligible commercial entity; and

"(II) entered into, or offered (even if not entered into), on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis.

"(ii) EXCEPTIONS.—This subparagraph shall not apply to—

"(I) an agreement, contract, or transaction described in paragraph (1) or subparagraphs (A), (B), or (C), including any agreement, contract, or transaction specifically excluded from subparagraph (A), (B), or (C);

"(II) any security;

"(III) a contract of sale that—

"(aa) results in actual delivery within 28 days or such other longer period as the Commission may determine by rule or regulation based upon the typical commercial practice in cash or spot markets for the commodity involved; or

"(bb) creates an enforceable obligation to deliver between a seller and a buyer that have the ability to deliver and accept delivery, respectively, in connection with the line of business of the seller and buyer; or

"(IV) an agreement, contract, or transaction that is listed on a national securities exchange registered under section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)); or

"(V) an identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C.27(b)).

"(iii) ENFORCEMENT.—Sections 4(a), 4(b), and 4b apply to any agreement, contract, or transaction described in clause (i), as if the agreement, contract, or transaction was a contract of sale of a commodity for future delivery.

"(iv) ELIGIBLE COMMERCIAL ENTITY.—For purposes of this subparagraph, an agricultural producer, packer, or handler shall be considered to be an eligible commercial entity for any agreement, contract, or transaction for a commodity in connection with the line of business of the agricultural producer, packer, or handler.".

(b) GRAMM-LEACH-BLILEY ACT.—Section 206(a) of the Gramm-Leach-Bliley Act (Public Law 106–102; 15 U.S.C. 78c note) is amended, in the matter preceding paragraph (1), by striking "For purposes of" and inserting "Except as provided in subsection (e), for purposes of".

(c) CONFORMING AMENDMENTS RELATING TO RETAIL FOREIGN EXCHANGE TRANSACTIONS.—

(1) Section 2(c)(2)(B)(i)(II) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(B)(i)(II)) is amended—

(A) in item (aa), by inserting "United States" before "financial institution";

(B) by striking items (dd) and (ff);

(C) by redesignating items (ee) and (gg) as items (dd) and (ff), respectively; and

(D) in item (dd) (as so redesignated), by striking the semicolon and inserting "; or".

(2) Section 2(c)(2) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)) (as amended by subsection (a)(2)) is amended by adding at the end the following:

"(E) PROHIBITION.—

"(i) DEFINITION OF FEDERAL REGULATORY AGENCY.—In this subparagraph, the term 'Federal regulatory agency' means—

"(I) the Commission;

"(II) the Securities and Exchange Commission;

"(III) an appropriate Federal banking agency;

"(IV) the National Credit Union Association; and

"(V) the Farm Credit Administration.

"(ii) PROHIBITION.—

"(I) IN GENERAL.—Except as provided in subclause (II), a person described in subparagraph (B)(i)(II) for which there is a Federal regulatory agency shall not offer to, or enter into with, a person that is not an eligible contract participant, any agreement, contract, or transaction in foreign currency described in subparagraph (B)(i)(I) except pursuant to a rule or regulation of a Federal regulatory agency allowing the agreement, contract, or transaction under such terms and conditions as the Federal regulatory agency shall prescribe.

"(II) EFFECTIVE DATE.—With regard to persons described in subparagraph (B)(i)(II) for which a Federal regulatory agency has issued a proposed rule concerning agreements, contracts, or transactions in foreign currency described in subparagraph (B)(i)(I) prior to the date of enactment of this subclause, subclause (I) shall take effect 90 days after the date of enactment of this subclause.

"(iii) REQUIREMENTS OF RULES AND REGULATIONS.—

"(I) IN GENERAL.—The rules and regulations described in clause (ii) shall prescribe appropriate requirements with respect to—

"(aa) disclosure;

"(bb) recordkeeping;

"(cc) capital and margin;

"(dd) reporting;

"(ee) business conduct;

"(ff) documentation; and

"(gg) such other standards or requirements as the Federal regulatory agency shall determine to be necessary.

"(II) TREATMENT.—The rules or regulations described in clause (ii) shall treat all agreements, contracts, and transactions in foreign currency described in subparagraph (B)(i)(I), and all agreements, contracts, and transactions in foreign currency that are functionally or economically similar to agreements, contracts, or transactions described in subparagraph (B)(i)(I), similarly.".

SEC. 743. OTHER AUTHORITY.

Unless otherwise provided by the amendments made by this subtitle, the amendments made by this subtitle do not divest any appropriate Federal banking agency, the Commodity Futures Trading Commission, the Securities and Exchange Commission, or other Federal or State agency of any authority derived from any other applicable law.

SEC. 744. RESTITUTION REMEDIES.

Section 6c(d) of the Commodity Exchange Act (7 U.S.C. 13a–1(d)) is amended by adding at the end the following:

"(3) EQUITABLE REMEDIES.—In any action brought under this section, the Commission may seek, and the court may impose, on a proper showing, on any person found in the action to have committed any violation, equitable remedies including—

"(A) restitution to persons who have sustained losses proximately caused by such violation (in the amount of such losses); and

"(B) disgorgement of gains received in connection with such violation.".

SEC. 745. ENHANCED COMPLIANCE BY REGISTERED ENTITIES.

(a) EFFECT OF INTERPRETATION.—Section 5c(a) of the Commodity Exchange Act (7 U.S.C. 7a–2(a)) is amended by striking paragraph (2) and inserting the following:

"(2) EFFECT OF INTERPRETATION.—An interpretation issued under paragraph (1) may provide the exclusive means for complying with each section described in paragraph (1).".

(b) NEW CONTRACTS, NEW RULES, AND RULE AMENDMENTS.—Section 5c of the Commodity Exchange Act (7 U.S.C. 7a–2) is amended by striking subsection (c) and inserting the following:

"(c) NEW CONTRACTS, NEW RULES, AND RULE AMENDMENTS.—

"(1) IN GENERAL.—A registered entity may elect to list for trading or accept for clearing any new contract, or other instrument, or may elect to approve and implement any new rule or rule amendment, by providing to the Commission (and the Secretary of the Treasury, in the case of a contract of sale of a government security for future delivery (or option on such a contract) or a rule or rule amendment specifically related to such a contract) a written certification that the new contract or instrument or clearing of the new contract or instrument, new rule, or rule amendment complies with this Act (including regulations under this Act).

"(2) RULE REVIEW.—The new rule or rule amendment described in paragraph (1) shall become effective, pursuant to the certification of the registered entity and notice of such certification to its members (in a manner to be determined by the Commission), on the date that is 10 business days after the date on which the Commission receives the certification (or such shorter period as determined by the Commission by rule or regulation) unless the Commission notifies the registered entity within such time that it is staying the certification because there exist novel or complex issues that require additional time to analyze, an inadequate explanation by the submitting registered entity, or a potential inconsistency with this Act (including regulations under this Act).

“(3) STAY OF CERTIFICATION FOR RULES.—

“(A) A notification by the Commission pursuant to paragraph (2) shall stay the certification of the new rule or rule amendment for up to an additional 90 days from the date of the notification.

“(B) A rule or rule amendment subject to a stay pursuant to subparagraph (A) shall become effective, pursuant to the certification of the registered entity, at the expiration of the period described in subparagraph (A) unless the Commission—

“(i) withdraws the stay prior to that time; or

“(ii) notifies the registered entity during such period that it objects to the proposed certification on the grounds that it is inconsistent with this Act (including regulations under this Act).

“(C) The Commission shall provide a not less than 30-day public comment period, within the 90-day period in which the stay is in effect as described in subparagraph (A), whenever the Commission reviews a rule or rule amendment pursuant to a notification by the Commission under this paragraph.

“(4) PRIOR APPROVAL.—

“(A) IN GENERAL.—A registered entity may request that the Commission grant prior approval to any new contract or other instrument, new rule, or rule amendment.

“(B) PRIOR APPROVAL REQUIRED.—Notwithstanding any other provision of this section, a designated contract market shall submit to the Commission for prior approval each rule amendment that materially changes the terms and conditions, as determined by the Commission, in any contract of sale for future delivery of a commodity specifically enumerated in section 1a(10) (or any option thereon) traded through its facilities if the rule amendment applies to contracts and delivery months which have already been listed for trading and have open interest.

“(C) DEADLINE.—If prior approval is requested under subparagraph (A), the Commission shall take final action on the request not later than 90 days after submission of the request, unless the person submitting the request agrees to an extension of the time limitation established under this subparagraph.

“(5) APPROVAL.—

“(A) RULES.—The Commission shall approve a new rule, or rule amendment, of a registered entity unless the Commission finds that the new rule, or rule amendment, is inconsistent with this subtitle (including regulations).

“(B) CONTRACTS AND INSTRUMENTS.—The Commission shall approve a new contract or other instrument unless the Commission finds that the new contract or other instrument would violate this Act (including regulations).

“(C) SPECIAL RULE FOR REVIEW AND APPROVAL OF EVENT CONTRACTS AND SWAPS CONTRACTS.—

“(i) EVENT CONTRACTS.—In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i)), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve—

"(I) activity that is unlawful under any Federal or State law;

"(II) terrorism;

"(III) assassination;

"(IV) war;

"(V) gaming; or

"(VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

"(ii) PROHIBITION.—No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.

"(iii) SWAPS CONTRACTS.—

"(I) IN GENERAL.—In connection with the listing of a swap for clearing by a derivatives clearing organization, the Commission shall determine, upon request or on its own motion, the initial eligibility, or the continuing qualification, of a derivatives clearing organization to clear such a swap under those criteria, conditions, or rules that the Commission, in its discretion, determines.

"(II) REQUIREMENTS.—Any such criteria, conditions, or rules shall consider—

"(aa) the financial integrity of the derivatives clearing organization; and

"(bb) any other factors which the Commission determines may be appropriate.

"(iv) DEADLINE.—The Commission shall take final action under clauses (i) and (ii) in not later than 90 days from the commencement of its review unless the party seeking to offer the contract or swap agrees to an extension of this time limitation.".

(c) VIOLATION OF CORE PRINCIPLES.—Section 5c of the Commodity Exchange Act (7 U.S.C. 7a–2) is amended by striking subsection (d).

SEC. 746. INSIDER TRADING.

Section 4c(a) of the Commodity Exchange Act (7 U.S.C. 6c(a)) is amended by adding at the end the following:

"(3) CONTRACT OF SALE.—It shall be unlawful for any employee or agent of any department or agency of the Federal Government who, by virtue of the employment or position of the employee or agent, acquires information that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, and which information has not been disseminated by the department or agency of the Federal Government holding or creating the information in a manner which makes it generally available to the trading public, or disclosed in a criminal, civil, or administrative hearing, or in a congressional, administrative, or Government Accountability Office report, hearing, audit, or investigation, to use the information in his personal capacity and for personal gain to enter into, or offer to enter into—

"(A) a contract of sale of a commodity for future delivery (or option on such a contract);

"(B) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)); or

"(C) a swap.

"(4) NONPUBLIC INFORMATION.—

"(A) IMPARTING OF NONPUBLIC INFORMATION.—It shall be unlawful for any employee or agent of any department or agency of the Federal Government who, by virtue of the employment or position of the employee or agent, acquires information that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, and which information has not been disseminated by the department or agency of the Federal Government holding or creating the information in a manner which makes it generally available to the trading public, or disclosed in a criminal, civil, or administrative hearing, or in a congressional, administrative, or Government Accountability Office report, hearing, audit, or investigation, to impart the information in his personal capacity and for personal gain with intent to assist another person, directly or indirectly, to use the information to enter into, or offer to enter into—

"(i) a contract of sale of a commodity for future delivery (or option on such a contract);

"(ii) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)); or

"(iii) a swap.

"(B) KNOWING USE.—It shall be unlawful for any person who receives information imparted by any employee or agent of any department or agency of the Federal Government as described in subparagraph (A) to knowingly use such information to enter into, or offer to enter into—

"(i) a contract of sale of a commodity for future delivery (or option on such a contract);

"(ii) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)); or

"(iii) a swap.

"(C) THEFT OF NONPUBLIC INFORMATION.—It shall be unlawful for any person to steal, convert, or misappropriate, by any means whatsoever, information held or created by any department or agency of the Federal Government that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, where such person knows, or acts in reckless disregard of the fact, that such information has not been disseminated by the department or agency of the Federal Government holding or creating the information in a manner which makes it generally available to the trading public, or disclosed in a criminal, civil, or administrative hearing, or in a congressional, administrative, or Government Accountability Office report, hearing, audit, or investigation, and to use such information, or to impart such information with the intent to assist another person, directly or indirectly, to use such information to enter into, or offer to enter into—

"(i) a contract of sale of a commodity for future delivery (or option on such a contract);

"(ii) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(a)); or

"(iii) a swap, provided, however, that nothing in this subparagraph shall preclude a person that has provided information concerning, or generated by, the person, its operations or activities, to any employee or agent of any department or agency of the Federal Government, voluntarily or as required by law, from using such information to enter into, or offer to enter into, a contract of sale, option, or swap described in clauses (i), (ii), or (iii).".

SEC. 747. ANTIDISRUPTIVE PRACTICES AUTHORITY.

Section 4c(a) of the Commodity Exchange Act (7 U.S.C. 6c(a)) (as amended by section 746) is amended by adding at the end the following:

"(5) DISRUPTIVE PRACTICES.—It shall be unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that—

"(A) violates bids or offers;

"(B) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or

"(C) is, is of the character of, or is commonly known to the trade as, 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution).

"(6) RULEMAKING AUTHORITY.—The Commission may make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to prohibit the trading practices described in paragraph (5) and any other trading practice that is disruptive of fair and equitable trading.

"(7) USE OF SWAPS TO DEFRAUD.—It shall be unlawful for any person to enter into a swap knowing, or acting in reckless disregard of the fact, that its counterparty will use the swap as part of a device, scheme, or artifice to defraud any third party.".

SEC. 748. COMMODITY WHISTLEBLOWER INCENTIVES AND PROTECTION.

The Commodity Exchange Act (7 U.S.C. 1 et seq.) is amended by adding at the end the following:

"SEC. 23. COMMODITY WHISTLEBLOWER INCENTIVES AND PROTECTION.

"(a) DEFINITIONS.—In this section:

"(1) COVERED JUDICIAL OR ADMINISTRATIVE ACTION.—The term 'covered judicial or administrative action' means any judicial or administrative action brought by the Commission under this Act that results in monetary sanctions exceeding $1,000,000.

"(2) FUND.—The term 'Fund' means the Commodity Futures Trading Commission Customer Protection Fund established under subsection (g).

"(3) MONETARY SANCTIONS.—The term 'monetary sanctions', when used with respect to any judicial or administrative action means—

"(A) any monies, including penalties, disgorgement, restitution, and interest ordered to be paid; and

"(B) any monies deposited into a disgorgement fund or other fund pursuant to section 308(b) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246(b)), as a result of such action or any settlement of such action.

"(4) ORIGINAL INFORMATION.—The term 'original information' means information that—

"(A) is derived from the independent knowledge or analysis of a whistleblower;

"(B) is not known to the Commission from any other source, unless the whistleblower is the original source of the information; and

"(C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information.

"(5) RELATED ACTION.—The term 'related action', when used with respect to any judicial or administrative action brought by the Commission under this Act, means any judicial or administrative action brought by an entity described in subclauses (I) through (VI) of subsection (h)(2)(C) that is based upon the original information provided by a whistleblower pursuant to subsection (a) that led to the successful enforcement of the Commission action.

"(6) SUCCESSFUL RESOLUTION.—The term 'successful resolution', when used with respect to any judicial or administrative action brought by the Commission under this Act, includes any settlement of such action.

"(7) WHISTLEBLOWER.—The term 'whistleblower' means any individual, or 2 or more individuals acting jointly, who provides information relating to a violation of this Act to the Commission, in a manner established by rule or regulation by the Commission.

"(b) AWARDS.—

"(1) IN GENERAL.—In any covered judicial or administrative action, or related action, the Commission, under regulations prescribed by the Commission and subject to subsection (c), shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action, in an aggregate amount equal to—

"(A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions; and

"(B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions.

"(2) PAYMENT OF AWARDS.—Any amount paid under paragraph (1) shall be paid from the Fund.

"(c) DETERMINATION OF AMOUNT OF AWARD; DENIAL OF AWARD.—

"(1) DETERMINATION OF AMOUNT OF AWARD.—

"(A) DISCRETION.—The determination of the amount of an award made under subsection (b) shall be in the discretion of the Commission.

"(B) CRITERIA.—In determining the amount of an award made under subsection (b), the Commission—

"(i) shall take into consideration—

"(I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action;

"(II) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action;

"(III) the programmatic interest of the Commission in deterring violations of the Act (including regulations under the Act) by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws; and

"(IV) such additional relevant factors as the Commission may establish by rule or regulation; and

"(ii) shall not take into consideration the balance of the Fund.

"(2) DENIAL OF AWARD.—No award under subsection (b) shall be made—

"(A) to any whistleblower who is, or was at the time the whistleblower acquired the original information submitted to the Commission, a member, officer, or employee of—

"(i) a appropriate regulatory agency;

"(ii) the Department of Justice;

"(iii) a registered entity;

"(iv) a registered futures association;

"(v) a self-regulatory organization as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)); or

"(vi) a law enforcement organization;

"(B) to any whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award under this section;

"(C) to any whistleblower who submits information to the Commission that is based on the facts underlying the covered action submitted previously by another whistleblower;

"(D) to any whistleblower who fails to submit information to the Commission in such form as the Commission may, by rule or regulation, require.

"(d) REPRESENTATION.—

"(1) PERMITTED REPRESENTATION.—Any whistleblower who makes a claim for an award under subsection (b) may be represented by counsel.

"(2) REQUIRED REPRESENTATION.—

"(A) IN GENERAL.—Any whistleblower who anonymously makes a claim for an award under subsection (b) shall be represented by counsel if the whistleblower submits the information upon which the claim is based.

"(B) DISCLOSURE OF IDENTITY.—Prior to the payment of an award, a whistleblower shall disclose the identity of the whistleblower and provide such other information as the Commission may require, directly or through counsel for the whistleblower.

"(e) NO CONTRACT NECESSARY.—No contract with the Commission is necessary for any whistleblower to receive an award under subsection (b), unless otherwise required by the Commission, by rule or regulation.

"(f) APPEALS.—

"(1) IN GENERAL.—Any determination made under this section, including whether, to whom, or in what amount to make awards, shall be in the discretion of the Commission.

"(2) APPEALS.—Any determination described in paragraph (1) may be appealed to the appropriate court of appeals of the United States not more than 30 days after the determination is issued by the Commission.

"(3) REVIEW.—The court shall review the determination made by the Commission in accordance with section 7064 of title 5, United States Code.

"(g) COMMODITY FUTURES TRADING COMMISSION CUSTOMER PROTECTION FUND.—

"(1) ESTABLISHMENT.—There is established in the Treasury of the United States a revolving fund to be known as the 'Commodity Futures Trading Commission Customer Protection Fund'.

"(2) USE OF FUND.—The Fund shall be available to the Commission, without further appropriation or fiscal year limitation, for—

"(A) the payment of awards to whistleblowers as provided in subsection (a); and

"(B) the funding of customer education initiatives designed to help customers protect themselves against fraud or other violations of this Act, or the rules and regulations thereunder.

"(3) DEPOSITS AND CREDITS.—There shall be deposited into or credited to the Fund:

"(A) MONETARY SANCTIONS.—Any monetary sanctions collected by the Commission in any covered judicial or administrative action that is not otherwise distributed to victims of a violation of this Act or the rules and regulations thereunder underlying such action, unless the balance of the Fund at the time the monetary judgment is collected exceeds $100,000,000.

"(B) ADDITIONAL AMOUNTS.—If the amounts deposited into or credited to the Fund under subparagraph (A) are not sufficient to satisfy an award made under subsection (b), there shall be deposited into or credited to the Fund an amount equal to the unsatisfied portion of the award from any monetary sanction collected by the Commission in any judicial or administrative action brought by the Commission under this Act that is based on information provided by a whistleblower.

"(C) INVESTMENT INCOME.—All income from investments made under paragraph (4).

"(4) INVESTMENTS.—

"(A) AMOUNTS IN FUND MAY BE INVESTED.—The Commission may request the Secretary of the Treasury to invest the portion of the Fund that is not, in the Commission's judgment, required to meet the current needs of the Fund.

"(B) ELIGIBLE INVESTMENTS.—Investments shall be made by the Secretary of the Treasury in obligations of the United States or obligations that are guaranteed as to principal and interest by the United States, with maturities suitable to the needs of the Fund as determined by the Commission.

"(C) INTEREST AND PROCEEDS CREDITED.—The interest on, and the proceeds from the sale or redemption of, any obligations held in the Fund shall be credited to, and form a part of, the Fund.

"(5) REPORTS TO CONGRESS.—Not later than October 30 of each year, the Commission shall transmit to the Committee on Agriculture, Nutrition, and Forestry of the Senate, and the Committee on Agriculture of the House of Representatives a report on—

"(A) the Commission's whistleblower award program under this section, including a description of the number of awards granted and the types of cases in which awards were granted during the preceding fiscal year;

"(B) customer education initiatives described in paragraph (2)(B) that were funded by the Fund during the preceding fiscal year;

"(C) the balance of the Fund at the beginning of the preceding fiscal year;

"(D) the amounts deposited into or credited to the Fund during the preceding fiscal year;

"(E) the amount of earnings on investments of amounts in the Fund during the preceding fiscal year;

"(F) the amount paid from the Fund during the preceding fiscal year to whistleblowers pursuant to subsection (b);

"(G) the amount paid from the Fund during the preceding fiscal year for customer education initiatives described in paragraph (2)(B);

"(H) the balance of the Fund at the end of the preceding fiscal year; and

"(I) a complete set of audited financial statements, including a balance sheet, income statement, and cash flow analysis.

"(h) PROTECTION OF WHISTLEBLOWERS.—

"(1) PROHIBITION AGAINST RETALIATION.—

"(A) IN GENERAL.—No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower—

"(i) in providing information to the Commission in accordance with subsection (b); or

"(ii) in assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information.

"(B) ENFORCEMENT.—

"(i) CAUSE OF ACTION.—An individual who alleges discharge or other discrimination in violation of subparagraph (A) may bring an action under this subsection in the appropriate district court of the United States for the relief provided in subparagraph (C), unless the individual who is alleging discharge or other discrimination in violation of subparagraph (A) is an employee of the Federal Government, in which case the individual shall only bring an action under section 1221 of title 5, United States Code.

"(ii) SUBPOENAS.—A subpoena requiring the attendance of a witness at a trial or hearing conducted under this subsection may be served at any place in the United States.

"(iii) STATUTE OF LIMITATIONS.—An action under this subsection may not be brought more than 2 years after the date on which the violation reported in subparagraph (A) is committed.

"(C) RELIEF.—Relief for an individual prevailing in an action brought under subparagraph (B) shall include—

"(i) reinstatement with the same seniority status that the individual would have had, but for the discrimination;

"(ii) the amount of back pay otherwise owed to the individual, with interest; and

"(iii) compensation for any special damages sustained as a result of the discharge or discrimination, including litigation costs, expert witness fees, and reasonable attorney's fees.

"(2) CONFIDENTIALITY.—

"(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), the Commission, and any officer or employee of the Commission, shall not disclose any information, including information provided by a whistleblower to the Commission, which could reasonably be expected to reveal the identity of a whistleblower, except in accordance with the provisions of section 552a of title 5, United States Code, unless and until required to be disclosed to a defendant or respondent in connection with a public proceeding instituted by the Commission or any entity described in subparagraph (C). For purposes of section 552 of title 5, United States Code, this paragraph shall be considered a statute described in subsection (b)(3)(B) of such section 552.

"(B) EFFECT.—Nothing in this paragraph is intended to limit the ability of the Attorney General to present such evidence to a grand jury or to share such evidence with potential witnesses or defendants in the course of an ongoing criminal investigation.

"(C) AVAILABILITY TO GOVERNMENT AGENCIES.—

"(i) IN GENERAL.—Without the loss of its status as confidential in the hands of the Commission, all information referred to in subparagraph (A) may, in the discretion of the Commission, when determined by the Commission to be necessary or appropriate to accomplish the purposes of this Act and protect customers and in accordance with clause (ii), be made available to—

"(I) the Department of Justice;

"(II) an appropriate department or agency of the Federal Government, acting within the scope of its jurisdiction;

"(III) a registered entity, registered futures association, or self-regulatory organization as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a));

"(IV) a State attorney general in connection with any criminal investigation;

"(V) an appropriate department or agency of any State, acting within the scope of its jurisdiction; and

"(VI) a foreign futures authority.

"(ii) MAINTENANCE OF INFORMATION.—Each of the entities, agencies, or persons described in clause (i) shall maintain information described in that clause as confidential, in accordance with the requirements in subparagraph (A).

"(iii) STUDY ON IMPACT OF FOIA EXEMPTION ON COMMODITY FUTURES TRADING COMMISSION.—

"(I) STUDY.—The Inspector General of the Commission shall conduct a study—

"(aa) on whether the exemption under section 552(b)(3) of title 5, United States Code (known as the Freedom of Information Act) established in paragraph (2)(A) aids whistleblowers in disclosing information to the Commission;

"(bb) on what impact the exemption has had on the public's ability to access information about the Commission's regulation of commodity futures and option markets; and

"(cc) to make any recommendations on whether the Commission should continue to use the exemption.

"(II) REPORT.—Not later than 30 months after the date of enactment of this clause, the Inspector General shall—

"(aa) submit a report on the findings of the study required under this clause to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on

Financial Services of the House of Representatives; and

"(bb) make the report available to the public through publication of a report on the website of the Commission.

"(3) RIGHTS RETAINED.—Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any whistleblower under any Federal or State law, or under any collective bargaining agreement.

"(i) RULEMAKING AUTHORITY.—The Commission shall have the authority to issue such rules and regulations as may be necessary or appropriate to implement the provisions of this section consistent with the purposes of this section.

"(j) IMPLEMENTING RULES.—The Commission shall issue final rules or regulations implementing the provisions of this section not later than 270 days after the date of enactment of the Wall Street Transparency and Accountability Act of 2010.

"(k) ORIGINAL INFORMATION.—Information submitted to the Commission by a whistleblower in accordance with rules or regulations implementing this section shall not lose its status as original information solely because the whistleblower submitted such information prior to the effective date of such rules or regulations, provided such information was submitted after the date of enactment of the Wall Street Transparency and Accountability Act of 2010.

"(l) AWARDS.—A whistleblower may receive an award pursuant to this section regardless of whether any violation of a provision of this Act, or a rule or regulation thereunder, underlying the judicial or administrative action upon which the award is based occurred prior to the date of enactment of the Wall Street Transparency and Accountability Act of 2010.

"(m) PROVISION OF FALSE INFORMATION.—A whistleblower who knowingly and willfully makes any false, fictitious, or fraudulent statement or representation, or who makes or uses any false writing or document knowing the same to contain any false, fictitious, or fraudulent statement or entry, shall not be entitled to an award under this section and shall be subject to prosecution under section 1001 of title 18, United States Code.

"(n) NONENFORCEABILITY OF CERTAIN PROVISIONS WAIVING RIGHTS AND REMEDIES OR REQUIRING ARBITRATION OF DISPUTES.—

"(1) WAIVER OF RIGHTS AND REMEDIES.—The rights and remedies provided for in this section may not be waived by any agreement, policy form, or condition of employment including by a predispute arbitration agreement.

"(2) PREDISPUTE ARBITRATION AGREEMENTS.—No predispute arbitration agreement shall be valid or enforceable, if the agreement requires arbitration of a dispute arising under this section.".

SEC. 749. CONFORMING AMENDMENTS.

(a) Section 4d of the Commodity Exchange Act (7 U.S.C. 6d) (as amended by section 724) is amended—

(1) in subsection (a)—

(A) in the matter preceding paragraph (1)—

(i) by striking "engage as" and inserting "be a"; and

(ii) by striking "or introducing broker" and all that follows through "or derivatives transaction execution facility";

(B) in paragraph (1), by striking "or introducing broker"; and

(C) in paragraph (2), by striking "if a futures commission merchant,"; and

(2) by adding at the end the following:

"(g) It shall be unlawful for any person to be an introducing broker unless such person shall have registered under this Act with the Commission as an introducing broker and such registration shall not have expired nor been suspended nor revoked.".

(b) Section 4m(3) of the Commodity Exchange Act (7 U.S.C. 6m(3)) is amended—

(1) by striking "(3) Subsection (1) of this section" and inserting the following:

"(3) EXCEPTION.—

"(A) IN GENERAL.—Paragraph (1)"; and

(2) by striking "to any investment trust" and all that follows through the period at the end and inserting the following: "to any commodity pool that is engaged primarily in trading commodity interests.

"(B) ENGAGED PRIMARILY.—For purposes of subparagraph (A), a commodity trading advisor or a commodity pool shall be considered to be 'engaged primarily' in the business of being a commodity trading advisor or commodity pool if it is or holds itself out to the public as being engaged primarily, or proposes to engage primarily, in the business of advising on commodity interests or investing, reinvesting, owning, holding, or trading in commodity interests, respectively.

"(C) COMMODITY INTERESTS.—For purposes of this paragraph, commodity interests shall include contracts of sale of a commodity for future delivery, options on such contracts, security futures, swaps, leverage contracts, foreign exchange, spot and forward contracts on physical commodities, and any monies held in an account used for trading commodity interests.".

(c) Section 5c of the Commodity Exchange Act (7 U.S.C. 7a–2) is amended—

(1) in subsection (a)(1)—

(A) by striking ", 5a(d),"; and

(B) by striking "and section (2)(h)(7) with respect to significant price discovery contracts,"; and

(2) in subsection (f)(1), by striking "section 4d(c) of this Act" and inserting "section 4d(e)".

(d) Section 5e of the Commodity Exchange Act (7 U.S.C. 7b) is amended by striking "or revocation of the right of an electronic trading facility to rely on the exemption set forth in section 2(h)(3) with respect to a significant price discovery contract,".

(e) Section 6(b) of the Commodity Exchange Act (7 U.S.C. 8(b)) is amended in the first sentence by striking ", or to revoke the right of an electronic trading facility to rely on the exemption set forth in section 2(h)(3) with respect to a significant price discovery contract,".

(f) Section 12(e)(2)(B) of the Commodity Exchange Act (7 U.S.C. 16(e)(2)(B)) is amended—

(1) by striking "section 2(c), 2(d), 2(f), or 2(g) of this Act" and inserting "section 2(c) or 2(f) of this Act"; and

(2) by striking "2(h) or".

(g) Section 17(r)(1) of the Commodity Exchange Act (7 U.S.C. 21(r)(1)) is amended by striking "section 4d(c) of this Act" and inserting "section 4d(e)".

(h) Section 22 of the Commodity Exchange Act is amended—

(1) in subsection (a)(1)(B), by—

(A) inserting "or any swap" after "commodity)"; and

(B) inserting "or any swap" after "such contract";

(2) in subsection (a)(1)(C), by adding at the end the following:

"(iv) a swap; or"; and

(3) in subsection (b)(1)(A), by striking "section 2(h)(7) or sections 5 through 5c" and inserting "section 5, 5b, 5c, 5h, or 21".

(i) Section 408(2)(C) of the Federal Deposit Insurance Corporation Improvement Act of 1991 (12 U.S.C. 4421(2)(C)) is amended—

(1) by striking "section 2(c), 2(d), 2(f), or (2)(g) of such Act" and inserting "section 2(c), 2(f), or 2(i) of that Act"; and

(2) by striking "2(h) or".

SEC. 750. STUDY ON OVERSIGHT OF CARBON MARKETS.

(a) INTERAGENCY WORKING GROUP.—There is established to carry out this section an interagency working group (referred to in this section as the "interagency group") composed of the following members or designees:

(1) The Chairman of the Commodity Futures Trading Commission (referred to in this section as the "Commission"), who shall serve as Chairman of the interagency group.

(2) The Secretary of Agriculture.

(3) The Secretary of the Treasury.

(4) The Chairman of the Securities and Exchange Commission.

(5) The Administrator of the Environmental Protection Agency.

(6) The Chairman of the Federal Energy Regulatory Commission.

(7) The Commissioner of the Federal Trade Commission.

(8) The Administrator of the Energy Information Administration.

(b) ADMINISTRATIVE SUPPORT.—The Commission shall provide the interagency group such administrative support services as are necessary to enable the interagency group to carry out the functions of the interagency group under this section.

(c) CONSULTATION.—In carrying out this section, the interagency group shall consult with representatives of exchanges, clearinghouses, self-regulatory bodies, major carbon market participants, consumers, and the general public, as the interagency group determines to be appropriate.

(d) STUDY.—The interagency group shall conduct a study on the oversight of existing and prospective carbon markets to ensure an efficient, secure, and transparent carbon market, including oversight of spot markets and derivative markets.

(e) REPORT.—Not later than 180 days after the date of enactment of this Act, the interagency group shall submit to Congress a report on the results of the study conducted under subsection (b), including recommendations for the oversight of existing and prospective carbon markets to ensure an efficient, secure, and transparent carbon market, including oversight of spot markets and derivative markets.

SEC. 751. ENERGY AND ENVIRONMENTAL MARKETS ADVISORY COMMITTEE.

Section 2(a) of the Commodity Exchange Act (7 U.S.C. 2(a)) (as amended by section 727) is amended by adding at the end the following:

"(15) ENERGY AND ENVIRONMENTAL MARKETS ADVISORY COMMITTEE.—

"(A) ESTABLISHMENT.—

"(i) IN GENERAL.—An Energy and Environmental Markets Advisory Committee is hereby established.

"(ii) MEMBERSHIP.—The Committee shall have 9 members.

"(iii) ACTIVITIES.—The Committee's objectives and scope of activities shall be—

"(I) to conduct public meetings;

"(II) to submit reports and recommendations to the Commission (including dissenting or minority views, if any); and

"(III) otherwise to serve as a vehicle for discussion and communication on matters of concern to exchanges, firms, end users, and regulators regarding energy and environmental markets and their regulation by the Commission.

"(B) REQUIREMENTS.—

"(i) IN GENERAL.—The Committee shall hold public meetings at such intervals as are necessary to carry out the functions of the Committee, but not less frequently than 2 times per year.

"(ii) MEMBERS.—Members shall be appointed to 3-year terms, but may be removed for cause by vote of the Commission.

"(C) APPOINTMENT.—The Commission shall appoint members with a wide diversity of opinion and who represent a broad spectrum of interests, including hedgers and consumers.

"(D) REIMBURSEMENT.—Members shall be entitled to per diem and travel expense reimbursement by the Commission.

"(E) FACA.—The Committee shall not be subject to the Federal Advisory Committee Act (5 U.S.C. App.).".

SEC. 752. INTERNATIONAL HARMONIZATION.

(a) In order to promote effective and consistent global regulation of swaps and security-based swaps, the Commodity Futures Trading Commission, the Securities and Exchange Commission, and the prudential regulators (as that term is defined in section 1a(39) of the Commodity Exchange Act), as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps, security-based swaps, swap entities, and security-based swap entities and may agree to such information-sharing arrangements as may be deemed to be necessary or appropriate in the public interest or for the protection of investors, swap counterparties, and security-based swap counterparties.

(b) In order to promote effective and consistent global regulation of contracts of sale of a commodity for future delivery and options on such contracts, the Commodity Futures Trading Commission shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of contracts of sale of a commodity for future delivery and options on such contracts, and may agree to such information-sharing arrangements as may be deemed necessary or appropriate in the public interest for the protection of users of contracts of sale of a commodity for future delivery.

SEC. 753. ANTI-MANIPULATION AUTHORITY.

(a) PROHIBITION REGARDING MANIPULATION AND FALSE INFORMATION.—Subsection (c) of section 6 of the Commodity Exchange Act (7 U.S.C. 9, 15) is amended to read as follows:

"(c) PROHIBITION REGARDING MANIPULATION AND FALSE INFORMATION.—

"(1) PROHIBITION AGAINST MANIPULATION.—It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate by not later than 1 year after the date of enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, provided no rule or regulation promulgated by the Commission shall require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect.

"(A) SPECIAL PROVISION FOR MANIPULATION BY FALSE REPORTING.—Unlawful manipulation for purposes of this paragraph shall include, but not be limited to, delivering, or causing to be delivered for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate.

"(B) EFFECT ON OTHER LAW.—Nothing in this paragraph shall affect, or be construed to affect, the applicability of section 9(a)(2).

"(C) GOOD FAITH MISTAKES.—Mistakenly transmitting, in good faith, false or misleading or inaccurate information to a price reporting service would not be sufficient to violate subsection (c)(1)(A).

"(2) PROHIBITION REGARDING FALSE INFORMATION.—It shall be unlawful for any person to make any false or misleading statement of a material fact to the Commission, including in any registration application or any report filed with the

Commission under this Act, or any other information relating to a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or to omit to state in any such statement any material fact that is necessary to make any statement of a material fact made not misleading in any material respect, if the person knew, or reasonably should have known, the statement to be false or misleading.

"(3) OTHER MANIPULATION.—In addition to the prohibition in paragraph (1), it shall be unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity.

"(4) ENFORCEMENT.—

"(A) AUTHORITY OF COMMISSION.—If the Commission has reason to believe that any person (other than a registered entity) is violating or has violated this subsection, or any other provision of this Act (including any rule, regulation, or order of the Commission promulgated in accordance with this subsection or any other provision of this Act), the Commission may serve upon the person a complaint.

"(B) CONTENTS OF COMPLAINT.—A complaint under subparagraph (A) shall—

"(i) contain a description of the charges against the person that is the subject of the complaint; and

"(ii) have attached or contain a notice of hearing that specifies the date and location of the hearing regarding the complaint.

"(C) HEARING.—A hearing described in subparagraph (B)(ii)—

"(i) shall be held not later than 3 days after service of the complaint described in subparagraph (A);

"(ii) shall require the person to show cause regarding why—

"(I) an order should not be made—

"(aa) to prohibit the person from trading on, or subject to the rules of, any registered entity; and

"(bb) to direct all registered entities to refuse all privileges to the person until further notice of the Commission; and

"(II) the registration of the person, if registered with the Commission in any capacity, should not be suspended or revoked; and

"(iii) may be held before—

"(I) the Commission; or

"(II) an administrative law judge designated by the Commission, under which the administrative law judge shall ensure that all evidence is recorded in written form and submitted to the Commission.

"(5) SUBPOENA.—For the purpose of securing effective enforcement of the provisions of this Act, for the purpose of any investigation or proceeding under this Act, and for the purpose of any action taken under section 12(f), any member of the Commission or any Administrative Law Judge or other officer designated by the Commission (except as provided in paragraph (7)) may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records that the Commission deems relevant or material to the inquiry.

"(6) WITNESSES.—The attendance of witnesses and the production of any such records may be required from any place in the United States, any State, or any foreign country or jurisdiction at any designated place of hearing.

"(7) SERVICE.—A subpoena issued under this section may be served upon any person who is not to be found within the territorial jurisdiction of any court of the United States in such manner as the Federal Rules of Civil Procedure prescribe for service of process in a foreign country, except that a subpoena to be served on a person who is not to be found within the territorial jurisdiction of any court of the United States may be issued only on the prior approval of the Commission.

"(8) REFUSAL TO OBEY.—In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction in which the investigation or proceeding is conducted, or where such person resides or transacts business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. Such court may issue an order requiring such person to appear before the Commission or member or Administrative Law Judge or other officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question.

"(9) FAILURE TO OBEY.—Any failure to obey such order of the court may be punished by the court as a contempt thereof. All process in any such case may be served in the judicial district wherein such person is an inhabitant or transacts business or wherever such person may be found.

"(10) EVIDENCE.—On the receipt of evidence under paragraph (4)(C)(iii), the Commission may—

"(A) prohibit the person that is the subject of the hearing from trading on, or subject to the rules of, any registered entity and require all registered entities to refuse the person all privileges on the registered entities for such period as the Commission may require in the order;

"(B) if the person is registered with the Commission in any capacity, suspend, for a period not to exceed 180 days, or revoke, the registration of the person;

"(C) assess such person—

"(i) a civil penalty of not more than an amount equal to the greater of—

"(I) $140,000; or

"(II) triple the monetary gain to such person for each such violation; or

"(ii) in any case of manipulation or attempted manipulation in violation of this subsection or section

9(a)(2), a civil penalty of not more than an amount equal to the greater of—

"(I) $1,000,000; or

"(II) triple the monetary gain to the person for each such violation; and

"(D) require restitution to customers of damages proximately caused by violations of the person.

"(11) ORDERS.—

"(A) NOTICE.—The Commission shall provide to a person described in paragraph (10) and the appropriate governing board of the registered entity notice of the order described in paragraph (10) by—

"(i) registered mail;

"(ii) certified mail; or

"(iii) personal delivery.

"(B) REVIEW.—

"(i) IN GENERAL.—A person described in paragraph (10) may obtain a review of the order or such other equitable relief as determined to be appropriate by a court described in clause (ii).

"(ii) PETITION.—To obtain a review or other relief under clause (i), a person may, not later than 15 days after notice is given to the person under clause (i), file a written petition to set aside the order with the United States Court of Appeals—

"(I) for the circuit in which the petitioner carries out the business of the petitioner; or

"(II) in the case of an order denying registration, the circuit in which the principal place of business of the petitioner is located, as listed on the application for registration of the petitioner.

"(C) PROCEDURE.—

"(i) DUTY OF CLERK OF APPROPRIATE COURT.—The clerk of the appropriate court under subparagraph (B)(ii) shall transmit to the Commission a copy of a petition filed under subparagraph (B)(ii).

"(ii) DUTY OF COMMISSION.—In accordance with section 2112 of title 28, United States Code, the Commission shall file in the appropriate court described in subparagraph (B)(ii) the record theretofore made.

"(iii) JURISDICTION OF APPROPRIATE COURT.—Upon the filing of a petition under subparagraph (B)(ii), the appropriate court described in subparagraph (B)(ii) may affirm, set aside, or modify the order of the Commission.".

(b) CEASE AND DESIST ORDERS, FINES.—Section 6(d) of the Commodity Exchange Act (7 U.S.C. 13b) is amended to read as follows:

"(d) If any person (other than a registered entity), is violating or has violated subsection (c) or any other provisions of this Act or of the rules, regulations, or orders of the Commission thereunder, the Commission may, upon notice and hearing, and subject to appeal as in other cases provided for in subsection (c), make and enter an order directing that such person shall cease and desist therefrom and, if such person thereafter and after the lapse of the period allowed for appeal of such order or after the affirmance of such order, shall knowingly fail or refuse to obey or comply with such order, such person, upon conviction thereof, shall be fined not more than the higher of $140,000 or triple the monetary gain to such person, or imprisoned for not more than 1 year, or both, except that if such knowing failure or refusal to obey or comply with such order involves any offense within subsection (a) or (b) of section 9, such person, upon conviction thereof, shall be subject to the penalties of said subsection (a) or (b): *Provided*, That any such cease and desist order under this subsection against any respondent in any case of manipulation shall be issued only in conjunction with an order issued against such respondent under subsection (c).".

(c) MANIPULATIONS; PRIVATE RIGHTS OF ACTION.—Section 22(a)(1) of the Commodity Exchange Act (7 U.S.C. 25(a)(1)) is amended by striking subparagraph (D) and inserting the following:

"(D) who purchased or sold a contract referred to in subparagraph (B) hereof or swap if the violation constitutes—

"(i) the use or employment of, or an attempt to use or employ, in connection with a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative device or contrivance in contravention of such rules and regulations as the Commission shall promulgate by not later than 1 year after the date of enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act; or

"(ii) a manipulation of the price of any such contract or swap or the price of the commodity underlying such contract or swap.".

(d) EFFECTIVE DATE.—

(1) The amendments made by this section shall take effect on the date on which the final rule promulgated by the Commodity Futures Trading Commission pursuant to this Act takes effect.

(2) Paragraph (1) shall not preclude the Commission from undertaking prior to the effective date any rulemaking necessary to implement the amendments contained in this section.

SEC. 754. EFFECTIVE DATE.

Unless otherwise provided in this title, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle.

Subtitle B—Regulation of Security-Based Swap Markets

SEC. 761. DEFINITIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934.

(a) DEFINITIONS.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended—

(1) in subparagraphs (A) and (B) of paragraph (5), by inserting "(not including security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants)" after "securities" each place that term appears;

(2) in paragraph (10), by inserting "security-based swap," after "security future,";

(3) in paragraph (13), by adding at the end the following: "For security-based swaps, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require.";

(4) in paragraph (14), by adding at the end the following: "For security-based swaps, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require.";

(5) in paragraph (39)—

(A) in subparagraph (B)(i)—

(i) in subclause (I), by striking "or government securities dealer" and inserting "government securities dealer, security-based swap dealer, or major security-based swap participant"; and

(ii) in subclause (II), by inserting "security-based swap dealer, major security-based swap participant," after "government securities dealer,";

(B) in subparagraph (C), by striking "or government securities dealer" and inserting "government securities dealer, security-based swap dealer, or major security-based swap participant"; and

(C) in subparagraph (D), by inserting "security-based swap dealer, major security-based swap participant," after "government securities dealer,"; and

(6) by adding at the end the following:

"(65) ELIGIBLE CONTRACT PARTICIPANT.—The term 'eligible contract participant' has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

"(66) MAJOR SWAP PARTICIPANT.—The term 'major swap participant' has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

"(67) MAJOR SECURITY-BASED SWAP PARTICIPANT.—

"(A) IN GENERAL.—The term 'major security-based swap participant' means any person—

"(i) who is not a security-based swap dealer; and

"(ii)(I) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;

"(II) whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or

"(III) that is a financial entity that—

"(aa) is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and

"(bb) maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission.

"(B) DEFINITION OF SUBSTANTIAL POSITION.—For purposes of subparagraph (A), the Commission shall define, by rule or regulation, the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person's relative position in uncleared as opposed to cleared security-based swaps and may take into consideration the value and quality of collateral held against counterparty exposures.

"(C) SCOPE OF DESIGNATION.—For purposes of subparagraph (A), a person may be designated as a major security-based swap participant for 1 or more categories of security-based swaps without being classified as a major security-based swap participant for all classes of security-based swaps.

"(68) SECURITY-BASED SWAP.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'security-based swap' means any agreement, contract, or transaction that—

"(i) is a swap, as that term is defined under section 1a of the Commodity Exchange Act (without regard to paragraph (47)(B)(x) of such section); and

"(ii) is based on—

"(I) an index that is a narrow-based security index, including any interest therein or on the value thereof;

"(II) a single security or loan, including any interest therein or on the value thereof; or

"(III) the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.

"(B) RULE OF CONSTRUCTION REGARDING MASTER AGREEMENTS.—The term 'security-based swap' shall be construed to include a master agreement that provides for an agreement, contract, or transaction that is a security-based swap pursuant to subparagraph (A), together with all supplements to any such master agreement, without regard to whether the master agreement contains an agreement, contract, or transaction that is not a security-based swap pursuant to subparagraph (A), except that the master agreement shall be considered to be a security-based swap only with respect to each agreement, contract, or transaction under the master agreement that is a security-based swap pursuant to subparagraph (A).

"(C) EXCLUSIONS.—The term 'security-based swap' does not include any agreement, contract, or transaction that meets the definition of a security-based swap only because such agreement, contract, or transaction references, is based upon, or settles through the transfer, delivery, or receipt of an exempted security under paragraph (12), as in effect on the date of enactment of the Futures Trading Act of 1982 (other than any municipal security as defined in paragraph (29) as in effect on the date of enactment of the Futures Trading Act of 1982), unless such agreement, contract, or transaction is of the character of, or is commonly known in the trade as, a put, call, or other option.

"(D) MIXED SWAP.—The term 'security-based swap' includes any agreement, contract, or transaction that is as described in subparagraph (A) and also is based on the value of 1 or more interest or other rates, currencies, commodities, instruments of indebtedness, indices, quantitative measures, other financial or economic interest or property of any kind (other than a single security or a narrow-based security index), or the occurrence, non-occurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence (other than an event described in subparagraph (A)(ii)(III)).

"(E) RULE OF CONSTRUCTION REGARDING USE OF THE TERM INDEX.—The term 'index' means an index or group of securities, including any interest therein or based on the value thereof.

"(69) SWAP.—The term 'swap' has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

"(70) PERSON ASSOCIATED WITH A SECURITY-BASED SWAP DEALER OR MAJOR SECURITY-BASED SWAP PARTICIPANT.—

"(A) IN GENERAL.—The term 'person associated with a security-based swap dealer or major security-based swap participant' or 'associated person of a security-based swap dealer or major security-based swap participant' means—

"(i) any partner, officer, director, or branch manager of such security-based swap dealer or major security-based swap participant (or any person occupying a similar status or performing similar functions);

"(ii) any person directly or indirectly controlling, controlled by, or under common control with such security-based swap dealer or major security-based swap participant; or

"(iii) any employee of such security-based swap dealer or major security-based swap participant.

"(B) EXCLUSION.—Other than for purposes of section 15F(l)(2), the term 'person associated with a security-based swap dealer or major security-based swap participant' or 'associated person of a security-based swap dealer or major security-based swap participant' does not include any person associated with a security-based swap dealer or major security-based swap participant whose functions are solely clerical or ministerial.

"(71) SECURITY-BASED SWAP DEALER.—

"(A) IN GENERAL.—The term 'security-based swap dealer' means any person who—

"(i) holds themself out as a dealer in security-based swaps;

"(ii) makes a market in security-based swaps;

"(iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or

"(iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps.

"(B) DESIGNATION BY TYPE OR CLASS.—A person may be designated as a security-based swap dealer for a single type or single class or category of security-based swap or activities and considered not to be a security-based swap dealer for other types, classes, or categories of security-based swaps or activities.

"(C) EXCEPTION.—The term 'security-based swap dealer' does not include a person that enters into security-based swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

"(D) DE MINIMIS EXCEPTION.—The Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimis quantity of security-based swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of any determination to exempt.

"(72) APPROPRIATE FEDERAL BANKING AGENCY.—The term 'appropriate Federal banking agency' has the same meaning as in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

"(73) BOARD.—The term 'Board' means the Board of Governors of the Federal Reserve System.

"(74) PRUDENTIAL REGULATOR.—The term 'prudential regulator' has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

"(75) SECURITY-BASED SWAP DATA REPOSITORY.—The term 'security-based swap data repository' means any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps.

"(76) SWAP DEALER.—The term 'swap dealer' has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

"(77) SECURITY-BASED SWAP EXECUTION FACILITY.—The term 'security-based swap execution facility' means a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—

"(A) facilitates the execution of security-based swaps between persons; and

"(B) is not a national securities exchange.

"(78) SECURITY-BASED SWAP AGREEMENT.—

"(A) IN GENERAL.—For purposes of sections 9, 10, 16, 20, and 21A of this Act, and section 17 of the Securities Act of 1933 (15 U.S.C. 77q), the term 'security-based swap agreement' means a swap agreement as defined in section 206A of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note) of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

"(B) EXCLUSIONS.—The term 'security-based swap agreement' does not include any security-based swap.".

(b) AUTHORITY TO FURTHER DEFINE TERMS.—The Securities and Exchange Commission may, by rule, further define—

(1) the term "commercial risk";

(2) any other term included in an amendment to the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) made by this subtitle; and

(3) the terms "security-based swap", "security-based swap dealer", "major security-based swap participant", and "eligible contract participant", with regard to security-based swaps (as such terms are defined in the amendments made by subsection (a)) for the purpose of including transactions and entities that have been structured to evade this subtitle or the amendments made by this subtitle.

SEC. 762. REPEAL OF PROHIBITION ON REGULATION OF SECURITY-BASED SWAP AGREEMENTS.

(a) REPEAL.—Sections 206B and 206C of the Gramm-Leach-Bliley Act (Public Law 106–102; 15 U.S.C. 78c note) are repealed.

(b) CONFORMING AMENDMENTS TO GRAMM-LEACH-BLILEY.—Section 206A(a) of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note) is amended in the material preceding paragraph (1), by striking "Except as" and all that follows through "that—" and inserting the following: "Except as provided in subsection (b), as used in this section, the term 'swap agreement' means any agreement, contract, or transaction that—".

(c) CONFORMING AMENDMENTS TO THE SECURITIES ACT OF 1933.—

(1) Section 2A of the Securities Act of 1933 (15 U.S.C. 77b–1) is amended—

(A) by striking subsection (a) and reserving that subsection; and

(B) by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)" each place that such term appears and inserting "(as defined in section 3(a)(78) of the Securities Exchange Act of 1934)".

(2) Section 17 of the Securities Act of 1933 (15 U.S.C. 77q) is amended—

(A) in subsection (a)—

(i) by inserting "(including security-based swaps)" after "securities"; and

(ii) by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)" and inserting "(as defined in section 3(a)(78) of the Securities Exchange Act)"; and

(B) in subsection (d), by striking "206B of the Gramm-Leach-Bliley Act" and inserting "3(a)(78) of the Securities Exchange Act of 1934".

(d) CONFORMING AMENDMENTS TO THE SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 3A (15 U.S.C. 78c–1)—

(A) by striking subsection (a) and reserving that subsection; and

(B) by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)" each place that the term appears;

(2) in section 9 (15 U.S.C. 78i)—

(A) in subsection (a), by striking paragraphs (2) through (5) and inserting the following:

"(2) To effect, alone or with 1 or more other persons, a series of transactions in any security registered on a national securities exchange, any security not so registered, or in connection with any security-based swap or security-based swap agreement with respect to such security creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

"(3) If a dealer, broker, security-based swap dealer, major security-based swap participant, or other person selling or offering for sale or purchasing or offering to purchase the security, a security-based swap, or a security-based swap agreement with respect to such security, to induce the purchase or sale of any security registered on a national securities exchange, any security not so registered, any security-based swap, or any security-based swap agreement with respect to such security by the circulation or dissemination in the ordinary course of business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations of any 1 or more persons conducted for the purpose of raising or depressing the price of such security.

"(4) If a dealer, broker, security-based swap dealer, major security-based swap participant, or other person selling or offering for sale or purchasing or offering to purchase the security, a security-based swap, or security-based swap agreement with respect to such security, to make, regarding any security registered on a national securities exchange, any security not so registered, any security-based swap, or any security-based swap agreement with respect to such security, for the purpose of inducing the purchase or sale of such security, such security-based swap, or such security-based swap agreement any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which that person knew or had reasonable ground to believe was so false or misleading.

"(5) For a consideration, received directly or indirectly from a broker, dealer, security-based swap dealer, major security-based swap participant, or other person selling or offering for sale or purchasing or offering to purchase the security, a security-based swap, or security-based swap agreement with respect to such security, to induce the purchase of any security registered on a national securities exchange, any security not so registered, any security-based swap, or any security-based swap agreement with respect to such security by the circulation or dissemination of information to the effect that the price of any such security will or is likely to rise or fall because of the market operations of any 1 or more persons conducted for the purpose of raising or depressing the price of such security."; and

(B) in subsection (i), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)";

(3) in section 10 (15 U.S.C. 78j)—

(A) in subsection (b), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)," each place that term appears; and

(B) in the matter following subsection (b), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act), in each place that such terms appear";

(4) in section 15 (15 U.S.C. 78o)—

(A) in subsection (c)(1)(A), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act),";

(B) in subparagraphs (B) and (C) of subsection (c)(1), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)" each place that term appears;

(C) by redesignating subsection (i), as added by section 303(f) of the Commodity Futures Modernization Act of 2000 (Public Law 106–554; 114 Stat. 2763A–455)), as subsection (j); and

(D) in subsection (j), as redesignated by subparagraph (C), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)";

(5) in section 16 (15 U.S.C. 78p)—

(A) in subsection (a)(2)(C), by striking "(as defined in section 206(b) of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note))";

(B) in subsection (a)(3)(B), by inserting "or security-based swaps" after "security-based swap agreement";

(C) in the first sentence of subsection (b), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)";

(D) in the third sentence of subsection (b), by striking "(as defined in section 206B of the Gramm-Leach Bliley Act)" and inserting "or a security-based swap"; and

(E) in subsection (g), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)";

(6) in section 20 (15 U.S.C. 78t),

(A) in subsection (d), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)"; and

(B) in subsection (f), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)"; and

(7) in section 21A (15 U.S.C. 78u–1)—

(A) in subsection (a)(1), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)"; and

(B) in subsection (g), by striking "(as defined in section 206B of the Gramm-Leach-Bliley Act)".

SEC. 763. AMENDMENTS TO THE SECURITIES EXCHANGE ACT OF 1934.

(a) CLEARING FOR SECURITY-BASED SWAPS.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 3B (as added by section 717 of this Act):

"SEC. 3C. CLEARING FOR SECURITY-BASED SWAPS.

"(a) IN GENERAL.—

"(1) STANDARD FOR CLEARING.—It shall be unlawful for any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a clearing agency that is registered under this Act or a clearing agency that is exempt from registration under this Act if the security-based swap is required to be cleared.

"(2) OPEN ACCESS.—The rules of a clearing agency described in paragraph (1) shall—

"(A) prescribe that all security-based swaps submitted to the clearing agency with the same terms and conditions are economically equivalent within the clearing agency and may be offset with each other within the clearing agency; and

"(B) provide for non-discriminatory clearing of a security-based swap executed bilaterally or on or through the rules of an unaffiliated national securities exchange or security-based swap execution facility.

"(b) COMMISSION REVIEW.—

"(1) COMMISSION-INITIATED REVIEW.—

"(A) The Commission on an ongoing basis shall review each security-based swap, or any group, category, type, or class of security-based swaps to make a determination that such security-based swap, or group, category, type, or class of security-based swaps should be required to be cleared.

"(B) The Commission shall provide at least a 30-day public comment period regarding any determination under subparagraph (A).

"(2) SWAP SUBMISSIONS.—

"(A) A clearing agency shall submit to the Commission each security-based swap, or any group, category, type, or class of security-based swaps that it plans to accept for clearing and provide notice to its members (in a manner to be determined by the Commission) of such submission.

"(B) Any security-based swap or group, category, type, or class of security-based swaps listed for clearing by a clearing agency as of the date of enactment of this subsection shall be considered submitted to the Commission.

"(C) The Commission shall—

"(i) make available to the public any submission received under subparagraphs (A) and (B);

"(ii) review each submission made under subparagraphs (A) and (B), and determine whether the security-based swap, or group, category, type, or class of security-based swaps, described in the submission is required to be cleared; and

"(iii) provide at least a 30-day public comment period regarding its determination whether the clearing requirement under subsection (a)(1) shall apply to the submission.

"(3) DEADLINE.—The Commission shall make its determination under paragraph (2)(C) not later than 90 days after receiving a submission made under paragraphs (2)(A) and (2)(B), unless the submitting clearing agency agrees to an extension for the time limitation established under this paragraph.

"(4) DETERMINATION.—

"(A) In reviewing a submission made under paragraph (2), the Commission shall review whether the submission is consistent with section 17A.

"(B) In reviewing a security-based swap, group of security-based swaps or class of security-based swaps pursuant to paragraph (1) or a submission made under paragraph (2), the Commission shall take into account the following factors:

"(i) The existence of significant outstanding notional exposures, trading liquidity and adequate pricing data.

"(ii) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

"(iii) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing agency available to clear the contract.

"(iv) The effect on competition, including appropriate fees and charges applied to clearing.

"(v) The existence of reasonable legal certainty in the event of the insolvency of the relevant clearing agency or 1 or more of its clearing members with regard to the treatment of customer and security-based swap counterparty positions, funds, and property.

"(C) In making a determination under subsection (b)(1) or paragraph (2)(C) that the clearing requirement shall apply, the Commission may require such terms and conditions to the requirement as the Commission determines to be appropriate.

"(5) RULES.—Not later than 1 year after the date of the enactment of this section, the Commission shall adopt rules for a clearing agency's submission for review, pursuant to this subsection, of a security-based swap, or a group, category, type, or class of security-based swaps, that it seeks to accept for clearing. Nothing in this paragraph limits the Commission from making a determination under paragraph (2)(C) for security-based swaps described in paragraph (2)(B).

"(c) STAY OF CLEARING REQUIREMENT.—

"(1) IN GENERAL.—After making a determination pursuant to subsection (b)(2), the Commission, on application of a counterparty to a security-based swap or on its own initiative, may stay the clearing requirement of subsection (a)(1) until the Commission completes a review of the terms of the security-based swap (or the group, category, type, or class of security-based swaps) and the clearing arrangement.

"(2) DEADLINE.—The Commission shall complete a review undertaken pursuant to paragraph (1) not later than 90 days after issuance of the stay, unless the clearing agency that clears the security-based swap, or group, category, type, or class of security-based swaps, agrees to an extension of the time limitation established under this paragraph.

"(3) DETERMINATION.—Upon completion of the review undertaken pursuant to paragraph (1), the Commission may—

"(A) determine, unconditionally or subject to such terms and conditions as the Commission determines to be appropriate, that the security-based swap, or group, category, type, or class of security-based swaps, must be cleared pursuant to this subsection if it finds that such clearing is consistent with subsection (b)(4); or

"(B) determine that the clearing requirement of subsection (a)(1) shall not apply to the security-based swap, or group, category, type, or class of security-based swaps.

"(4) RULES.—Not later than 1 year after the date of the enactment of this section, the Commission shall adopt rules for reviewing, pursuant to this subsection, a clearing agency's clearing of a security-based swap, or a group, category, type, or class of security-based swaps, that it has accepted for clearing.

"(d) PREVENTION OF EVASION.—

"(1) IN GENERAL.—The Commission shall prescribe rules under this section (and issue interpretations of rules prescribed under this section), as determined by the Commission to be necessary to prevent evasions of the mandatory clearing requirements under this Act.

"(2) DUTY OF COMMISSION TO INVESTIGATE AND TAKE CERTAIN ACTIONS.—To the extent the Commission finds that a particular security-based swap or any group, category, type, or class of security-based swaps that would otherwise be subject to mandatory clearing but no clearing agency has listed the security-based swap or the group, category, type, or class of security-based swaps for clearing, the Commission shall—

"(A) investigate the relevant facts and circumstances;

"(B) within 30 days issue a public report containing the results of the investigation; and

"(C) take such actions as the Commission determines to be necessary and in the public interest, which may include requiring the retaining of adequate margin or capital by parties to the security-based swap or the group, category, type, or class of security-based swaps.

"(3) EFFECT ON AUTHORITY.—Nothing in this subsection—

"(A) authorizes the Commission to adopt rules requiring a clearing agency to list for clearing a security-based swap or any group, category, type, or class of security-based swaps if the clearing of the security-based swap or the group, category, type, or class of security-based swaps would threaten the financial integrity of the clearing agency; and

"(B) affects the authority of the Commission to enforce the open access provisions of subsection (a)(2) with respect to a security-based swap or the group, category, type, or class of security-based swaps that is listed for clearing by a clearing agency.

"(e) REPORTING TRANSITION RULES.—Rules adopted by the Commission under this section shall provide for the reporting of data, as follows:

"(1) Security-based swaps entered into before the date of the enactment of this section shall be reported to a registered security-based swap data repository or the Commission no later than 180 days after the effective date of this section.

"(2) Security-based swaps entered into on or after such date of enactment shall be reported to a registered security-based swap data repository or the Commission no later than the later of—

"(A) 90 days after such effective date; or

"(B) such other time after entering into the security-based swap as the Commission may prescribe by rule or regulation.

"(f) CLEARING TRANSITION RULES.—

"(1) Security-based swaps entered into before the date of the enactment of this section are exempt from the clearing requirements of this subsection if reported pursuant to subsection (e)(1).

"(2) Security-based swaps entered into before application of the clearing requirement pursuant to this section are exempt from the clearing requirements of this section if reported pursuant to subsection (e)(2).

"(g) EXCEPTIONS.—

"(1) IN GENERAL.—The requirements of subsection (a)(1) shall not apply to a security-based swap if 1 of the counterparties to the security-based swap—

"(A) is not a financial entity;

"(B) is using security-based swaps to hedge or mitigate commercial risk; and

"(C) notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared security-based swaps.

"(2) OPTION TO CLEAR.—The application of the clearing exception in paragraph (1) is solely at the discretion of the counterparty to the security-based swap that meets the conditions of subparagraphs (A) through (C) of paragraph (1).

"(3) FINANCIAL ENTITY DEFINITION.—

"(A) IN GENERAL.—For the purposes of this subsection, the term 'financial entity' means—

"(i) a swap dealer;

"(ii) a security-based swap dealer;

"(iii) a major swap participant;

"(iv) a major security-based swap participant;

"(v) a commodity pool as defined in section 1a(10) of the Commodity Exchange Act;

"(vi) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80–b–2(a));

"(vii) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002);

"(viii) a person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956.

"(B) EXCLUSION.—The Commission shall consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions, including—

"(i) depository institutions with total assets of $10,000,000,000 or less;

"(ii) farm credit system institutions with total assets of $10,000,000,000 or less; or

"(iii) credit unions with total assets of $10,000,000,000 or less.

"(4) TREATMENT OF AFFILIATES.—

"(A) IN GENERAL.—An affiliate of a person that qualifies for an exception under this subsection (including affiliate entities predominantly engaged in providing financing for the purchase of the merchandise or manufactured goods of the person) may qualify for the exception only if the affiliate, acting on behalf of the person and as an agent, uses the security-based swap to hedge or mitigate the commercial risk of the person or other affiliate of the person that is not a financial entity.

"(B) PROHIBITION RELATING TO CERTAIN AFFILIATES.—The exception in subparagraph (A) shall not apply if the affiliate is—

"(i) a swap dealer;

"(ii) a security-based swap dealer;

"(iii) a major swap participant;

"(iv) a major security-based swap participant;

"(v) an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3), but for paragraph (1) or (7) of subsection (c) of that Act (15 U.S.C. 80a–3(c));

"(vi) a commodity pool; or

"(vii) a bank holding company with over $50,000,000,000 in consolidated assets.

"(C) TRANSITION RULE FOR AFFILIATES.—An affiliate, subsidiary, or a wholly owned entity of a person that qualifies for an exception under subparagraph (A) and is predominantly engaged in providing financing for the purchase or lease of merchandise or manufactured goods of the person shall be exempt from the margin requirement described in section 15F(e) and the clearing requirement described in subsection (a) with regard to security-based swaps entered into to mitigate the risk of the financing activities for not less than a 2-year period beginning on the date of enactment of this subparagraph.

"(5) ELECTION OF COUNTERPARTY.—

"(A) SECURITY-BASED SWAPS REQUIRED TO BE CLEARED.—With respect to any security-based swap that is subject to the mandatory clearing requirement under subsection (a) and entered into by a security-based swap dealer or a major security-based swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant, the counterparty shall have the sole right to select the clearing agency at which the security-based swap will be cleared.

"(B) SECURITY-BASED SWAPS NOT REQUIRED TO BE CLEARED.—With respect to any security-based swap that is not subject to the mandatory clearing requirement under subsection (a) and entered into by a security-based swap dealer or a major security-based swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant, the counterparty—

"(i) may elect to require clearing of the security-based swap; and

"(ii) shall have the sole right to select the clearing agency at which the security-based swap will be cleared.

"(6) ABUSE OF EXCEPTION.—The Commission may prescribe such rules or issue interpretations of the rules as the Commission determines to be necessary to prevent abuse of the exceptions described in this subsection. The Commission may also request information from those persons claiming the clearing exception as necessary to prevent abuse of the exceptions described in this subsection.

"(h) TRADE EXECUTION.—

"(1) IN GENERAL.—With respect to transactions involving security-based swaps subject to the clearing requirement of subsection (a)(1), counterparties shall—

"(A) execute the transaction on an exchange; or

"(B) execute the transaction on a security-based swap execution facility registered under section 3D or a security-based swap execution facility that is exempt from registration under section 3D(e).

"(2) EXCEPTION.—The requirements of subparagraphs (A) and (B) of paragraph (1) shall not apply if no exchange or security-based swap execution facility makes the security-based swap available to trade or for security-based swap transactions subject to the clearing exception under subsection (g).

"(i) BOARD APPROVAL.—Exemptions from the requirements of this section to clear a security-based swap or execute a security-based swap through a national securities exchange or security-based swap execution facility shall be available to a counterparty that is an issuer of securities that are registered under section 12 or that is required to file reports pursuant to section 15(d), only if an appropriate committee of the issuer's board or governing body has reviewed and approved the issuer's decision to enter into security-based swaps that are subject to such exemptions.

"(j) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(1) IN GENERAL.—Each registered clearing agency shall designate an individual to serve as a chief compliance officer.

"(2) DUTIES.—The chief compliance officer shall—

"(A) report directly to the board or to the senior officer of the clearing agency;

"(B) in consultation with its board, a body performing a function similar thereto, or the senior officer of the registered clearing agency, resolve any conflicts of interest that may arise;

"(C) be responsible for administering each policy and procedure that is required to be established pursuant to this section;

"(D) ensure compliance with this title (including regulations issued under this title) relating to agreements, contracts, or transactions, including each rule prescribed by the Commission under this section;

"(E) establish procedures for the remediation of noncompliance issues identified by the compliance officer through any—

"(i) compliance office review;

"(ii) look-back;

"(iii) internal or external audit finding;

"(iv) self-reported error; or

"(v) validated complaint; and

"(F) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

"(3) ANNUAL REPORTS.—

"(A) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

"(i) the compliance of the registered clearing agency or security-based swap execution facility of the compliance officer with respect to this title (including regulations under this title); and

"(ii) each policy and procedure of the registered clearing agency of the compliance officer (including the code of ethics and conflict of interest policies of the registered clearing agency).

"(B) REQUIREMENTS.—A compliance report under subparagraph (A) shall—

"(i) accompany each appropriate financial report of the registered clearing agency that is required to be furnished to the Commission pursuant to this section; and

"(ii) include a certification that, under penalty of law, the compliance report is accurate and complete.".

(b) CLEARING AGENCY REQUIREMENTS.—Section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q–1) is amended by adding at the end the following:

"(g) REGISTRATION REQUIREMENT.—It shall be unlawful for a clearing agency, unless registered with the Commission, directly or indirectly to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a clearing agency with respect to a security-based swap.

"(h) VOLUNTARY REGISTRATION.—A person that clears agreements, contracts, or transactions that are not required to be cleared under this title may register with the Commission as a clearing agency.

"(i) STANDARDS FOR CLEARING AGENCIES CLEARING SECURITY-BASED SWAP TRANSACTIONS.—To be registered and to maintain registration as a clearing agency that clears security-based swap transactions, a clearing agency shall comply with such standards as the Commission may establish by rule. In establishing any such standards, and in the exercise of its oversight of such a clearing agency pursuant to this title, the Commission may conform such standards or oversight to reflect evolving United States and international standards. Except where the Commission determines otherwise by rule or regulation, a clearing agency shall have reasonable discretion in establishing the manner in which it complies with any such standards.

"(j) RULES.—The Commission shall adopt rules governing persons that are registered as clearing agencies for security-based swaps under this title.

"(k) EXEMPTIONS.—The Commission may exempt, conditionally or unconditionally, a clearing agency from registration under this section for the clearing of security-based swaps if the Commission determines that the clearing agency is subject to comparable, comprehensive supervision and regulation by the Commodity Futures Trading Commission or the appropriate government authorities in the home country of the agency. Such conditions may include, but are not limited to, requiring that the clearing agency be available for inspection by the Commission and make available all information requested by the Commission.

"(l) EXISTING DEPOSITORY INSTITUTIONS AND DERIVATIVE CLEARING ORGANIZATIONS.—

"(1) IN GENERAL.—A depository institution or derivative clearing organization registered with the Commodity Futures Trading Commission under the Commodity Exchange Act that is required to be registered as a clearing agency under this section is deemed to be registered under this section solely for the purpose of clearing security-based swaps to the extent that, before the date of enactment of this subsection—

"(A) the depository institution cleared swaps as a multilateral clearing organization; or

"(B) the derivative clearing organization cleared swaps pursuant to an exemption from registration as a clearing agency.

"(2) CONVERSION OF DEPOSITORY INSTITUTIONS.—A depository institution to which this subsection applies may, by the vote of the shareholders owning not less than 51 percent of the voting interests of the depository institution, be converted into a State corporation, partnership, limited liability company, or similar legal form pursuant to a plan of conversion, if the conversion is not in contravention of applicable State law.

"(3) SHARING OF INFORMATION.—The Commodity Futures Trading Commission shall make available to the Commission, upon request, all information determined to be relevant by the Commodity Futures Trading Commission regarding a derivatives clearing organization deemed to be registered with the Commission under paragraph (1).

"(m) MODIFICATION OF CORE PRINCIPLES.—The Commission may conform the core principles established in this section to reflect evolving United States and international standards.".

(c) SECURITY-BASED SWAP EXECUTION FACILITIES.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 3C (as added by subsection (a) of this section) the following:

"SEC. 3D. SECURITY-BASED SWAP EXECUTION FACILITIES.

"(a) REGISTRATION.—

"(1) IN GENERAL.—No person may operate a facility for the trading or processing of security-based swaps, unless the facility is registered as a security-based swap execution facility or as a national securities exchange under this section.

"(2) DUAL REGISTRATION.—Any person that is registered as a security-based swap execution facility under this section shall register with the Commission regardless of whether the person also is registered with the Commodity Futures Trading Commission as a swap execution facility.

"(b) TRADING AND TRADE PROCESSING.—A security-based swap execution facility that is registered under subsection (a) may—

"(1) make available for trading any security-based swap; and

"(2) facilitate trade processing of any security-based swap.

"(c) IDENTIFICATION OF FACILITY USED TO TRADE SECURITY-BASED SWAPS BY NATIONAL SECURITIES EXCHANGES.—A national securities exchange shall, to the extent that the exchange also operates a security-based swap execution facility and uses the same electronic trade execution system for listing and executing trades of security-based swaps on or through the exchange and the facility, identify whether electronic trading of such security-based swaps is taking place on or through the national securities exchange or the security-based swap execution facility.

"(d) CORE PRINCIPLES FOR SECURITY-BASED SWAP EXECUTION FACILITIES.—

"(1) COMPLIANCE WITH CORE PRINCIPLES.—

"(A) IN GENERAL.—To be registered, and maintain registration, as a security-based swap execution facility, the security-based swap execution facility shall comply with—

"(i) the core principles described in this subsection; and

"(ii) any requirement that the Commission may impose by rule or regulation.

"(B) REASONABLE DISCRETION OF SECURITY-BASED SWAP EXECUTION FACILITY.—Unless otherwise determined by the Commission, by rule or regulation, a security-based swap execution facility described in subparagraph (A) shall have reasonable discretion in establishing the manner in which it complies with the core principles described in this subsection.

"(2) COMPLIANCE WITH RULES.—A security-based swap execution facility shall—

"(A) establish and enforce compliance with any rule established by such security-based swap execution facility, including—

"(i) the terms and conditions of the security-based swaps traded or processed on or through the facility; and

"(ii) any limitation on access to the facility;

"(B) establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, including means—

"(i) to provide market participants with impartial access to the market; and

"(ii) to capture information that may be used in establishing whether rule violations have occurred; and

"(C) establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades.

"(3) SECURITY-BASED SWAPS NOT READILY SUSCEPTIBLE TO MANIPULATION.—The security-based swap execution facility shall permit trading only in security-based swaps that are not readily susceptible to manipulation.

"(4) MONITORING OF TRADING AND TRADE PROCESSING.—The security-based swap execution facility shall—

"(A) establish and enforce rules or terms and conditions defining, or specifications detailing—

"(i) trading procedures to be used in entering and executing orders traded on or through the facilities of the security-based swap execution facility; and

"(ii) procedures for trade processing of security-based swaps on or through the facilities of the security-based swap execution facility; and

"(B) monitor trading in security-based swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.

"(5) ABILITY TO OBTAIN INFORMATION.—The security-based swap execution facility shall—

"(A) establish and enforce rules that will allow the facility to obtain any necessary information to perform any of the functions described in this subsection;

"(B) provide the information to the Commission on request; and

"(C) have the capacity to carry out such international information-sharing agreements as the Commission may require.

"(6) FINANCIAL INTEGRITY OF TRANSACTIONS.—The security-based swap execution facility shall establish and enforce rules and procedures for ensuring the financial integrity of security-based swaps entered on or through the facilities of the security-based swap execution facility, including the clearance and settlement of security-based swaps pursuant to section 3C(a)(1).

"(7) EMERGENCY AUTHORITY.—The security-based swap execution facility shall adopt rules to provide for the exercise of emergency authority, in consultation or cooperation with the Commission, as is necessary and appropriate, including the authority to liquidate or transfer open positions in any security-based swap or to suspend or curtail trading in a security-based swap.

"(8) TIMELY PUBLICATION OF TRADING INFORMATION.—

"(A) IN GENERAL.—The security-based swap execution facility shall make public timely information on price, trading volume, and other trading data on security-based swaps to the extent prescribed by the Commission.

"(B) CAPACITY OF SECURITY-BASED SWAP EXECUTION FACILITY.—The security-based swap execution facility shall be required to have the capacity to electronically capture and transmit and disseminate trade information with respect to transactions executed on or through the facility.

"(9) RECORDKEEPING AND REPORTING.—

"(A) IN GENERAL.—A security-based swap execution facility shall—

"(i) maintain records of all activities relating to the business of the facility, including a complete audit trail, in a form and manner acceptable to the Commission for a period of 5 years; and

"(ii) report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under this title.

"(B) REQUIREMENTS.—The Commission shall adopt data collection and reporting requirements for security-based swap execution facilities that are comparable to corresponding requirements for clearing agencies and security-based swap data repositories.

"(10) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this title, the security-based swap execution facility shall not—

"(A) adopt any rules or taking any actions that result in any unreasonable restraint of trade; or

"(B) impose any material anticompetitive burden on trading or clearing.

"(11) CONFLICTS OF INTEREST.—The security-based swap execution facility shall—

"(A) establish and enforce rules to minimize conflicts of interest in its decision-making process; and

"(B) establish a process for resolving the conflicts of interest.

"(12) FINANCIAL RESOURCES.—

"(A) IN GENERAL.—The security-based swap execution facility shall have adequate financial, operational, and managerial resources to discharge each responsibility of the security-based swap execution facility, as determined by the Commission.

"(B) DETERMINATION OF RESOURCE ADEQUACY.—The financial resources of a security-based swap execution facility shall be considered to be adequate if the value of the financial resources—

"(i) enables the organization to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure for that organization in extreme but plausible market conditions; and

"(ii) exceeds the total amount that would enable the security-based swap execution facility to cover the operating costs of the security-based swap execution facility for a 1-year period, as calculated on a rolling basis.

"(13) SYSTEM SAFEGUARDS.—The security-based swap execution facility shall—

"(A) establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk, through the development of appropriate controls and procedures, and automated systems, that—

"(i) are reliable and secure; and

"(ii) have adequate scalable capacity;

"(B) establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allow for—

"(i) the timely recovery and resumption of operations; and

"(ii) the fulfillment of the responsibilities and obligations of the security-based swap execution facility; and

"(C) periodically conduct tests to verify that the backup resources of the security-based swap execution facility are sufficient to ensure continued—

"(i) order processing and trade matching;

"(ii) price reporting;

"(iii) market surveillance; and

"(iv) maintenance of a comprehensive and accurate audit trail.

"(14) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(A) IN GENERAL.—Each security-based swap execution facility shall designate an individual to serve as a chief compliance officer.

"(B) DUTIES.—The chief compliance officer shall—

"(i) report directly to the board or to the senior officer of the facility;

"(ii) review compliance with the core principles in this subsection;

"(iii) in consultation with the board of the facility, a body performing a function similar to that of a board, or the senior officer of the facility, resolve any conflicts of interest that may arise;

"(iv) be responsible for establishing and administering the policies and procedures required to be established pursuant to this section;

"(v) ensure compliance with this title and the rules and regulations issued under this title, including rules prescribed by the Commission pursuant to this section;

"(vi) establish procedures for the remediation of noncompliance issues found during—

"(I) compliance office reviews;

"(II) look backs;

"(III) internal or external audit findings;

"(IV) self-reported errors; or

"(V) through validated complaints; and

"(vii) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

"(C) ANNUAL REPORTS.—

"(i) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

"(I) the compliance of the security-based swap execution facility with this title; and

"(II) the policies and procedures, including the code of ethics and conflict of interest policies, of the security-based security-based swap execution facility.

"(ii) REQUIREMENTS.—The chief compliance officer shall—

"(I) submit each report described in clause (i) with the appropriate financial report of the security-based swap execution facility that is required to be submitted to the Commission pursuant to this section; and

"(II) include in the report a certification that, under penalty of law, the report is accurate and complete.

"(e) EXEMPTIONS.—The Commission may exempt, conditionally or unconditionally, a security-based swap execution facility from registration under this section if the Commission finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the Commodity Futures Trading Commission.

"(f) RULES.—The Commission shall prescribe rules governing the regulation of security-based swap execution facilities under this section.".

(d) SEGREGATION OF ASSETS HELD AS COLLATERAL IN SECURITY-BASED SWAP TRANSACTIONS.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 3D (as added by subsection (b)) the following:

"SEC. 3E. SEGREGATION OF ASSETS HELD AS COLLATERAL IN SECURITY-BASED SWAP TRANSACTIONS.

"(a) REGISTRATION REQUIREMENT.—It shall be unlawful for any person to accept any money, securities, or property (or to extend any credit in lieu of money, securities, or property) from, for, or on behalf of a security-based swaps customer to margin, guarantee, or secure a security-based swap cleared by or through a clearing agency (including money, securities, or property accruing to the customer as the result of such a security-based swap), unless the person shall have registered under this title with the Commission as a broker, dealer, or security-based swap dealer, and the registration shall not have expired nor been suspended nor revoked.

"(b) CLEARED SECURITY-BASED SWAPS.—

"(1) SEGREGATION REQUIRED.—A broker, dealer, or security-based swap dealer shall treat and deal with all money, securities, and property of any security-based swaps customer received to margin, guarantee, or secure a security-based swap cleared by or though a clearing agency (including money, securities, or property accruing to the security-based swaps customer as the result of such a security-based swap) as belonging to the security-based swaps customer.

"(2) COMMINGLING PROHIBITED.—Money, securities, and property of a security-based swaps customer described in paragraph (1) shall be separately accounted for and shall not be commingled with the funds of the broker, dealer, or security-based swap dealer or be used to margin, secure, or guarantee any trades or contracts of any security-based swaps customer or person other than the person for whom the same are held.

"(c) EXCEPTIONS.—

"(1) USE OF FUNDS.—

"(A) IN GENERAL.—Notwithstanding subsection (b), money, securities, and property of a security-based swaps customer of a broker, dealer, or security-based swap dealer described in subsection (b) may, for convenience, be commingled and deposited in the same 1 or more accounts with any bank or trust company or with a clearing agency.

"(B) WITHDRAWAL.—Notwithstanding subsection (b), such share of the money, securities, and property described in subparagraph (A) as in the normal course of business shall be necessary to margin, guarantee, secure, transfer, adjust, or settle a cleared security-based swap with a clearing agency, or with any member of the clearing agency, may be withdrawn and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage, and other charges, lawfully accruing in connection with the cleared security-based swap.

"(2) COMMISSION ACTION.—Notwithstanding subsection (b), in accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the security-based swaps customer of a broker, dealer, or security-based swap dealer described in subsection (b) may be commingled and deposited as provided in this section with any other money, securities, or property received by the broker, dealer, or security-based swap dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swaps customer of the broker, dealer, or security-based swap dealer.

"(d) PERMITTED INVESTMENTS.—Money described in subsection (b) may be invested in obligations of the United States, in general obligations of any State or of any political subdivision of a State, and in obligations fully guaranteed as to principal and interest by the United States, or in any other investment that the Commission may by rule or regulation prescribe, and such investments shall be made in accordance with such rules and regulations and subject to such conditions as the Commission may prescribe.

"(e) PROHIBITION.—It shall be unlawful for any person, including any clearing agency and any depository institution, that has received any money, securities, or property for deposit in a separate account or accounts as provided in subsection (b) to hold, dispose of, or use any such money, securities, or property as belonging to the depositing broker, dealer, or security-based swap dealer or any person other than the swaps customer of the broker, dealer, or security-based swap dealer.

"(f) SEGREGATION REQUIREMENTS FOR UNCLEARED SECURITY-BASED SWAPS.—

"(1) SEGREGATION OF ASSETS HELD AS COLLATERAL IN UNCLEARED SECURITY-BASED SWAP TRANSACTIONS.—

"(A) NOTIFICATION.—A security-based swap dealer or major security-based swap participant shall be required to notify the counterparty of the security-based swap dealer or major security-based swap participant at the beginning of a security-based swap transaction that the counterparty has the right to require segregation of the funds of other property supplied to margin, guarantee, or secure the obligations of the counterparty.

"(B) SEGREGATION AND MAINTENANCE OF FUNDS.—At the request of a counterparty to a security-based swap that provides funds or other property to a security-based swap dealer or major security-based swap participant to margin, guarantee, or secure the obligations of the counterparty, the security-based swap dealer or major security-based swap participant shall—

"(i) segregate the funds or other property for the benefit of the counterparty; and

"(ii) in accordance with such rules and regulations as the Commission may promulgate, maintain the funds or other property in a segregated account separate from the assets and other interests of the security-based swap dealer or major security-based swap participant.

"(2) APPLICABILITY.—The requirements described in paragraph (1) shall—

"(A) apply only to a security-based swap between a counterparty and a security-based swap dealer or major security-based swap participant that is not submitted for clearing to a clearing agency; and

"(B)(i) not apply to variation margin payments; or

"(ii) not preclude any commercial arrangement regarding—

"(I) the investment of segregated funds or other property that may only be invested in such investments as the Commission may permit by rule or regulation; and

"(II) the related allocation of gains and losses resulting from any investment of the segregated funds or other property.

"(3) USE OF INDEPENDENT THIRD-PARTY CUSTODIANS.—The segregated account described in paragraph (1) shall be—

"(A) carried by an independent third-party custodian; and

"(B) designated as a segregated account for and on behalf of the counterparty.

"(4) REPORTING REQUIREMENT.—If the counterparty does not choose to require segregation of the funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty, the security-based swap dealer or major security-based swap participant shall report to the counterparty of the security-based swap dealer or major security-based swap participant on a quarterly basis that the back office procedures of the security-based swap dealer or major security-based swap participant relating to margin and collateral requirements are in compliance with the agreement of the counterparties.

"(g) BANKRUPTCY.—A security-based swap, as defined in section 3(a)(68) shall be considered to be a security as such term is used in section 101(53A)(B) and subchapter III of title 11, United States Code. An account that holds a security-based swap, other than a portfolio margining account referred to in section 15(c)(3)(C) shall be considered to be a securities account, as that term is defined in section 741 of title 11, United States Code. The definitions of the terms 'purchase' and 'sale' in section 3(a)(13) and (14) shall be applied to the terms 'purchase' and 'sale', as used in section 741 of title 11, United States Code. The term 'customer', as defined in section 741 of title 11, United States Code, excludes any person, to the extent that such person has a claim based on any open repurchase agreement, open reverse repurchase agreement, stock borrowed agreement, non-cleared option, or non-cleared security-based swap except to the extent of any margin delivered to or by the customer with respect to which there is a customer protection requirement under section 15(c)(3) or a segregation requirement.".

(e) TRADING IN SECURITY-BASED SWAPS.—Section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) is amended by adding at the end the following:

"(l) SECURITY-BASED SWAPS.—It shall be unlawful for any person to effect a transaction in a security-based swap with or for a person that is not an eligible contract participant, unless such transaction is effected on a national securities exchange registered pursuant to subsection (b).".

(f) ADDITIONS OF SECURITY-BASED SWAPS TO CERTAIN ENFORCEMENT PROVISIONS.—Section 9(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78i(b)) is amended by striking paragraphs (1) through (3) and inserting the following:

"(1) any transaction in connection with any security whereby any party to such transaction acquires—

"(A) any put, call, straddle, or other option or privilege of buying the security from or selling the security to another without being bound to do so;

"(B) any security futures product on the security; or

"(C) any security-based swap involving the security or the issuer of the security;

"(2) any transaction in connection with any security with relation to which such person has, directly or indirectly, any interest in any—

"(A) such put, call, straddle, option, or privilege;

"(B) such security futures product; or

"(C) such security-based swap; or

"(3) any transaction in any security for the account of any person who such person has reason to believe has, and who actually has, directly or indirectly, any interest in any—

"(A) such put, call, straddle, option, or privilege;

"(B) such security futures product with relation to such security; or

"(C) any security-based swap involving such security or the issuer of such security.".

(g) RULEMAKING AUTHORITY TO PREVENT FRAUD, MANIPULATION AND DECEPTIVE CONDUCT IN SECURITY-BASED SWAPS.—Section 9 of the Securities Exchange Act of 1934 (15 U.S.C. 78i) is amended by adding at the end the following:

"(j) It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security-based swap, in connection with which such person engages in any fraudulent, deceptive, or manipulative act or practice, makes any fictitious quotation, or engages in any transaction, practice, or course of business which operates as a fraud or deceit upon any person. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such transactions, acts, practices, and courses of business as are fraudulent, deceptive, or manipulative, and such quotations as are fictitious.''.

(h) POSITION LIMITS AND POSITION ACCOUNTABILITY FOR SECURITY-BASED SWAPS.—The Securities Exchange Act of 1934 is amended by inserting after section 10A (15 U.S.C. 78j–1) the following:

''SEC. 10B. POSITION LIMITS AND POSITION ACCOUNTABILITY FOR SECURITY-BASED SWAPS AND LARGE TRADER REPORTING.

''(a) POSITION LIMITS.—As a means reasonably designed to prevent fraud and manipulation, the Commission shall, by rule or regulation, as necessary or appropriate in the public interest or for the protection of investors, establish limits (including related hedge exemption provisions) on the size of positions in any security-based swap that may be held by any person. In establishing such limits, the Commission may require any person to aggregate positions in—

''(1) any security-based swap and any security or loan or group of securities or loans on which such security-based swap is based, which such security-based swap references, or to which such security-based swap is related as described in paragraph (68) of section 3(a), and any other instrument relating to such security or loan or group or index of securities or loans; or

''(2) any security-based swap and—

''(A) any security or group or index of securities, the price, yield, value, or volatility of which, or of which any interest therein, is the basis for a material term of such security-based swap as described in paragraph (68) of section 3(a); and

''(B) any other instrument relating to the same security or group or index of securities described under subparagraph (A).

''(b) EXEMPTIONS.—The Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person or class of persons, any security-based swap or class of security-based swaps, or any transaction or class of transactions from any requirement the Commission may establish under this section with respect to position limits.

''(c) SRO RULES.—

''(1) IN GENERAL.—As a means reasonably designed to prevent fraud or manipulation, the Commission, by rule, regulation, or order, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title, may direct a self-regulatory organization—

''(A) to adopt rules regarding the size of positions in any security-based swap that may be held by—

''(i) any member of such self-regulatory organization; or

''(ii) any person for whom a member of such self-regulatory organization effects transactions in such security-based swap; and

"(B) to adopt rules reasonably designed to ensure compliance with requirements prescribed by the Commission under this subsection.

"(2) REQUIREMENT TO AGGREGATE POSITIONS.—In establishing the limits under paragraph (1), the self-regulatory organization may require such member or person to aggregate positions in—

"(A) any security-based swap and any security or loan or group or narrow-based security index of securities or loans on which such security-based swap is based, which such security-based swap references, or to which such security-based swap is related as described in section 3(a)(68), and any other instrument relating to such security or loan or group or narrow-based security index of securities or loans; or

"(B)(i) any security-based swap; and

"(ii) any security-based swap and any other instrument relating to the same security or group or narrow-based security index of securities.

"(d) LARGE TRADER REPORTING.—The Commission, by rule or regulation, may require any person that effects transactions for such person's own account or the account of others in any securities-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans as set forth in paragraphs (1) and (2) of subsection (a) under this section to report such information as the Commission may prescribe regarding any position or positions in any security-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans and any other instrument relating to such security or loan or group or narrow-based security index of securities or loans as set forth in paragraphs (1) and (2) of subsection (a) under this section.".

(i) PUBLIC REPORTING AND REPOSITORIES FOR SECURITY-BASED SWAPS.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

"(m) PUBLIC AVAILABILITY OF SECURITY-BASED SWAP TRANSACTION DATA.—

"(1) IN GENERAL.—

"(A) DEFINITION OF REAL-TIME PUBLIC REPORTING.—In this paragraph, the term 'real-time public reporting' means to report data relating to a security-based swap transaction, including price and volume, as soon as technologically practicable after the time at which the security-based swap transaction has been executed.

"(B) PURPOSE.—The purpose of this subsection is to authorize the Commission to make security-based swap transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery.

"(C) GENERAL RULE.—The Commission is authorized to provide by rule for the public availability of security-based swap transaction, volume, and pricing data as follows:

"(i) With respect to those security-based swaps that are subject to the mandatory clearing requirement described in section 3C(a)(1) (including those security-based swaps that are excepted from the requirement pursuant to section 3C(g)), the Commission shall require real-time public reporting for such transactions.

"(ii) With respect to those security-based swaps that are not subject to the mandatory clearing requirement described in section 3C(a)(1), but are cleared at a registered clearing agency, the Commission shall require real-time public reporting for such transactions.

"(iii) With respect to security-based swaps that are not cleared at a registered clearing agency and which are reported to a security-based swap data repository or the Commission under section 3C(a)(6), the Commission shall require real-time public reporting for such transactions, in a manner that does not disclose the business transactions and market positions of any person.

"(iv) With respect to security-based swaps that are determined to be required to be cleared under section 3C(b) but are not cleared, the Commission shall require real-time public reporting for such transactions.

"(D) REGISTERED ENTITIES AND PUBLIC REPORTING.—The Commission may require registered entities to publicly disseminate the security-based swap transaction and pricing data required to be reported under this paragraph.

"(E) RULEMAKING REQUIRED.—With respect to the rule providing for the public availability of transaction and pricing data for security-based swaps described in clauses (i) and (ii) of subparagraph (C), the rule promulgated by the Commission shall contain provisions—

"(i) to ensure such information does not identify the participants;

"(ii) to specify the criteria for determining what constitutes a large notional security-based swap transaction (block trade) for particular markets and contracts;

"(iii) to specify the appropriate time delay for reporting large notional security-based swap transactions (block trades) to the public; and

"(iv) that take into account whether the public disclosure will materially reduce market liquidity.

"(F) TIMELINESS OF REPORTING.—Parties to a security-based swap (including agents of the parties to a security-based swap) shall be responsible for reporting security-based swap transaction information to the appropriate registered entity in a timely manner as may be prescribed by the Commission.

"(G) REPORTING OF SWAPS TO REGISTERED SECURITY-BASED SWAP DATA REPOSITORIES.—Each security-based swap (whether cleared or uncleared) shall be reported to a registered security-based swap data repository.

"(H) REGISTRATION OF CLEARING AGENCIES.—A clearing agency may register as a security-based swap data repository.

"(2) SEMIANNUAL AND ANNUAL PUBLIC REPORTING OF AGGREGATE SECURITY-BASED SWAP DATA.—

"(A) IN GENERAL.—In accordance with subparagraph (B), the Commission shall issue a written report on a semiannual and annual basis to make available to the public information relating to—

"(i) the trading and clearing in the major security-based swap categories; and

"(ii) the market participants and developments in new products.

"(B) USE; CONSULTATION.—In preparing a report under subparagraph (A), the Commission shall—

"(i) use information from security-based swap data repositories and clearing agencies; and

"(ii) consult with the Office of the Comptroller of the Currency, the Bank for International Settlements, and such other regulatory bodies as may be necessary.

"(C) AUTHORITY OF COMMISSION.—The Commission may, by rule, regulation, or order, delegate the public reporting responsibilities of the Commission under this paragraph in accordance with such terms and conditions as the Commission determines to be appropriate and in the public interest.

"(n) SECURITY-BASED SWAP DATA REPOSITORIES.—

"(1) REGISTRATION REQUIREMENT.—It shall be unlawful for any person, unless registered with the Commission, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a security-based swap data repository.

"(2) INSPECTION AND EXAMINATION.—Each registered security-based swap data repository shall be subject to inspection and examination by any representative of the Commission.

"(3) COMPLIANCE WITH CORE PRINCIPLES.—

"(A) IN GENERAL.—To be registered, and maintain registration, as a security-based swap data repository, the security-based swap data repository shall comply with—

"(i) the requirements and core principles described in this subsection; and

"(ii) any requirement that the Commission may impose by rule or regulation.

"(B) REASONABLE DISCRETION OF SECURITY-BASED SWAP DATA REPOSITORY.—Unless otherwise determined by the Commission, by rule or regulation, a security-based swap data repository described in subparagraph (A) shall have reasonable discretion in establishing the manner in which the security-based swap data repository complies with the core principles described in this subsection.

"(4) STANDARD SETTING.—

"(A) DATA IDENTIFICATION.—

"(i) IN GENERAL.—In accordance with clause (ii), the Commission shall prescribe standards that specify the data elements for each security-based swap that shall be collected and maintained by each registered security-based swap data repository.

"(ii) REQUIREMENT.—In carrying out clause (i), the Commission shall prescribe consistent data element standards applicable to registered entities and reporting counterparties.

"(B) DATA COLLECTION AND MAINTENANCE.—The Commission shall prescribe data collection and data maintenance standards for security-based swap data repositories.

"(C) COMPARABILITY.—The standards prescribed by the Commission under this subsection shall be comparable to the data standards imposed by the Commission on clearing agencies in connection with their clearing of security-based swaps.

"(5) DUTIES.—A security-based swap data repository shall—

"(A) accept data prescribed by the Commission for each security-based swap under subsection (b);

"(B) confirm with both counterparties to the security-based swap the accuracy of the data that was submitted;

"(C) maintain the data described in subparagraph (A) in such form, in such manner, and for such period as may be required by the Commission;

"(D)(i) provide direct electronic access to the Commission (or any designee of the Commission, including another registered entity); and

"(ii) provide the information described in subparagraph (A) in such form and at such frequency as the Commission may require to comply with the public reporting requirements set forth in subsection (m);

"(E) at the direction of the Commission, establish automated systems for monitoring, screening, and analyzing security-based swap data;

"(F) maintain the privacy of any and all security-based swap transaction information that the security-based swap data repository receives from a security-based swap dealer, counterparty, or any other registered entity; and

"(G) on a confidential basis pursuant to section 24, upon request, and after notifying the Commission of the request, make available all data obtained by the security-based swap data repository, including individual counterparty trade and position data, to—

"(i) each appropriate prudential regulator;

"(ii) the Financial Stability Oversight Council;

"(iii) the Commodity Futures Trading Commission;

"(iv) the Department of Justice; and

"(v) any other person that the Commission determines to be appropriate, including—

"(I) foreign financial supervisors (including foreign futures authorities);

"(II) foreign central banks; and

"(III) foreign ministries.

"(H) CONFIDENTIALITY AND INDEMNIFICATION AGREEMENT.—Before the security-based swap data repository may share information with any entity described in subparagraph (G)—

"(i) the security-based swap data repository shall receive a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in section 24 relating to the information on security-based swap transactions that is provided; and "(ii) each entity shall agree to indemnify the security-based swap data repository and the Commission for any expenses arising from litigation relating to the information provided under section 24.

"(6) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(A) IN GENERAL.—Each security-based swap data repository shall designate an individual to serve as a chief compliance officer.

"(B) DUTIES.—The chief compliance officer shall—

"(i) report directly to the board or to the senior officer of the security-based swap data repository;

"(ii) review the compliance of the security-based swap data repository with respect to the requirements and core principles described in this subsection;

"(iii) in consultation with the board of the security-based swap data repository, a body performing a function similar to the board of the security-based swap data repository, or the senior officer of the security-based swap data repository, resolve any conflicts of interest that may arise;

"(iv) be responsible for administering each policy and procedure that is required to be established pursuant to this section;

"(v) ensure compliance with this title (including regulations) relating to agreements, contracts, or transactions, including each rule prescribed by the Commission under this section;

"(vi) establish procedures for the remediation of noncompliance issues identified by the chief compliance officer through any—

"(I) compliance office review;

"(II) look-back;

"(III) internal or external audit finding;

"(IV) self-reported error; or

"(V) validated complaint; and

"(vii) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

"(C) ANNUAL REPORTS.—

"(i) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

"(I) the compliance of the security-based swap data repository of the chief compliance officer with respect to this title (including regulations); and

"(II) each policy and procedure of the security-based swap data repository of the chief compliance officer (including the code of ethics and conflict of interest policies of the security-based swap data repository).

"(ii) REQUIREMENTS.—A compliance report under clause (i) shall—

"(I) accompany each appropriate financial report of the security-based swap data repository that is required to be furnished to the Commission pursuant to this section; and

"(II) include a certification that, under penalty of law, the compliance report is accurate and complete.

"(7) CORE PRINCIPLES APPLICABLE TO SECURITY-BASED SWAP DATA REPOSITORIES.—

"(A) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this title, the swap data repository shall not—

"(i) adopt any rule or take any action that results in any unreasonable restraint of trade; or

"(ii) impose any material anticompetitive burden on the trading, clearing, or reporting of transactions.

"(B) GOVERNANCE ARRANGEMENTS.—Each security-based swap data repository shall establish governance arrangements that are transparent—

"(i) to fulfill public interest requirements; and

"(ii) to support the objectives of the Federal Government, owners, and participants.

"(C) CONFLICTS OF INTEREST.—Each security-based swap data repository shall—

"(i) establish and enforce rules to minimize conflicts of interest in the decision-making process of the security-based swap data repository; and

"(ii) establish a process for resolving any conflicts of interest described in clause (i).

"(D) ADDITIONAL DUTIES DEVELOPED BY COMMISSION.—

"(i) IN GENERAL.—The Commission may develop 1 or more additional duties applicable to security-based swap data repositories.

"(ii) CONSIDERATION OF EVOLVING STANDARDS.—In developing additional duties under subparagraph (A), the Commission may take into consideration any evolving standard of the United States or the international community.

"(iii) ADDITIONAL DUTIES FOR COMMISSION DESIGNEES.—The Commission shall establish additional duties for any registrant described in section 13(m)(2)(C) in order to minimize conflicts of interest, protect data, ensure compliance, and guarantee the safety and security of the security-based swap data repository.

"(8) REQUIRED REGISTRATION FOR SECURITY-BASED SWAP DATA REPOSITORIES.—Any person that is required to be registered as a security-based swap data repository under this subsection shall register with the Commission, regardless of whether that person is also licensed under the Commodity Exchange Act as a swap data repository.

"(9) RULES.—The Commission shall adopt rules governing persons that are registered under this subsection.".

SEC. 764. REGISTRATION AND REGULATION OF SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS.

(a) IN GENERAL.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 15E (15 U.S.C. 78o–7) the following:

"SEC. 15F. REGISTRATION AND REGULATION OF SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS.

"(a) REGISTRATION.—

"(1) SECURITY-BASED SWAP DEALERS.—It shall be unlawful for any person to act as a security-based swap dealer unless the person is registered as a security-based swap dealer with the Commission.

"(2) MAJOR SECURITY-BASED SWAP PARTICIPANTS.—It shall be unlawful for any person to act as a major security-based swap participant unless the person is registered as a major security-based swap participant with the Commission.

"(b) REQUIREMENTS.—

"(1) IN GENERAL.—A person shall register as a security-based swap dealer or major security-based swap participant by filing a registration application with the Commission.

"(2) CONTENTS.—

"(A) IN GENERAL.—The application shall be made in such form and manner as prescribed by the Commission, and shall contain such information, as the Commission considers necessary concerning the business in which the applicant is or will be engaged.

"(B) CONTINUAL REPORTING.—A person that is registered as a security-based swap dealer or major security-based swap participant shall continue to submit to the Commission reports that contain such information pertaining to the business of the person as the Commission may require.

"(3) EXPIRATION.—Each registration under this section shall expire at such time as the Commission may prescribe by rule or regulation.

"(4) RULES.—Except as provided in subsections (d) and (e), the Commission may prescribe rules applicable to security-based swap dealers and major security-based swap participants, including rules that limit the activities of non-bank security-based swap dealers and major security-based swap participants.

"(5) TRANSITION.—Not later than 1 year after the date of enactment of the Wall Street Transparency and Accountability Act of 2010, the Commission shall issue rules under this section to provide for the registration of security-based swap dealers and major security-based swap participants.

"(6) STATUTORY DISQUALIFICATION.—Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, it shall be unlawful for a security-based swap dealer or a major security-based swap participant to permit any person associated with a security-based swap dealer or a major security-based swap participant who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant, if the security-based swap dealer or major security-based swap participant knew, or in the exercise of reasonable care should have known, of the statutory disqualification.

"(c) DUAL REGISTRATION.—

"(1) SECURITY-BASED SWAP DEALER.—Any person that is required to be registered as a security-based swap dealer under this section shall register with the Commission, regardless of whether the person also is registered with the Commodity Futures Trading Commission as a swap dealer.

"(2) MAJOR SECURITY-BASED SWAP PARTICIPANT.—Any person that is required to be registered as a major security-based swap participant under this section shall register with the Commission, regardless of whether the person also is registered with the Commodity Futures Trading Commission as a major swap participant.

"(d) RULEMAKING.—

"(1) IN GENERAL.—The Commission shall adopt rules for persons that are registered as security-based swap dealers or major security-based swap participants under this section.

"(2) EXCEPTION FOR PRUDENTIAL REQUIREMENTS.—

"(A) IN GENERAL.—The Commission may not prescribe rules imposing prudential requirements on security-based swap dealers or major security-based swap participants for which there is a prudential regulator.

"(B) APPLICABILITY.—Subparagraph (A) does not limit the authority of the Commission to prescribe rules as directed under this section.

"(e) CAPITAL AND MARGIN REQUIREMENTS.—

"(1) IN GENERAL.—

"(A) SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS THAT ARE BANKS.—Each registered security-based swap dealer and major security-based swap participant for which there is not a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the prudential regulator shall by rule or regulation prescribe under paragraph (2)(A).

"(B) SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS THAT ARE NOT BANKS.—Each registered security-based swap dealer and major security-based swap participant for which there is not a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the Commission shall by rule or regulation prescribe under paragraph (2)(B).

"(2) RULES.—

"(A) SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS THAT ARE BANKS.—The prudential regulators, in consultation with the Commission and the Commodity Futures Trading Commission, shall adopt rules for security-based swap dealers and major security-based swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is a prudential regulator imposing—

"(i) capital requirements; and

"(ii) both initial and variation margin requirements on all security-based swaps that are not cleared by a registered clearing agency.

"(B) SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS THAT ARE NOT BANKS.—The Commission shall adopt rules for security-based swap dealers and major security-based swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is not a prudential regulator imposing—

"(i) capital requirements; and

"(ii) both initial and variation margin requirements on all swaps that are not cleared by a registered clearing agency.

"(C) CAPITAL.—In setting capital requirements for a person that is designated as a security-based swap dealer or a major security-based swap participant for a single type or single class or category of security-based swap or activities, the prudential regulator and the Commission shall take into account the risks associated with other types of security-based swaps or classes of security-based swaps or categories of security-based swaps engaged in and the other activities conducted by that person that are not otherwise subject to regulation applicable to that person by virtue of the status of the person.

"(3) STANDARDS FOR CAPITAL AND MARGIN.—

"(A) IN GENERAL.—To offset the greater risk to the security-based swap dealer or major security-based swap participant and the financial system arising from the use of security-based swaps that are not cleared, the requirements imposed under paragraph (2) shall —

"(i) help ensure the safety and soundness of the security-based swap dealer or major security-based swap participant; and

"(ii) be appropriate for the risk associated with the non-cleared security-based swaps held as a security-based swap dealer or major security-based swap participant.

"(B) RULE OF CONSTRUCTION.—

"(i) IN GENERAL.—Nothing in this section shall limit, or be construed to limit, the authority—

"(I) of the Commission to set financial responsibility rules for a broker or dealer registered pursuant to section 15(b) (except for section 15(b)(11) thereof) in accordance with section 15(c)(3); or

"(II) of the Commodity Futures Trading Commission to set financial responsibility rules for a futures commission merchant or introducing broker registered pursuant to section 4f(a) of the Commodity Exchange Act (except for section 4f(a)(3) thereof) in accordance with section 4f(b) of the Commodity Exchange Act.

"(ii) FUTURES COMMISSION MERCHANTS AND OTHER DEALERS.—A futures commission merchant, introducing broker, broker, or dealer shall maintain sufficient capital to comply with the stricter of any applicable capital requirements to which such futures commission merchant, introducing broker, broker, or dealer is subject to under this title or the Commodity Exchange Act.

"(C) MARGIN REQUIREMENTS.—In prescribing margin requirements under this subsection, the prudential regulator with respect to security-based swap dealers and major security-based swap participants that are depository institutions, and the Commission with respect to security-based swap dealers and major security-based swap participants that are not depository institutions shall permit the use of noncash collateral, as the regulator or the Commission determines to be consistent with—

"(i) preserving the financial integrity of markets trading security-based swaps; and

"(ii) preserving the stability of the United States financial system.

"(D) COMPARABILITY OF CAPITAL AND MARGIN REQUIREMENTS.—

"(i) IN GENERAL.—The prudential regulators, the Commission, and the Securities and Exchange Commission shall periodically (but not less frequently than annually) consult on minimum capital requirements and minimum initial and variation margin requirements.

"(ii) COMPARABILITY.—The entities described in clause (i) shall, to the maximum extent practicable, establish and maintain comparable minimum capital requirements and minimum initial and variation margin requirements, including the use of noncash collateral, for—

"(I) security-based swap dealers; and

"(II) major security-based swap participants.

"(f) REPORTING AND RECORDKEEPING.—

"(1) IN GENERAL.—Each registered security-based swap dealer and major security-based swap participant—

"(A) shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and positions and financial condition of the registered security-based swap dealer or major security-based swap participant;

"(B)(i) for which there is a prudential regulator, shall keep books and records of all activities related to the business as a security-based swap dealer or major security-based swap participant in such form and manner and for such period as may be prescribed by the Commission by rule or regulation; and

"(ii) for which there is no prudential regulator, shall keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation; and

"(C) shall keep books and records described in subparagraph (B) open to inspection and examination by any representative of the Commission.

"(2) RULES.—The Commission shall adopt rules governing reporting and recordkeeping for security-based swap dealers and major security-based swap participants.

"(g) DAILY TRADING RECORDS.—

"(1) IN GENERAL.—Each registered security-based swap dealer and major security-based swap participant shall maintain daily trading records of the security-based swaps of the registered security-based swap dealer and major security-based swap participant and all related records (including related cash or forward transactions) and recorded communications, including electronic mail, instant messages, and recordings of telephone calls, for such period as may be required by the Commission by rule or regulation.

"(2) INFORMATION REQUIREMENTS.—The daily trading records shall include such information as the Commission shall require by rule or regulation.

"(3) COUNTERPARTY RECORDS.—Each registered security-based swap dealer and major security-based swap participant shall maintain daily trading records for each counterparty in a manner and form that is identifiable with each security-based swap transaction.

"(4) AUDIT TRAIL.—Each registered security-based swap dealer and major security-based swap participant shall maintain a complete audit trail for conducting comprehensive and accurate trade reconstructions.

"(5) RULES.—The Commission shall adopt rules governing daily trading records for security-based swap dealers and major security-based swap participants.

"(h) BUSINESS CONDUCT STANDARDS.—

"(1) IN GENERAL.—Each registered security-based swap dealer and major security-based swap participant shall conform with such business conduct standards as prescribed in paragraph (3) and as may be prescribed by the Commission by rule or regulation that relate to—

"(A) fraud, manipulation, and other abusive practices involving security-based swaps (including security-based swaps that are offered but not entered into);

"(B) diligent supervision of the business of the registered security-based swap dealer and major security-based swap participant;

"(C) adherence to all applicable position limits; and

"(D) such other matters as the Commission determines to be appropriate.

"(2) RESPONSIBILITIES WITH RESPECT TO SPECIAL ENTITIES.—

"(A) ADVISING SPECIAL ENTITIES.—A security-based swap dealer or major security-based swap participant that acts as an advisor to special entity regarding a security-based swap shall comply with the requirements of paragraph (4) with respect to such special entity.

"(B) ENTERING OF SECURITY-BASED SWAPS WITH RESPECT TO SPECIAL ENTITIES.—A security-based swap dealer that enters into or offers to enter into security-based swap with a special entity shall comply with the requirements of paragraph (5) with respect to such special entity.

"(C) SPECIAL ENTITY DEFINED.—For purposes of this subsection, the term 'special entity' means—

"(i) a Federal agency;

"(ii) a State, State agency, city, county, municipality, or other political subdivision of a State or;

"(iii) any employee benefit plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002);

"(iv) any governmental plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); or "(v) any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986.

"(3) BUSINESS CONDUCT REQUIREMENTS.—Business conduct requirements adopted by the Commission shall—

"(A) establish a duty for a security-based swap dealer or major security-based swap participant to verify that any counterparty meets the eligibility standards for an eligible contract participant;

"(B) require disclosure by the security-based swap dealer or major security-based swap participant to any counterparty to the transaction (other than a security-based swap dealer, major security-based swap participant, security-based swap dealer, or major security-based swap participant) of—

"(i) information about the material risks and characteristics of the security-based swap;

"(ii) any material incentives or conflicts of interest that the security-based swap dealer or major security-based swap participant may have in connection with the security-based swap; and

"(iii)(I) for cleared security-based swaps, upon the request of the counterparty, receipt of the daily mark of the transaction from the appropriate derivatives clearing organization; and

"(II) for uncleared security-based swaps, receipt of the daily mark of the transaction from the security-based swap dealer or the major security-based swap participant;

"(C) establish a duty for a security-based swap dealer or major security-based swap participant to communicate in a fair and balanced manner based on principles of fair dealing and good faith; and

"(D) establish such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act.

"(4) SPECIAL REQUIREMENTS FOR SECURITY-BASED SWAP DEALERS ACTING AS ADVISORS.—

"(A) IN GENERAL.—It shall be unlawful for a security-based swap dealer or major security-based swap participant—

"(i) to employ any device, scheme, or artifice to defraud any special entity or prospective customer who is a special entity;

"(ii) to engage in any transaction, practice, or course of business that operates as a fraud or deceit on any special entity or prospective customer who is a special entity; or

"(iii) to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative.

"(B) DUTY.—Any security-based swap dealer that acts as an advisor to a special entity shall have a duty to act in the best interests of the special entity.

"(C) REASONABLE EFFORTS.—Any security-based swap dealer that acts as an advisor to a special entity shall make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any security-based swap recommended by the security-based swap dealer is in the best interests of the special entity, including information relating to—

"(i) the financial status of the special entity;

"(ii) the tax status of the special entity;

"(iii) the investment or financing objectives of the special entity; and

"(iv) any other information that the Commission may prescribe by rule or regulation.

"(5) SPECIAL REQUIREMENTS FOR SECURITY-BASED SWAP DEALERS AS COUNTERPARTIES TO SPECIAL ENTITIES.—

"(A) IN GENERAL.—Any security-based swap dealer or major security-based swap participant that offers to or enters into a security-based swap with a special entity shall—

"(i) comply with any duty established by the Commission for a security-based swap dealer or major security-based swap participant, with respect to a counterparty that is an eligible contract participant within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18) of the Commodity Exchange Act, that requires the security-based swap dealer or major security-based swap participant to have a reasonable basis to believe that the counterparty that is a special entity has an independent representative that—

"(I) has sufficient knowledge to evaluate the transaction and risks;

"(II) is not subject to a statutory disqualification;

"(III) is independent of the security-based swap dealer or major security-based swap participant;

"(IV) undertakes a duty to act in the best interests of the counterparty it represents;

"(V) makes appropriate disclosures;

"(VI) will provide written representations to the special entity regarding fair pricing and the appropriateness of the transaction; and

"(VII) in the case of employee benefit plans subject to the Employee Retirement Income Security act of 1974, is a fiduciary as defined in section 3 of that Act (29 U.S.C. 1002); and

"(ii) before the initiation of the transaction, disclose to the special entity in writing the capacity in which the security-based swap dealer is acting.

"(B) COMMISSION AUTHORITY.—The Commission may establish such other standards and requirements under this paragraph as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act.

"(6) RULES.—The Commission shall prescribe rules under this subsection governing business conduct standards for security-based swap dealers and major security-based swap participants.

"(7) APPLICABILITY.—This subsection shall not apply with respect to a transaction that is—

"(A) initiated by a special entity on an exchange or security-based swaps execution facility; and

"(B) the security-based swap dealer or major security-based swap participant does not know the identity of the counterparty to the transaction."

"(i) DOCUMENTATION STANDARDS.—

"(1) IN GENERAL.—Each registered security-based swap dealer and major security-based swap participant shall conform with such standards as may be prescribed by the Commission, by rule or regulation, that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all security-based swaps.

"(2) RULES.—The Commission shall adopt rules governing documentation standards for security-based swap dealers and major security-based swap participants.

"(j) DUTIES.—Each registered security-based swap dealer and major security-based swap participant shall, at all times, comply with the following requirements:

"(1) MONITORING OF TRADING.—The security-based swap dealer or major security-based swap participant shall monitor its trading in security-based swaps to prevent violations of applicable position limits.

"(2) RISK MANAGEMENT PROCEDURES.—The security-based swap dealer or major security-based swap participant shall establish robust and professional risk management systems adequate for managing the day-to-day business of the security-based swap dealer or major security-based swap participant.

"(3) DISCLOSURE OF GENERAL INFORMATION.—The security-based swap dealer or major security-based swap participant shall disclose to the Commission and to the prudential regulator for the security-based swap dealer or major security-based swap participant, as applicable, information concerning—

"(A) terms and conditions of its security-based swaps;

"(B) security-based swap trading operations, mechanisms, and practices;

"(C) financial integrity protections relating to security-based swaps; and

"(D) other information relevant to its trading in security-based swaps.

"(4) ABILITY TO OBTAIN INFORMATION.—The security-based swap dealer or major security-based swap participant shall—

"(A) establish and enforce internal systems and procedures to obtain any necessary information to perform any of the functions described in this section; and

"(B) provide the information to the Commission and to the prudential regulator for the security-based swap dealer or major security-based swap participant, as applicable, on request.

"(5) CONFLICTS OF INTEREST.—The security-based swap dealer and major security-based swap participant shall implement conflict-of-interest systems and procedures that—

"(A) establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any security-based swap or acting in a role of providing clearing activities or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards described in this title; and

"(B) address such other issues as the Commission determines to be appropriate.

"(6) ANTITRUST CONSIDERATIONS.—Unless necessary or appropriate to achieve the purposes of this title, the security-based swap dealer or major security-based swap participant shall not—

"(A) adopt any process or take any action that results in any unreasonable restraint of trade; or

"(B) impose any material anticompetitive burden on trading or clearing.

"(7) RULES.—The Commission shall prescribe rules under this subsection governing duties of security-based swap dealers and major security-based swap participants.

"(k) DESIGNATION OF CHIEF COMPLIANCE OFFICER.—

"(1) IN GENERAL.—Each security-based swap dealer and major security-based swap participant shall designate an individual to serve as a chief compliance officer.

"(2) DUTIES.—The chief compliance officer shall—

"(A) report directly to the board or to the senior officer of the security-based swap dealer or major security-based swap participant;

"(B) review the compliance of the security-based swap dealer or major security-based swap participant with respect to the security-based swap dealer and major security-based swap participant requirements described in this section;

"(C) in consultation with the board of directors, a body performing a function similar to the board, or the senior officer of the organization, resolve any conflicts of interest that may arise;

"(D) be responsible for administering each policy and procedure that is required to be established pursuant to this section;

"(E) ensure compliance with this title (including regulations) relating to security-based swaps, including each rule prescribed by the Commission under this section;

"(F) establish procedures for the remediation of noncompliance issues identified by the chief compliance officer through any—

"(i) compliance office review;

"(ii) look-back;

"(iii) internal or external audit finding;

"(iv) self-reported error; or

"(v) validated complaint; and

"(G) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

"(3) ANNUAL REPORTS.—

"(A) IN GENERAL.—In accordance with rules prescribed by the Commission, the chief compliance officer shall annually prepare and sign a report that contains a description of—

"(i) the compliance of the security-based swap dealer or major swap participant with respect to this title (including regulations); and

"(ii) each policy and procedure of the security-based swap dealer or major security-based swap participant of the chief compliance officer (including the code of ethics and conflict of interest policies).

"(B) REQUIREMENTS.—A compliance report under subparagraph (A) shall—

"(i) accompany each appropriate financial report of the security-based swap dealer or major security-based swap participant that is required to be furnished to the Commission pursuant to this section; and

"(ii) include a certification that, under penalty of law, the compliance report is accurate and complete.

"(l) ENFORCEMENT AND ADMINISTRATIVE PROCEEDING AUTHORITY.—

"(1) PRIMARY ENFORCEMENT AUTHORITY.—

"(A) SECURITIES AND EXCHANGE COMMISSION.—Except as provided in subparagraph (B), (C), or (D), the Commission shall have primary authority to enforce subtitle B, and the amendments made by subtitle B of the Wall Street Transparency and Accountability Act of 2010, with respect to any person.

"(B) PRUDENTIAL REGULATORS.—The prudential regulators shall have exclusive authority to enforce the provisions of subsection (e) and other prudential requirements of this title (including risk management standards), with respect to security-based swap dealers or major security-based swap participants for which they are the prudential regulator.

"(C) REFERRAL.—

"(i) VIOLATIONS OF NONPRUDENTIAL REQUIREMENTS.—If the appropriate Federal banking agency for security-based swap dealers or major security-based swap participants that are depository institutions has cause to believe that such security-based swap dealer or major security-based swap participant may have engaged in conduct that constitutes a violation of the nonprudential requirements of this section or rules adopted by the Commission thereunder, the agency may recommend in writing to the Commission that the Commission initiate an enforcement proceeding as authorized under this title. The recommendation shall be accompanied by a written explanation of the concerns giving rise to the recommendation.

"(ii) VIOLATIONS OF PRUDENTIAL REQUIREMENTS.—If the Commission has cause to believe that a securities-based swap dealer or major securities-based swap participant that has a prudential regulator may have engaged in conduct that constitute a violation of the prudential requirements of subsection (e) or rules adopted thereunder, the Commission may recommend in writing to the prudential regulator that the prudential regulator initiate an enforcement proceeding as authorized under this title. The recommendation shall be accompanied by a written explanation of the concerns giving rise to the recommendation.

"(D) BACKSTOP ENFORCEMENT AUTHORITY.—

"(i) INITIATION OF ENFORCEMENT PROCEEDING BY PRUDENTIAL REGULATOR.—If the Commission does not initiate an enforcement proceeding before the end of the 90-day period beginning on the date on which the Commission receives a written report under subsection (C)(i), the prudential regulator may initiate an enforcement proceeding.

"(ii) INITIATION OF ENFORCEMENT PROCEEDING BY COMMISSION.—If the prudential regulator does not initiate an enforcement proceeding before the end of the 90-day period beginning on the date on which the prudential regulator receives a written report under subsection (C)(ii), the Commission may initiate an enforcement proceeding.

"(2) CENSURE, DENIAL, SUSPENSION; NOTICE AND HEARING.—The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, or revoke the registration of any security-based swap dealer or major security-based swap participant that has registered with the Commission pursuant to subsection (b) if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, or revocation is in the public interest and that such security-based swap dealer or major security-based swap participant, or any person associated with such security-based swap dealer or major security-based swap participant effecting or involved in effecting transactions in security-based swaps on behalf of such security-based swap dealer or major security-based swap participant, whether prior or subsequent to becoming so associated—

"(A) has committed or omitted any act, or is subject to an order or finding, enumerated in subparagraph (A), (D), or (E) of paragraph (4) of section 15(b);

"(B) has been convicted of any offense specified in subparagraph (B) of such paragraph (4) within 10 years of the commencement of the proceedings under this subsection;

"(C) is enjoined from any action, conduct, or practice specified in subparagraph (C) of such paragraph (4);

"(D) is subject to an order or a final order specified in subparagraph (F) or (H), respectively, of such paragraph (4); or

"(E) has been found by a foreign financial regulatory authority to have committed or omitted any act, or violated any foreign statute or regulation, enumerated in subparagraph (G) of such paragraph (4).

"(3) ASSOCIATED PERSONS.—With respect to any person who is associated, who is seeking to become associated, or, at the time of the alleged misconduct, who was associated or was seeking to become associated with a security-based swap dealer or major security-based swap participant for the purpose of effecting or being involved in effecting security-based swaps on behalf of such security-based swap dealer or major security-based swap participant, the Commission, by order, shall censure, place limitations on the activities or functions of such person, or suspend for a period not exceeding 12 months, or bar such person from being associated with a security-based swap dealer or major security-based swap participant, if the Commission finds, on the record after notice and opportunity for a hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person—

"(A) has committed or omitted any act, or is subject to an order or finding, enumerated in subparagraph (A), (D), or (E) of paragraph (4) of section 15(b);

"(B) has been convicted of any offense specified in subparagraph (B) of such paragraph (4) within 10 years of the commencement of the proceedings under this subsection;

"(C) is enjoined from any action, conduct, or practice specified in subparagraph (C) of such paragraph (4);

"(D) is subject to an order or a final order specified in subparagraph (F) or (H), respectively, of such paragraph (4); or

"(E) has been found by a foreign financial regulatory authority to have committed or omitted any act, or violated any foreign statute or regulation, enumerated in subparagraph (G) of such paragraph (4).

"(4) UNLAWFUL CONDUCT.—It shall be unlawful—

"(A) for any person as to whom an order under paragraph (3) is in effect, without the consent of the Commission, willfully to become, or to be, associated with a security-based swap dealer or major security-based swap participant in contravention of such order; or

"(B) for any security-based swap dealer or major security-based swap participant to permit such a person, without the consent of the Commission, to become or remain a person associated with the security-based swap dealer or major security-based swap participant in contravention of such order, if such security-based swap dealer or major security-based swap participant knew, or in the exercise of reasonable care should have known, of such order.".

(b) SAVINGS CLAUSE.—Notwithstanding any other provision of this title, nothing in this subtitle shall be construed as divesting any appropriate Federal banking agency of any authority it may have to establish or enforce, with respect to a person for which such agency is the appropriate Federal banking agency, prudential or other standards pursuant to authority by Federal law other than this title.

SEC. 765. RULEMAKING ON CONFLICT OF INTEREST.

(a) IN GENERAL.—In order to mitigate conflicts of interest, not later than 180 days after the date of enactment of the Wall Street Transparency and Accountability Act of 2010, the Securities and Exchange Commission shall adopt rules which may include numerical limits on the control of, or the voting rights with respect to, any clearing agency that clears security-based swaps, or on the control of any security-based swap execution facility or national securities exchange that posts or makes available for trading security-based swaps, by a bank holding company (as defined in section

2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841)) with total consolidated assets of $50,000,000,000 or more, a nonbank financial company (as defined in section 102) supervised by the Board of Governors of the Federal Reserve System, affiliate of such a bank holding company or nonbank financial company, a security-based swap dealer, major security-based swap participant, or person associated with a security-based swap dealer or major security-based swap participant.

(b) PURPOSES.—The Securities and Exchange Commission shall adopt rules if the Commission determines, after the review described in subsection (a), that such rules are necessary or appropriate to improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a security-based swap dealer or major security-based swap participant's conduct of business with, a clearing agency, national securities exchange, or security-based swap execution facility that clears, posts, or makes available for trading security-based swaps and in which such security-based swap dealer or major security-based swap participant has a material debt or equity investment.

(c) CONSIDERATIONS.—In adopting rules pursuant to this section, the Securities and Exchange Commission shall consider any conflicts of interest arising from the amount of equity owned by a single investor, the ability to vote, cause the vote of, or withhold votes entitled to be cast on any matters by the holders of the ownership interest, and the governance arrangements of any derivatives clearing organization that clears swaps, or swap execution facility or board of trade designated as a contract market that posts swaps or makes swaps available for trading.

SEC. 766. REPORTING AND RECORDKEEPING.

(a) IN GENERAL.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 13 the following:

"SEC. 13A. REPORTING AND RECORDKEEPING FOR CERTAIN SECURITY-BASED SWAPS.

"(a) REQUIRED REPORTING OF SECURITY-BASED SWAPS NOT ACCEPTED BY ANY CLEARING AGENCY OR DERIVATIVES CLEARING ORGANIZATION.—

"(1) IN GENERAL.—Each security-based swap that is not accepted for clearing by any clearing agency or derivatives clearing organization shall be reported to—

"(A) a security-based swap data repository described in section 13(n); or

"(B) in the case in which there is no security-based swap data repository that would accept the security-based swap, to the Commission pursuant to this section within such time period as the Commission may by rule or regulation prescribe.

"(2) TRANSITION RULE FOR PREENACTMENT SECURITY-BASED SWAPS.—

"(A) SECURITY-BASED SWAPS ENTERED INTO BEFORE THE DATE OF ENACTMENT OF THE WALL STREET TRANSPARENCY AND ACCOUNTABILITY ACT OF 2010.—Each security-based swap entered into before the date of enactment of the Wall Street Transparency and Accountability Act of 2010, the terms of which have not expired as of the date of enactment of that Act, shall be reported to a registered security-based swap data repository or the Commission by a date that is not later than—

"(i) 30 days after issuance of the interim final rule; or

"(ii) such other period as the Commission determines to be appropriate.

"(B) COMMISSION RULEMAKING.—The Commission shall promulgate an interim final rule within 90 days of the date of enactment of this section providing for the reporting of each security-based swap entered into before the date of enactment as referenced in subparagraph (A).

"(C) EFFECTIVE DATE.—The reporting provisions described in this section shall be effective upon the date of the enactment of this section.

"(3) REPORTING OBLIGATIONS.—

"(A) SECURITY-BASED SWAPS IN WHICH ONLY 1 COUNTERPARTY IS A SECURITY-BASED SWAP DEALER OR MAJOR SECURITY-BASED SWAP PARTICIPANT.—With respect to a security-based swap in which only 1 counterparty is a security-based swap dealer or major security-based swap participant, the security-based swap dealer or major security-based swap participant shall report the security-based swap as required under paragraphs (1) and (2).

"(B) SECURITY-BASED SWAPS IN WHICH 1 COUNTERPARTY IS A SECURITY-BASED SWAP DEALER AND THE OTHER A MAJOR SECURITY-BASED SWAP PARTICIPANT.—With respect to a security-based swap in which 1 counterparty is a security-based swap dealer and the other a major security-based swap participant, the security-based swap dealer shall report the security-based swap as required under paragraphs (1) and (2).

"(C) OTHER SECURITY-BASED SWAPS.—With respect to any other security-based swap not described in subparagraph (A) or (B), the counterparties to the security-based swap shall select a counterparty to report the security-based swap as required under paragraphs (1) and (2).

"(b) DUTIES OF CERTAIN INDIVIDUALS.—Any individual or entity that enters into a security-based swap shall meet each requirement described in subsection (c) if the individual or entity did not—

"(1) clear the security-based swap in accordance with section 3C(a)(1); or

"(2) have the data regarding the security-based swap accepted by a security-based swap data repository in accordance with rules (including timeframes) adopted by the Commission under this title.

"(c) REQUIREMENTS.—An individual or entity described in subsection (b) shall—

"(1) upon written request from the Commission, provide reports regarding the security-based swaps held by the individual or entity to the Commission in such form and in such manner as the Commission may request; and

"(2) maintain books and records pertaining to the security-based swaps held by the individual or entity in such form, in such manner, and for such period as the Commission may require, which shall be open to inspection by—

"(A) any representative of the Commission;

"(B) an appropriate prudential regulator;

"(C) the Commodity Futures Trading Commission;

"(D) the Financial Stability Oversight Council; and

"(E) the Department of Justice.

"(d) IDENTICAL DATA.—In prescribing rules under this section, the Commission shall require individuals and entities described in subsection (b) to submit to the Commission a report that contains data that is not less comprehensive than the data required to be collected by security-based swap data repositories under this title.".

(b) BENEFICIAL OWNERSHIP REPORTING.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended—

(1) in subsection (d)(1), by inserting "or otherwise becomes or is deemed to become a beneficial owner of any of the foregoing upon the purchase or sale of a security-based swap that the Commission may define by rule, and" after "Alaska Native Claims Settlement Act,"; and

(2) in subsection (g)(1), by inserting "or otherwise becomes or is deemed to become a beneficial owner of any security of a class described in subsection (d)(1) upon the purchase or sale of a security-based swap that the Commission may define by rule" after "subsection (d)(1) of this section".

(c) REPORTS BY INSTITUTIONAL INVESTMENT MANAGERS.—Section 13(f)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(f)(1)) is amended by inserting "or otherwise becomes or is deemed to become a beneficial owner of any security of a class described in subsection (d)(1) upon the purchase or sale of a security-based swap that the Commission may define by rule," after "subsection (d)(1) of this section".

(d) ADMINISTRATIVE PROCEEDING AUTHORITY.—Section 15(b)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)(4)) is amended—

(1) in subparagraph (C), by inserting "security-based swap dealer, major security-based swap participant," after "government securities dealer,"; and

(2) in subparagraph (F), by striking "broker or dealer" and inserting "broker, dealer, security-based swap dealer, or a major security-based swap participant".

(e) SECURITY-BASED SWAP BENEFICIAL OWNERSHIP.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

"(o) BENEFICIAL OWNERSHIP.—For purposes of this section and section 16, a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap, only to the extent that the Commission, by rule, determines after consultation with the prudential regulators and the Secretary of the Treasury, that the purchase or sale of the security-based swap, or class of security-based swap, provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of this section that the purchase or sale of the security-based swaps, or class of security-based swap, be deemed the acquisition of beneficial ownership of the equity security.".

SEC. 767. STATE GAMING AND BUCKET SHOP LAWS.

Section 28(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(a)) is amended to read as follows:

"(a) LIMITATION ON JUDGMENTS.—

"(1) IN GENERAL.—No person permitted to maintain a suit for damages under the provisions of this title shall recover, through satisfaction of judgment in 1 or more actions, a total amount in excess of the actual damages to that person on account of the act complained of. Except as otherwise specifically provided in this title, nothing in this title shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations under this title.

"(2) RULE OF CONSTRUCTION.—Except as provided in subsection (f), the rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity.

"(3) STATE BUCKET SHOP LAWS.—No State law which prohibits or regulates the making or promoting of wagering or gaming contracts, or the operation of 'bucket shops' or other similar or related activities, shall invalidate—

"(A) any put, call, straddle, option, privilege, or other security subject to this title (except any security that has a pari-mutuel payout or otherwise is determined by the Commission, acting by rule, regulation, or order, to be appropriately subject to such laws), or apply to any activity which is incidental or related to the offer, purchase, sale, exercise, settlement, or closeout of any such security;

"(B) any security-based swap between eligible contract participants; or

"(C) any security-based swap effected on a national securities exchange registered pursuant to section 6(b).

"(4) OTHER STATE PROVISIONS.—No provision of State law regarding the offer, sale, or distribution of securities shall apply to any transaction in a security-based swap or a security futures product, except that this paragraph may not be construed as limiting any State antifraud law of general applicability. A security-based swap may not be regulated as an insurance contract under any provision of State law.".

SEC. 768. AMENDMENTS TO THE SECURITIES ACT OF 1933; TREATMENT OF SECURITY-BASED SWAPS.

(a) DEFINITIONS.—Section 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)) is amended—

(1) in paragraph (1), by inserting "security-based swap," after "security future,";

(2) in paragraph (3), by adding at the end the following: "Any offer or sale of a security-based swap by or on behalf of the issuer of the securities upon which such security-based swap is based or is referenced, an affiliate of the issuer, or an underwriter, shall constitute a contract for sale of, sale of, offer for sale, or offer to sell such securities."; and

(3) by adding at the end the following:

"(17) The terms 'swap' and 'security-based swap' have the same meanings as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

"(18) The terms 'purchase' or 'sale' of a security-based swap shall be deemed to mean the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require.''.

(b) REGISTRATION OF SECURITY-BASED SWAPS.—Section 5 of the Securities Act of 1933 (15 U.S.C. 77e) is amended by adding at the end the following:

''(d) Notwithstanding the provisions of section 3 or 4, unless a registration statement meeting the requirements of section 10(a) is in effect as to a security-based swap, it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell, offer to buy or purchase or sell a security-based swap to any person who is not an eligible contract participant as defined in section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)).''.

SEC. 769. DEFINITIONS UNDER THE INVESTMENT COMPANY ACT OF 1940.

Section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–2) is amended by adding at the end the following:

''(54) The terms 'commodity pool', 'commodity pool operator', 'commodity trading advisor', 'major swap participant', 'swap', 'swap dealer', and 'swap execution facility' have the same meanings as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).''.

SEC. 770. DEFINITIONS UNDER THE INVESTMENT ADVISERS ACT OF 1940.

Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2) is amended by adding at the end the following:

''(29) The terms 'commodity pool', 'commodity pool operator', 'commodity trading advisor', 'major swap participant', 'swap', 'swap dealer', and 'swap execution facility' have the same meanings as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).''.

SEC. 771. OTHER AUTHORITY.

Unless otherwise provided by its terms, this subtitle does not divest any appropriate Federal banking agency, the Securities and Exchange Commission, the Commodity Futures Trading Commission, or any other Federal or State agency, of any authority derived from any other provision of applicable law.

SEC. 772. JURISDICTION.

(a) IN GENERAL.—Section 36 of the Securities Exchange Act of 1934 (15 U.S.C. 78mm) is amended by adding at the end the following:

''(c) DERIVATIVES.—Unless the Commission is expressly authorized by any provision described in this subsection to grant exemptions, the Commission shall not grant exemptions, with respect to amendments made by subtitle B of the Wall Street Transparency and Accountability Act of 2010, with respect to paragraphs (65), (66), (68), (69), (70), (71), (72), (73), (74), (75), (76), and (79) of section 3(a), and sections 10B(a), 10B(b), 10B(c), 13A, 15F, 17A(g), 17A(h), 17A(i), 17A(j), 17A(k), and 17A(l); provided that the Commission shall have exemptive authority under this title with respect to security-based swaps as to the same matters that the Commodity

Futures Trading Commission has under the Wall Street Transparency and Accountability Act of 2010 with respect to swaps, including under section 4(c) of the Commodity Exchange Act.''.

(b) RULE OF CONSTRUCTION.—Section 30 of the Securities Exchange Act of 1934 (15 U.S.C. 78dd) is amended by adding at the end the following:

''(c) RULE OF CONSTRUCTION.—No provision of this title that was added by the Wall Street Transparency and Accountability Act of 2010, or any rule or regulation thereunder, shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of any provision of this title that was added by the Wall Street Transparency and Accountability Act of 2010. This subsection shall not be construed to limit the jurisdiction of the Commission under any provision of this title, as in effect prior to the date of enactment of the Wall Street Transparency and Accountability Act of 2010.''.

SEC. 773. CIVIL PENALTIES.

Section 21B of the Securities Exchange Act of 1934 (15 U.S.C. 78p-2) is amended by adding at the end the following:

''(f) SECURITY-BASED SWAPS.—

''(1) CLEARING AGENCY.—Any clearing agency that knowingly or recklessly evades or participates in or facilitates an evasion of the requirements of section 3C shall be liable for a civil money penalty in twice the amount otherwise available for a violation of section 3C.

''(2) SECURITY-BASED SWAP DEALER OR MAJOR SECURITY-BASED SWAP PARTICIPANT.—Any security-based swap dealer or major security-based swap participant that knowingly or recklessly evades or participates in or facilitates an evasion of the requirements of section 3C shall be liable for a civil money penalty in twice the amount otherwise available for a violation of section 3C.''.

SEC. 774. EFFECTIVE DATE.

Unless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle.

TITLE VIII—PAYMENT, CLEARING, AND SETTLEMENT SUPERVISION

SEC. 801. SHORT TITLE.

This title may be cited as the ''Payment, Clearing, and Settlement Supervision Act of 2010''.

SEC. 802. FINDINGS AND PURPOSES.

(a) FINDINGS.—Congress finds the following:

(1) The proper functioning of the financial markets is dependent upon safe and efficient arrangements for the clearing

and settlement of payment, securities, and other financial transactions.

(2) Financial market utilities that conduct or support multilateral payment, clearing, or settlement activities may reduce risks for their participants and the broader financial system, but such utilities may also concentrate and create new risks and thus must be well designed and operated in a safe and sound manner.

(3) Payment, clearing, and settlement activities conducted by financial institutions also present important risks to the participating financial institutions and to the financial system.

(4) Enhancements to the regulation and supervision of systemically important financial market utilities and the conduct of systemically important payment, clearing, and settlement activities by financial institutions are necessary—

(A) to provide consistency;

(B) to promote robust risk management and safety and soundness;

(C) to reduce systemic risks; and

(D) to support the stability of the broader financial system.

(b) PURPOSE.—The purpose of this title is to mitigate systemic risk in the financial system and promote financial stability by—

(1) authorizing the Board of Governors to promote uniform standards for the—

(A) management of risks by systemically important financial market utilities; and

(B) conduct of systemically important payment, clearing, and settlement activities by financial institutions;

(2) providing the Board of Governors an enhanced role in the supervision of risk management standards for systemically important financial market utilities;

(3) strengthening the liquidity of systemically important financial market utilities; and

(4) providing the Board of Governors an enhanced role in the supervision of risk management standards for systemically important payment, clearing, and settlement activities by financial institutions.

SEC. 803. DEFINITIONS.

In this title, the following definitions shall apply:

(1) APPROPRIATE FINANCIAL REGULATOR.—The term "appropriate financial regulator" means—

(A) the primary financial regulatory agency, as defined in section 2 of this Act;

(B) the National Credit Union Administration, with respect to any insured credit union under the Federal Credit Union Act (12 U.S.C. 1751 et seq.); and

(C) the Board of Governors, with respect to organizations operating under section 25A of the Federal Reserve Act (12 U.S.C. 611), and any other financial institution engaged in a designated activity.

(2) DESIGNATED ACTIVITY.—The term "designated activity" means a payment, clearing, or settlement activity that the Council has designated as systemically important under section 804.

(3) DESIGNATED CLEARING ENTITY.—The term "designated clearing entity" means a designated financial market utility that is a derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) or a clearing agency registered with the Securities and Exchange Commission under section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1).

(4) DESIGNATED FINANCIAL MARKET UTILITY.—The term "designated financial market utility" means a financial market utility that the Council has designated as systemically important under section 804.

(5) FINANCIAL INSTITUTION.—

(A) IN GENERAL.—The term "financial institution" means—

(i) a depository institution, as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(ii) a branch or agency of a foreign bank, as defined in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101);

(iii) an organization operating under section 25 or 25A of the Federal Reserve Act (12 U.S.C. 601–604a and 611 through 631);

(iv) a credit union, as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752);

(v) a broker or dealer, as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c);

(vi) an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3);

(vii) an insurance company, as defined in section 2 of the Investment Company Act of 1940 (15 U.S.C. 80a–2);

(viii) an investment adviser, as defined in section 202 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2);

(ix) a futures commission merchant, commodity trading advisor, or commodity pool operator, as defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a); and

(x) any company engaged in activities that are financial in nature or incidental to a financial activity, as described in section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)).

(B) EXCLUSIONS.—The term "financial institution" does not include designated contract markets, registered futures associations, swap data repositories, and swap execution facilities registered under the Commodity Exchange Act (7 U.S.C. 1 et seq.), or national securities exchanges, national securities associations, alternative trading systems, securities information processors solely with respect to the activities of the entity as a securities information processor, security-based swap data repositories, and swap execution facilities registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), or designated clearing entities, provided that the exclusions in this subparagraph apply only with respect to the activities that require the entity to be so registered.

(6) FINANCIAL MARKET UTILITY.—

(A) INCLUSION.—The term "financial market utility" means any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person.

(B) EXCLUSIONS.—The term "financial market utility" does not include—

(i) designated contract markets, registered futures associations, swap data repositories, and swap execution facilities registered under the Commodity Exchange Act (7 U.S.C. 1 et seq.), or national securities exchanges, national securities associations, alternative trading systems, security-based swap data repositories, and swap execution facilities registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), solely by reason of their providing facilities for comparison of data respecting the terms of settlement of securities or futures transactions effected on such exchange or by means of any electronic system operated or controlled by such entities, provided that the exclusions in this clause apply only with respect to the activities that require the entity to be so registered; and

(ii) any broker, dealer, transfer agent, or investment company, or any futures commission merchant, introducing broker, commodity trading advisor, or commodity pool operator, solely by reason of functions performed by such institution as part of brokerage, dealing, transfer agency, or investment company activities, or solely by reason of acting on behalf of a financial market utility or a participant therein in connection with the furnishing by the financial market utility of services to its participants or the use of services of the financial market utility by its participants, provided that services performed by such institution do not constitute critical risk management or processing functions of the financial market utility.

(7) PAYMENT, CLEARING, OR SETTLEMENT ACTIVITY.—

(A) IN GENERAL.—The term "payment, clearing, or settlement activity" means an activity carried out by 1 or more financial institutions to facilitate the completion of financial transactions, but shall not include any offer or sale of a security under the Securities Act of 1933 (15 U.S.C. 77a et seq.), or any quotation, order entry, negotiation, or other pre-trade activity or execution activity.

(B) FINANCIAL TRANSACTION.—For the purposes of subparagraph (A), the term "financial transaction" includes—

(i) funds transfers;

(ii) securities contracts;

(iii) contracts of sale of a commodity for future delivery;

(iv) forward contracts;

(v) repurchase agreements;

(vi) swaps;

(vii) security-based swaps;

(viii) swap agreements;

(ix) security-based swap agreements;

(x) foreign exchange contracts;

(xi) financial derivatives contracts; and

(xii) any similar transaction that the Council determines to be a financial transaction for purposes of this title.

(C) INCLUDED ACTIVITIES.—When conducted with respect to a financial transaction, payment, clearing, and settlement activities may include—

(i) the calculation and communication of unsettled financial transactions between counterparties;

(ii) the netting of transactions;

(iii) provision and maintenance of trade, contract, or instrument information;

(iv) the management of risks and activities associated with continuing financial transactions;

(v) transmittal and storage of payment instructions;

(vi) the movement of funds;

(vii) the final settlement of financial transactions; and

(viii) other similar functions that the Council may determine.

(D) EXCLUSION.—Payment, clearing, and settlement activities shall not include public reporting of swap transaction data under section 727 or 763(i) of the Wall Street Transparency and Accountability Act of 2010.

(8) SUPERVISORY AGENCY.—

(A) IN GENERAL.—The term "Supervisory Agency" means the Federal agency that has primary jurisdiction over a designated financial market utility under Federal banking, securities, or commodity futures laws, as follows:

(i) The Securities and Exchange Commission, with respect to a designated financial market utility that is a clearing agency registered with the Securities and Exchange Commission.

(ii) The Commodity Futures Trading Commission, with respect to a designated financial market utility that is a derivatives clearing organization registered with the Commodity Futures Trading Commission.

(iii) The appropriate Federal banking agency, with respect to a designated financial market utility that is an institution described in section 3(q) of the Federal Deposit Insurance Act.

(iv) The Board of Governors, with respect to a designated financial market utility that is otherwise not subject to the jurisdiction of any agency listed in clauses (i), (ii), and (iii).

(B) MULTIPLE AGENCY JURISDICTION.—If a designated financial market utility is subject to the jurisdictional supervision of more than 1 agency listed in subparagraph (A), then such agencies should agree on 1 agency to act as the Supervisory Agency, and if such agencies cannot agree on which agency has primary jurisdiction, the Council shall decide which agency is the Supervisory Agency for purposes of this title.

(9) SYSTEMICALLY IMPORTANT AND SYSTEMIC IMPORTANCE.—The terms "systemically important" and "systemic importance" mean a situation where the failure of or a disruption to the functioning of a financial market utility or the conduct of a payment, clearing, or settlement activity could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States.

SEC. 804. DESIGNATION OF SYSTEMIC IMPORTANCE.

(a) DESIGNATION.—

(1) FINANCIAL STABILITY OVERSIGHT COUNCIL.—The Council, on a nondelegable basis and by a vote of not fewer than ⅔ of members then serving, including an affirmative vote by the Chairperson of the Council, shall designate those financial market utilities or payment, clearing, or settlement activities that the Council determines are, or are likely to become, systemically important.

(2) CONSIDERATIONS.—In determining whether a financial market utility or payment, clearing, or settlement activity is, or is likely to become, systemically important, the Council shall take into consideration the following:

(A) The aggregate monetary value of transactions processed by the financial market utility or carried out through the payment, clearing, or settlement activity.

(B) The aggregate exposure of the financial market utility or a financial institution engaged in payment, clearing, or settlement activities to its counterparties.

(C) The relationship, interdependencies, or other interactions of the financial market utility or payment, clearing, or settlement activity with other financial market utilities or payment, clearing, or settlement activities.

(D) The effect that the failure of or a disruption to the financial market utility or payment, clearing, or settlement activity would have on critical markets, financial institutions, or the broader financial system.

(E) Any other factors that the Council deems appropriate.

(b) RESCISSION OF DESIGNATION.—

(1) IN GENERAL.—The Council, on a nondelegable basis and by a vote of not fewer than ⅔ of members then serving, including an affirmative vote by the Chairperson of the Council, shall rescind a designation of systemic importance for a designated financial market utility or designated activity if the Council determines that the utility or activity no longer meets the standards for systemic importance.

(2) EFFECT OF RESCISSION.—Upon rescission, the financial market utility or financial institutions conducting the activity will no longer be subject to the provisions of this title or any rules or orders prescribed under this title.

(c) CONSULTATION AND NOTICE AND OPPORTUNITY FOR HEARING.—

(1) CONSULTATION.—Before making any determination under subsection (a) or (b), the Council shall consult with the relevant Supervisory Agency and the Board of Governors.

(2) ADVANCE NOTICE AND OPPORTUNITY FOR HEARING.—

(A) IN GENERAL.—Before making any determination under subsection (a) or (b), the Council shall provide the financial market utility or, in the case of a payment, clearing, or settlement activity, financial institutions with advance notice of the proposed determination of the Council.

(B) NOTICE IN FEDERAL REGISTER.—The Council shall provide such advance notice to financial institutions by publishing a notice in the Federal Register.

(C) REQUESTS FOR HEARING.—Within 30 days from the date of any notice of the proposed determination of the Council, the financial market utility or, in the case of a payment, clearing, or settlement activity, a financial institution engaged in the designated activity may request, in writing, an opportunity for a written or oral hearing before the Council to demonstrate that the proposed designation or rescission of designation is not supported by substantial evidence.

(D) WRITTEN SUBMISSIONS.—Upon receipt of a timely request, the Council shall fix a time, not more than 30 days after receipt of the request, unless extended at the request of the financial market utility or financial institution, and place at which the financial market utility or financial institution may appear, personally or through counsel, to submit written materials, or, at the sole discretion of the Council, oral testimony or oral argument.

(3) EMERGENCY EXCEPTION.—

(A) WAIVER OR MODIFICATION BY VOTE OF THE COUNCIL.—The Council may waive or modify the requirements of paragraph (2) if the Council determines, by an affirmative vote of not fewer than ⅔ of members then serving, including an affirmative vote by the Chairperson of the Council, that the waiver or modification is necessary to prevent or mitigate an immediate threat to the financial system posed by the financial market utility or the payment, clearing, or settlement activity.

(B) NOTICE OF WAIVER OR MODIFICATION.—The Council shall provide notice of the waiver or modification to the financial market utility concerned or, in the case of a payment, clearing, or settlement activity, to financial institutions, as soon as practicable, which shall be no later than 24 hours after the waiver or modification in the case of a financial market utility and 3 business days in the case of financial institutions. The Council shall provide the notice to financial institutions by posting a notice on the website of the Council and by publishing a notice in the Federal Register.

(d) NOTIFICATION OF FINAL DETERMINATION.—

(1) AFTER HEARING.—Within 60 days of any hearing under subsection (c)(2), the Council shall notify the financial market utility or financial institutions of the final determination of the Council in writing, which shall include findings of fact upon which the determination of the Council is based.

(2) WHEN NO HEARING REQUESTED.—If the Council does not receive a timely request for a hearing under subsection (c)(2), the Council shall notify the financial market utility or financial institutions of the final determination of the Council in writing not later than 30 days after the expiration of the date by which a financial market utility or a financial institution could have requested a hearing. All notices to financial institutions under this subsection shall be published in the Federal Register.

(e) EXTENSION OF TIME PERIODS.—The Council may extend the time periods established in subsections (c) and (d) as the Council determines to be necessary or appropriate.

SEC. 805. STANDARDS FOR SYSTEMICALLY IMPORTANT FINANCIAL MARKET UTILITIES AND PAYMENT, CLEARING, OR SETTLEMENT ACTIVITIES.

(a) AUTHORITY TO PRESCRIBE STANDARDS.—

(1) BOARD OF GOVERNORS.—Except as provided in paragraph (2), the Board of Governors, by rule or order, and in consultation with the Council and the Supervisory Agencies, shall prescribe risk management standards, taking into consideration relevant international standards and existing prudential requirements, governing—

(A) the operations related to the payment, clearing, and settlement activities of designated financial market utilities; and

(B) the conduct of designated activities by financial institutions.

(2) SPECIAL PROCEDURES FOR DESIGNATED CLEARING ENTITIES AND DESIGNATED ACTIVITIES OF CERTAIN FINANCIAL INSTITUTIONS.—

(A) CFTC AND COMMISSION.—The Commodity Futures Trading Commission and the Commission may each prescribe regulations, in consultation with the Council and the Board of Governors, containing risk management standards, taking into consideration relevant international standards and existing prudential requirements, for those designated clearing entities and financial institutions engaged in designated activities for which each is the Supervisory Agency or the appropriate financial regulator, governing—

(i) the operations related to payment, clearing, and settlement activities of such designated clearing entities; and

(ii) the conduct of designated activities by such financial institutions.

(B) REVIEW AND DETERMINATION.—The Board of Governors may determine that existing prudential requirements of the Commodity Futures Trading Commission, the Commission, or both (including requirements prescribed pursuant to subparagraph (A)) with respect to designated clearing entities and financial institutions engaged in designated activities for which the Commission or the Commodity Futures Trading Commission is the Supervisory Agency or the appropriate financial regulator are insufficient to prevent or mitigate significant liquidity, credit, operational, or other risks to the financial markets or to the financial stability of the United States.

(C) WRITTEN DETERMINATION.—Any determination by the Board of Governors under subparagraph (B) shall be provided in writing to the Commodity Futures Trading Commission or the Commission, as applicable, and the Council, and shall explain why existing prudential requirements, considered as a whole, are insufficient to ensure that the operations and activities of the designated clearing entities or the activities of financial institutions described in subparagraph (B) will not pose significant liquidity, credit, operational, or other risks to the financial markets or to the financial stability of the United States. The Board of Governors' determination shall contain a detailed analysis supporting its findings and identify the specific prudential requirements that are insufficient.

(D) CFTC AND COMMISSION RESPONSE.—The Commodity Futures Trading Commission or the Commission, as applicable, shall within 60 days either object to the Board of Governors' determination with a detailed analysis as to why existing prudential requirements are sufficient, or submit an explanation to the Council and the Board of Governors describing the actions to be taken in response to the Board of Governors' determination.

(E) AUTHORIZATION.—Upon an affirmative vote by not fewer than 2/3 of members then serving on the Council, the Council shall either find that the response submitted under subparagraph (D) is sufficient, or require the Commodity Futures Trading Commission, or the Commission, as applicable, to prescribe such risk management standards as the Council determines is necessary to address the specific prudential requirements that are determined to be insufficient."

(b) OBJECTIVES AND PRINCIPLES.—The objectives and principles for the risk management standards prescribed under subsection (a) shall be to—

(1) promote robust risk management;

(2) promote safety and soundness;

(3) reduce systemic risks; and

(4) support the stability of the broader financial system.

(c) SCOPE.—The standards prescribed under subsection (a) may address areas such as—

(1) risk management policies and procedures;

(2) margin and collateral requirements;

(3) participant or counterparty default policies and procedures;

(4) the ability to complete timely clearing and settlement of financial transactions;

(5) capital and financial resource requirements for designated financial market utilities; and

(6) other areas that are necessary to achieve the objectives and principles in subsection (b).

(d) LIMITATION ON SCOPE.—Except as provided in subsections (e) and (f) of section 807, nothing in this title shall be construed to permit the Council or the Board of Governors to take any action or exercise any authority granted to the Commodity Futures Trading Commission under section 2(h) of the Commodity Exchange

Act or the Securities and Exchange Commission under section 3C(a) of the Securities Exchange Act of 1934, including—

(1) the approval of, disapproval of, or stay of the clearing requirement for any group, category, type, or class of swaps that a designated clearing entity may accept for clearing;

(2) the determination that any group, category, type, or class of swaps shall be subject to the mandatory clearing requirement of section 2(h)(1) of the Commodity Exchange Act or section 3C(a)(1) of the Securities Exchange Act of 1934;

(3) the determination that any person is exempt from the mandatory clearing requirement of section 2(h)(1) of the Commodity Exchange Act or section 3C(a)(1) of the Securities Exchange Act of 1934; or

(4) any authority granted to the Commodity Futures Trading Commission or the Securities and Exchange Commission with respect to transaction reporting or trade execution.

(e) THRESHOLD LEVEL.—The standards prescribed under subsection (a) governing the conduct of designated activities by financial institutions shall, where appropriate, establish a threshold as to the level or significance of engagement in the activity at which a financial institution will become subject to the standards with respect to that activity.

(f) COMPLIANCE REQUIRED.—Designated financial market utilities and financial institutions subject to the standards prescribed under subsection (a) for a designated activity shall conduct their operations in compliance with the applicable risk management standards.

SEC. 806. OPERATIONS OF DESIGNATED FINANCIAL MARKET UTILITIES.

(a) FEDERAL RESERVE ACCOUNT AND SERVICES.—The Board of Governors may authorize a Federal Reserve Bank to establish and maintain an account for a designated financial market utility and provide the services listed in section 11A(b) of the Federal Reserve Act (12 U.S.C. 248a(b)) and deposit accounts under the first undesignated paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 342) to the designated financial market utility that the Federal Reserve Bank is authorized under the Federal Reserve Act to provide to a depository institution, subject to any applicable rules, orders, standards, or guidelines prescribed by the Board of Governors.

(b) ADVANCES.—The Board of Governors may authorize a Federal Reserve bank under section 10B of the Federal Reserve Act (12 U.S.C. 347b) to provide to a designated financial market utility discount and borrowing privileges only in unusual or exigent circumstances, upon the affirmative vote of a majority of the Board of Governors then serving (or such other number in accordance with the provisions of section 11(r)(2) of the Federal Reserve Act (12 U.S.C. 248(r)(2)) after consultation with the Secretary, and upon a showing by the designated financial market utility that it is unable to secure adequate credit accommodations from other banking institutions. All such discounts and borrowing privileges shall be subject to such other limitations, restrictions, and regulations as the Board of Governors may prescribe. Access to discount and borrowing privileges under section 10B of the Federal Reserve Act as authorized in this section does not require a designated financial market utility to be or become a bank or bank holding company.

(c) EARNINGS ON FEDERAL RESERVE BALANCES.—A Federal Reserve Bank may pay earnings on balances maintained by or on behalf of a designated financial market utility in the same manner and to the same extent as the Federal Reserve Bank may pay earnings to a depository institution under the Federal Reserve Act, subject to any applicable rules, orders, standards, or guidelines prescribed by the Board of Governors.

(d) RESERVE REQUIREMENTS.—The Board of Governors may exempt a designated financial market utility from, or modify any, reserve requirements under section 19 of the Federal Reserve Act (12 U.S.C. 461) applicable to a designated financial market utility.

(e) CHANGES TO RULES, PROCEDURES, OR OPERATIONS.—

(1) ADVANCE NOTICE.—

(A) ADVANCE NOTICE OF PROPOSED CHANGES REQUIRED.—A designated financial market utility shall provide notice 60 days in advance notice to its Supervisory Agency of any proposed change to its rules, procedures, or operations that could, as defined in rules of each Supervisory Agency, materially affect, the nature or level of risks presented by the designated financial market utility.

(B) TERMS AND STANDARDS PRESCRIBED BY THE SUPERVISORY AGENCIES.—Each Supervisory Agency, in consultation with the Board of Governors, shall prescribe regulations that define and describe the standards for determining when notice is required to be provided under subparagraph (A).

(C) CONTENTS OF NOTICE.—The notice of a proposed change shall describe—

(i) the nature of the change and expected effects on risks to the designated financial market utility, its participants, or the market; and

(ii) how the designated financial market utility plans to manage any identified risks.

(D) ADDITIONAL INFORMATION.—The Supervisory Agency may require a designated financial market utility to provide any information necessary to assess the effect the proposed change would have on the nature or level of risks associated with the designated financial market utility's payment, clearing, or settlement activities and the sufficiency of any proposed risk management techniques.

(E) NOTICE OF OBJECTION.—The Supervisory Agency shall notify the designated financial market utility of any objection regarding the proposed change within 60 days from the later of—

(i) the date that the notice of the proposed change is received; or

(ii) the date any further information requested for consideration of the notice is received.

(F) CHANGE NOT ALLOWED IF OBJECTION.—A designated financial market utility shall not implement a change to which the Supervisory Agency has an objection.

(G) CHANGE ALLOWED IF NO OBJECTION WITHIN 60 DAYS.—A designated financial market utility may implement a change if it has not received an objection to the proposed change within 60 days of the later of—

(i) the date that the Supervisory Agency receives the notice of proposed change; or

(ii) the date the Supervisory Agency receives any further information it requests for consideration of the notice.

(H) REVIEW EXTENSION FOR NOVEL OR COMPLEX ISSUES.—The Supervisory Agency may, during the 60-day review period, extend the review period for an additional 60 days for proposed changes that raise novel or complex issues, subject to the Supervisory Agency providing the designated financial market utility with prompt written notice of the extension. Any extension under this subparagraph will extend the time periods under subparagraphs (E) and (G).

(I) CHANGE ALLOWED EARLIER IF NOTIFIED OF NO OBJECTION.—A designated financial market utility may implement a change in less than 60 days from the date of receipt of the notice of proposed change by the Supervisory Agency, or the date the Supervisory Agency receives any further information it requested, if the Supervisory Agency notifies the designated financial market utility in writing that it does not object to the proposed change and authorizes the designated financial market utility to implement the change on an earlier date, subject to any conditions imposed by the Supervisory Agency.

(2) EMERGENCY CHANGES.—

(A) IN GENERAL.—A designated financial market utility may implement a change that would otherwise require advance notice under this subsection if it determines that—

(i) an emergency exists; and

(ii) immediate implementation of the change is necessary for the designated financial market utility to continue to provide its services in a safe and sound manner.

(B) NOTICE REQUIRED WITHIN 24 HOURS.—The designated financial market utility shall provide notice of any such emergency change to its Supervisory Agency, as soon as practicable, which shall be no later than 24 hours after implementation of the change.

(C) CONTENTS OF EMERGENCY NOTICE.—In addition to the information required for changes requiring advance notice, the notice of an emergency change shall describe—

(i) the nature of the emergency; and

(ii) the reason the change was necessary for the designated financial market utility to continue to provide its services in a safe and sound manner.

(D) MODIFICATION OR RESCISSION OF CHANGE MAY BE REQUIRED.—The Supervisory Agency may require modification or rescission of the change if it finds that the change is not consistent with the purposes of this Act or any applicable rules, orders, or standards prescribed under section 805(a).

(3) COPYING THE BOARD OF GOVERNORS.—The Supervisory Agency shall provide the Board of Governors concurrently with a complete copy of any notice, request, or other information it issues, submits, or receives under this subsection.

(4) CONSULTATION WITH BOARD OF GOVERNORS.—Before taking any action on, or completing its review of, a change proposed by a designated financial market utility, the Supervisory Agency shall consult with the Board of Governors.

SEC. 807. EXAMINATION OF AND ENFORCEMENT ACTIONS AGAINST DESIGNATED FINANCIAL MARKET UTILITIES.

(a) EXAMINATION.—Notwithstanding any other provision of law and subject to subsection (d), the Supervisory Agency shall conduct examinations of a designated financial market utility at least once annually in order to determine the following:

(1) The nature of the operations of, and the risks borne by, the designated financial market utility.

(2) The financial and operational risks presented by the designated financial market utility to financial institutions, critical markets, or the broader financial system.

(3) The resources and capabilities of the designated financial market utility to monitor and control such risks.

(4) The safety and soundness of the designated financial market utility.

(5) The designated financial market utility's compliance with—

(A) this title; and

(B) the rules and orders prescribed under this title.

(b) SERVICE PROVIDERS.—Whenever a service integral to the operation of a designated financial market utility is performed for the designated financial market utility by another entity, whether an affiliate or non-affiliate and whether on or off the premises of the designated financial market utility, the Supervisory Agency may examine whether the provision of that service is in compliance with applicable law, rules, orders, and standards to the same extent as if the designated financial market utility were performing the service on its own premises.

(c) ENFORCEMENT.—For purposes of enforcing the provisions of this title, a designated financial market utility shall be subject to, and the appropriate Supervisory Agency shall have authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) in the same manner and to the same extent as if the designated financial market utility was an insured depository institution and the Supervisory Agency was the appropriate Federal banking agency for such insured depository institution.

(d) BOARD OF GOVERNORS INVOLVEMENT IN EXAMINATIONS.—

(1) BOARD OF GOVERNORS CONSULTATION ON EXAMINATION PLANNING.—The Supervisory Agency shall consult annually with the Board of Governors regarding the scope and methodology of any examination conducted under subsections (a) and (b). The Supervisory Agency shall lead all examinations conducted under subsections (a) and (b)

(2) BOARD OF GOVERNORS PARTICIPATION IN EXAMINATION.—The Board of Governors may, in its discretion, participate in any examination led by a Supervisory Agency and conducted under subsections (a) and (b).

(e) BOARD OF GOVERNORS ENFORCEMENT RECOMMENDATIONS.—

(1) RECOMMENDATION.—The Board of Governors may, after consulting with the Council and the Supervisory Agency, at any time recommend to the Supervisory Agency that such

agency take enforcement action against a designated financial market utility in order to prevent or mitigate significant liquidity, credit, operational, or other risks to the financial markets or to the financial stability of the United States. Any such recommendation for enforcement action shall provide a detailed analysis supporting the recommendation of the Board of Governors.

(2) CONSIDERATION.—The Supervisory Agency shall consider the recommendation of the Board of Governors and submit a response to the Board of Governors within 60 days.

(3) BINDING ARBITRATION.—If the Supervisory Agency rejects, in whole or in part, the recommendation of the Board of Governors, the Board of Governors may refer the recommendation to the Council for a binding decision on whether an enforcement action is warranted.

(4) ENFORCEMENT ACTION.—Upon an affirmative vote by a majority of the Council in favor of the Board of Governors' recommendation under paragraph (3), the Council may require the Supervisory Agency to—

(A) exercise the enforcement authority referenced in subsection (c); and

(B) take enforcement action against the designated financial market utility.

(f) EMERGENCY ENFORCEMENT ACTIONS BY THE BOARD OF GOVERNORS.—

(1) IMMINENT RISK OF SUBSTANTIAL HARM.—The Board of Governors may, after consulting with the Supervisory Agency and upon an affirmative vote by a majority the Council, take enforcement action against a designated financial market utility if the Board of Governors has reasonable cause to conclude that—

(A) either—

(i) an action engaged in, or contemplated by, a designated financial market utility (including any change proposed by the designated financial market utility to its rules, procedures, or operations that would otherwise be subject to section 806(e)) poses an imminent risk of substantial harm to financial institutions, critical markets, or the broader financial system of the United States; or

(ii) the condition of a designated financial market utility poses an imminent risk of substantial harm to financial institutions, critical markets, or the broader financial system; and

(B) the imminent risk of substantial harm precludes the Board of Governors' use of the procedures in subsection (e).

(2) ENFORCEMENT AUTHORITY.—For purposes of taking enforcement action under paragraph (1), a designated financial market utility shall be subject to, and the Board of Governors shall have authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) in the same manner and to the same extent as if the designated financial market utility was an insured depository institution and the Board of Governors was the appropriate Federal banking agency for such insured depository institution.

SEC. 808. EXAMINATION OF AND ENFORCEMENT ACTIONS AGAINST FINANCIAL INSTITUTIONS SUBJECT TO STANDARDS FOR DESIGNATED ACTIVITIES.

(a) EXAMINATION.—The appropriate financial regulator is authorized to examine a financial institution subject to the standards prescribed under section 805(a) for a designated activity in order to determine the following:

(1) The nature and scope of the designated activities engaged in by the financial institution.

(2) The financial and operational risks the designated activities engaged in by the financial institution may pose to the safety and soundness of the financial institution.

(3) The financial and operational risks the designated activities engaged in by the financial institution may pose to other financial institutions, critical markets, or the broader financial system.

(4) The resources available to and the capabilities of the financial institution to monitor and control the risks described in paragraphs (2) and (3).

(5) The financial institution's compliance with this title and the rules and orders prescribed under section 805(a).

(b) ENFORCEMENT.—For purposes of enforcing the provisions of this title, and the rules and orders prescribed under this section, a financial institution subject to the standards prescribed under section 805(a) for a designated activity shall be subject to, and the appropriate financial regulator shall have authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) in the same manner and to the same extent as if the financial institution was an insured depository institution and the appropriate financial regulator was the appropriate Federal banking agency for such insured depository institution.

(c) TECHNICAL ASSISTANCE.—The Board of Governors shall consult with and provide such technical assistance as may be required by the appropriate financial regulators to ensure that the rules and orders prescribed under this title are interpreted and applied in as consistent and uniform a manner as practicable.

(d) DELEGATION.—

(1) EXAMINATION.—

(A) REQUEST TO BOARD OF GOVERNORS.—The appropriate financial regulator may request the Board of Governors to conduct or participate in an examination of a financial institution subject to the standards prescribed under section 805(a) for a designated activity in order to assess the compliance of such financial institution with—

(i) this title; or

(ii) the rules or orders prescribed under this title.

(B) EXAMINATION BY BOARD OF GOVERNORS.—Upon receipt of an appropriate written request, the Board of Governors will conduct the examination under such terms and conditions to which the Board of Governors and the appropriate financial regulator mutually agree.

(2) ENFORCEMENT.—

(A) REQUEST TO BOARD OF GOVERNORS.—The appropriate financial regulator may request the Board of Governors to enforce this title or the rules or orders prescribed under this title against a financial institution that is subject to the standards prescribed under section 805(a) for a designated activity.

(B) ENFORCEMENT BY BOARD OF GOVERNORS.—Upon receipt of an appropriate written request, the Board of Governors shall determine whether an enforcement action is warranted, and, if so, it shall enforce compliance with this title or the rules or orders prescribed under this title and, if so, the financial institution shall be subject to, and the Board of Governors shall have authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) in the same manner and to the same extent as if the financial institution was an insured depository institution and the Board of Governors was the appropriate Federal banking agency for such insured depository institution.

(e) BACK-UP AUTHORITY OF THE BOARD OF GOVERNORS.—

(1) EXAMINATION AND ENFORCEMENT.—Notwithstanding any other provision of law, the Board of Governors may—

(A) conduct an examination of the type described in subsection (a) of any financial institution that is subject to the standards prescribed under section 805(a) for a designated activity; and

(B) enforce the provisions of this title or any rules or orders prescribed under this title against any financial institution that is subject to the standards prescribed under section 805(a) for a designated activity.

(2) LIMITATIONS.—

(A) EXAMINATION.—The Board of Governors may exercise the authority described in paragraph (1)(A) only if the Board of Governors has—

(i) reasonable cause to believe that a financial institution is not in compliance with this title or the rules or orders prescribed under this title with respect to a designated activity;

(ii) notified, in writing, the appropriate financial regulator and the Council of its belief under clause (i) with supporting documentation included;

(iii) requested the appropriate financial regulator to conduct a prompt examination of the financial institution;

(iv) either—

(I) not been afforded a reasonable opportunity to participate in an examination of the financial institution by the appropriate financial regulator within 30 days after the date of the Board's notification under clause (ii); or

(II) reasonable cause to believe that the financial institution's noncompliance with this title or the rules or orders prescribed under this title poses a substantial risk to other financial institutions, critical markets, or the broader financial system, subject to the Board of Governors affording the appropriate financial regulator a reasonable opportunity to participate in the examination; and

(v) obtained the approval of the Council upon an affirmative vote by a majority of the Council.

(B) ENFORCEMENT.—The Board of Governors may exercise the authority described in paragraph (1)(B) only if the Board of Governors has—

(i) reasonable cause to believe that a financial institution is not in compliance with this title or the rules or orders prescribed under this title with respect to a designated activity;

(ii) notified, in writing, the appropriate financial regulator and the Council of its belief under clause (i) with supporting documentation included and with a recommendation that the appropriate financial regulator take 1 or more specific enforcement actions against the financial institution;

(iii) either—

(I) not been notified, in writing, by the appropriate financial regulator of the commencement of an enforcement action recommended by the Board of Governors against the financial institution within 60 days from the date of the notification under clause (ii); or

(II) reasonable cause to believe that the financial institution's noncompliance with this title or the rules or orders prescribed under this title poses significant liquidity, credit, operational, or other risks to the financial markets or to the financial stability of the United States, subject to the Board of Governors notifying the appropriate financial regulator of the Board's enforcement action; and

(iv) obtained the approval of the Council upon an affirmative vote by a majority of the Council.

(3) ENFORCEMENT PROVISIONS.—For purposes of taking enforcement action under paragraph (1), the financial institution shall be subject to, and the Board of Governors shall have authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) in the same manner and to the same extent as if the financial institution was an insured depository institution and the Board of Governors was the appropriate Federal banking agency for such insured depository institution.

SEC. 809. REQUESTS FOR INFORMATION, REPORTS, OR RECORDS.

(a) INFORMATION TO ASSESS SYSTEMIC IMPORTANCE.—

(1) FINANCIAL MARKET UTILITIES.—The Council is authorized to require any financial market utility to submit such information as the Council may require for the sole purpose of assessing whether that financial market utility is systemically important, but only if the Council has reasonable cause to believe that the financial market utility meets the standards for systemic importance set forth in section 804.

(2) FINANCIAL INSTITUTIONS ENGAGED IN PAYMENT, CLEARING, OR SETTLEMENT ACTIVITIES.—The Council is authorized to require any financial institution to submit such information as the Council may require for the sole purpose of assessing whether any payment, clearing, or settlement activity engaged in or supported by a financial institution is systemically important, but only if the Council has reasonable cause to believe

that the activity meets the standards for systemic importance set forth in section 804.

(b) REPORTING AFTER DESIGNATION.—

(1) DESIGNATED FINANCIAL MARKET UTILITIES.—The Board of Governors and the Council may each require a designated financial market utility to submit reports or data to the Board of Governors and the Council in such frequency and form as deemed necessary by the Board of Governors or the Council in order to assess the safety and soundness of the utility and the systemic risk that the utility's operations pose to the financial system.

(2) FINANCIAL INSTITUTIONS SUBJECT TO STANDARDS FOR DESIGNATED ACTIVITIES.—The Board of Governors and the Council may each require 1 or more financial institutions subject to the standards prescribed under section 805(a) for a designated activity to submit, in such frequency and form as deemed necessary by the Board of Governors or the Council, reports and data to the Board of Governors and the Council solely with respect to the conduct of the designated activity and solely to assess whether—

(A) the rules, orders, or standards prescribed under section 805(a) with respect to the designated activity appropriately address the risks to the financial system presented by such activity; and

(B) the financial institutions are in compliance with this title and the rules and orders prescribed under section 805(a) with respect to the designated activity.

(3) LIMITATION.—The Board of Governors may, upon an affirmative vote by a majority of the Council, prescribe regulations under this section that impose a recordkeeping or reporting requirement on designated clearing entities or financial institutions engaged in designated activities that are subject to standards that have been prescribed under section 805(a)(2).

(c) COORDINATION WITH APPROPRIATE FEDERAL SUPERVISORY AGENCY.—

(1) ADVANCE COORDINATION.—Before requesting any material information from, or imposing reporting or recordkeeping requirements on, any financial market utility or any financial institution engaged in a payment, clearing, or settlement activity, the Board of Governors or the Council shall coordinate with the Supervisory Agency for a financial market utility or the appropriate financial regulator for a financial institution to determine if the information is available from or may be obtained by the agency in the form, format, or detail required by the Board of Governors or the Council.

(2) SUPERVISORY REPORTS.—Notwithstanding any other provision of law, the Supervisory Agency, the appropriate financial regulator, and the Board of Governors are authorized to disclose to each other and the Council copies of its examination reports or similar reports regarding any financial market utility or any financial institution engaged in payment, clearing, or settlement activities.

(d) TIMING OF RESPONSE FROM APPROPRIATE FEDERAL SUPERVISORY AGENCY.—If the information, report, records, or data requested by the Board of Governors or the Council under subsection (c)(1) are not provided in full by the Supervisory Agency or the appropriate financial regulator in less than 15 days after the date on which the material is requested, the Board of Governors or the Council may request the information or impose recordkeeping or reporting requirements directly on such persons as provided in subsections (a) and (b) with notice to the agency.

(e) SHARING OF INFORMATION.—

(1) MATERIAL CONCERNS.—Notwithstanding any other provision of law, the Board of Governors, the Council, the appropriate financial regulator, and any Supervisory Agency are authorized to—

(A) promptly notify each other of material concerns about a designated financial market utility or any financial institution engaged in designated activities; and

(B) share appropriate reports, information, or data relating to such concerns.

(2) OTHER INFORMATION.—Notwithstanding any other provision of law, the Board of Governors, the Council, the appropriate financial regulator, or any Supervisory Agency may, under such terms and conditions as it deems appropriate, provide confidential supervisory information and other information obtained under this title to each other, and to the Secretary, Federal Reserve Banks, State financial institution supervisory agencies, foreign financial supervisors, foreign central banks, and foreign finance ministries, subject to reasonable assurances of confidentiality, provided, however, that no person or entity receiving information pursuant to this section may disseminate such information to entities or persons other than those listed in this paragraph without complying with applicable law, including section 8 of the Commodity Exchange Act (7 U.S.C. 12).

(f) PRIVILEGE MAINTAINED.—The Board of Governors, the Council, the appropriate financial regulator, and any Supervisory Agency providing reports or data under this section shall not be deemed to have waived any privilege applicable to those reports or data, or any portion thereof, by providing the reports or data to the other party or by permitting the reports or data, or any copies thereof, to be used by the other party.

(g) DISCLOSURE EXEMPTION.—Information obtained by the Board of Governors, the Supervisory Agencies, or the Council under this section and any materials prepared by the Board of Governors, the Supervisory Agencies, or the Council regarding their assessment of the systemic importance of financial market utilities or any payment, clearing, or settlement activities engaged in by financial institutions, and in connection with their supervision of designated financial market utilities and designated activities, shall be confidential supervisory information exempt from disclosure under section 552 of title 5, United States Code. For purposes of such section 552, this subsection shall be considered a statute described in subsection (b)(3) of such section 552.

SEC. 810. RULEMAKING.

The Board of Governors, the Supervisory Agencies, and the Council are authorized to prescribe such rules and issue such orders as may be necessary to administer and carry out their respective authorities and duties granted under this title and prevent evasions thereof.

SEC. 811. OTHER AUTHORITY.

Unless otherwise provided by its terms, this title does not divest any appropriate financial regulator, any Supervisory Agency, or any other Federal or State agency, of any authority derived from any other applicable law, except that any standards prescribed by the Board of Governors under section 805 shall supersede any less stringent requirements established under other authority to the extent of any conflict.

SEC. 812. CONSULTATION.

(a) CFTC.—The Commodity Futures Trading Commission shall consult with the Board of Governors—

(1) prior to exercising its authorities under sections 2(h)(2)(C), 2(h)(3)(A), 2(h)(3)(C), 2(h)(4)(A), and 2(h)(4)(B) of the Commodity Exchange Act, as amended by the Wall Street Transparency and Accountability Act of 2010;

(2) with respect to any rule or rule amendment of a derivatives clearing organization for which a stay of certification has been issued under section 745(b)(3) of the Wall Street Transparency and Accountability Act of 2010; and

(3) prior to exercising its rulemaking authorities under section 728 of the Wall Street Transparency and Accountability Act of 2010.

(b) SEC.—The Commission shall consult with the Board of Governors—

(1) prior to exercising its authorities under sections 3C(a)(2)(C), 3C(a)(3)(A), 3C(a)(3)(C), 3C(a)(4)(A), and 3C(a)(4)(B) of the Securities Exchange Act of 1934, as amended by the Wall Street Transparency and Accountability Act of 2010;

(2) with respect to any proposed rule change of a clearing agency for which an extension of the time for review has been designated under section 19(b)(2) of the Securities Exchange Act of 1934; and

(3) prior to exercising its rulemaking authorities under section 13(n) of the Securities Exchange Act of 1934, as added by section 763(i) of the Wall Street Transparency and Accountability Act of 2010.

SEC. 813. COMMON FRAMEWORK FOR DESIGNATED CLEARING ENTITY RISK MANAGEMENT.

The Commodity Futures Trading Commission and the Commission shall coordinate with the Board of Governors to jointly develop risk management supervision programs for designated clearing entities. Not later than 1 year after the date of enactment of this Act, the Commodity Futures Trading Commission, the Commission, and the Board of Governors shall submit a joint report to the Committee on Banking, Housing, and Urban Affairs and the Committee on Agriculture, Nutrition, and Forestry of the Senate, and the Committee on Financial Services and the Committee on Agriculture of the House of Representatives recommendations for—

(1) improving consistency in the designated clearing entity oversight programs of the Commission and the Commodity Futures Trading Commission;

(2) promoting robust risk management by designated clearing entities;

(3) promoting robust risk management oversight by regulators of designated clearing entities; and

(4) improving regulators' ability to monitor the potential effects of designated clearing entity risk management on the stability of the financial system of the United States.

SEC. 814. EFFECTIVE DATE.

This title is effective as of the date of enactment of this Act.

TITLE IX—INVESTOR PROTECTIONS AND IMPROVEMENTS TO THE REGULATION OF SECURITIES

SEC. 901. SHORT TITLE.

This title may be cited as the "Investor Protection and Securities Reform Act of 2010".

Subtitle A—Increasing Investor Protection

SEC. 911. INVESTOR ADVISORY COMMITTEE ESTABLISHED.

Title I of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by adding at the end the following:

"SEC. 39. INVESTOR ADVISORY COMMITTEE.

"(a) ESTABLISHMENT AND PURPOSE.—

"(1) ESTABLISHMENT.—There is established within the Commission the Investor Advisory Committee (referred to in this section as the 'Committee').

"(2) PURPOSE.—The Committee shall—

"(A) advise and consult with the Commission on—

"(i) regulatory priorities of the Commission;

"(ii) issues relating to the regulation of securities products, trading strategies, and fee structures, and the effectiveness of disclosure;

"(iii) initiatives to protect investor interest; and

"(iv) initiatives to promote investor confidence and the integrity of the securities marketplace; and

"(B) submit to the Commission such findings and recommendations as the Committee determines are appropriate, including recommendations for proposed legislative changes.

"(b) MEMBERSHIP.—

"(1) IN GENERAL.—The members of the Committee shall be—

"(A) the Investor Advocate;

"(B) a representative of State securities commissions;

"(C) a representative of the interests of senior citizens; and

"(D) not fewer than 10, and not more than 20, members appointed by the Commission, from among individuals who—

"(i) represent the interests of individual equity and debt investors, including investors in mutual funds;

"(ii) represent the interests of institutional investors, including the interests of pension funds and registered investment companies;

"(iii) are knowledgeable about investment issues and decisions; and

"(iv) have reputations of integrity.

"(2) TERM.—Each member of the Committee appointed under paragraph (1)(B) shall serve for a term of 4 years.

"(3) MEMBERS NOT COMMISSION EMPLOYEES.—Members appointed under paragraph (1)(B) shall not be deemed to be employees or agents of the Commission solely because of membership on the Committee.

"(c) CHAIRMAN; VICE CHAIRMAN; SECRETARY; ASSISTANT SECRETARY.—

"(1) IN GENERAL.—The members of the Committee shall elect, from among the members of the Committee—

"(A) a chairman, who may not be employed by an issuer;

"(B) a vice chairman, who may not be employed by an issuer;

"(C) a secretary; and

"(D) an assistant secretary.

"(2) TERM.—Each member elected under paragraph (1) shall serve for a term of 3 years in the capacity for which the member was elected under paragraph (1).

"(d) MEETINGS.—

"(1) FREQUENCY OF MEETINGS.—The Committee shall meet—

"(A) not less frequently than twice annually, at the call of the chairman of the Committee; and

"(B) from time to time, at the call of the Commission.

"(2) NOTICE.—The chairman of the Committee shall give the members of the Committee written notice of each meeting, not later than 2 weeks before the date of the meeting.

"(e) COMPENSATION AND TRAVEL EXPENSES.—Each member of the Committee who is not a full-time employee of the United States shall—

"(1) be entitled to receive compensation at a rate not to exceed the daily equivalent of the annual rate of basic pay in effect for a position at level V of the Executive Schedule under section 5316 of title 5, United States Code, for each day during which the member is engaged in the actual performance of the duties of the Committee; and

"(2) while away from the home or regular place of business of the member in the performance of services for the Committee, be allowed travel expenses, including per diem in lieu of subsistence, in the same manner as persons employed intermittently in the Government service are allowed expenses under section 5703(b) of title 5, United States Code.

"(f) STAFF.—The Commission shall make available to the Committee such staff as the chairman of the Committee determines are necessary to carry out this section.

"(g) REVIEW BY COMMISSION.—The Commission shall—

"(1) review the findings and recommendations of the Committee; and

"(2) each time the Committee submits a finding or recommendation to the Commission, promptly issue a public statement—

"(A) assessing the finding or recommendation of the Committee; and

"(B) disclosing the action, if any, the Commission intends to take with respect to the finding or recommendation.

"(h) COMMITTEE FINDINGS.—Nothing in this section shall require the Commission to agree to or act upon any finding or recommendation of the Committee.

"(i) FEDERAL ADVISORY COMMITTEE ACT.—The Federal Advisory Committee Act (5 U.S.C. App.) shall not apply with respect to the Committee and its activities.

"(j) AUTHORIZATION OF APPROPRIATIONS.—There is authorized to be appropriated to the Commission such sums as are necessary to carry out this section.".

SEC. 912. CLARIFICATION OF AUTHORITY OF THE COMMISSION TO ENGAGE IN INVESTOR TESTING.

Section 19 of the Securities Act of 1933 (15 U.S.C. 77s) is amended by adding at the end the following:

"(e) EVALUATION OF RULES OR PROGRAMS.—For the purpose of evaluating any rule or program of the Commission issued or carried out under any provision of the securities laws, as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c), and the purposes of considering, proposing, adopting, or engaging in any such rule or program or developing new rules or programs, the Commission may—

"(1) gather information from and communicate with investors or other members of the public;

"(2) engage in such temporary investor testing programs as the Commission determines are in the public interest or would protect investors; and

"(3) consult with academics and consultants, as necessary to carry out this subsection.

"(f) RULE OF CONSTRUCTION.—For purposes of the Paperwork Reduction Act (44 U.S.C. 3501 et seq.), any action taken under subsection (e) shall not be construed to be a collection of information.".

SEC. 913. STUDY AND RULEMAKING REGARDING OBLIGATIONS OF BROKERS, DEALERS, AND INVESTMENT ADVISERS.

(a) DEFINITION.—For purposes of this section, the term "retail customer" means a natural person, or the legal representative of such natural person, who—

(1) receives personalized investment advice about securities from a broker or dealer or investment adviser; and

(2) uses such advice primarily for personal, family, or household purposes.

(b) STUDY.—The Commission shall conduct a study to evaluate—

(1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards; and

(2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care

for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.

(c) CONSIDERATIONS.—In conducting the study required under subsection (b), the Commission shall consider—

(1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards;

(2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute;

(3) whether retail customers understand that there are different standards of care applicable to brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers in the provision of personalized investment advice about securities to retail customers;

(4) whether the existence of different standards of care applicable to brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers is a source of confusion for retail customers regarding the quality of personalized investment advice that retail customers receive;

(5) the regulatory, examination, and enforcement resources devoted to, and activities of, the Commission, the States, and a national securities association to enforce the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers when providing personalized investment advice and recommendations about securities to retail customers, including—

(A) the effectiveness of the examinations of brokers, dealers, and investment advisers in determining compliance with regulations;

(B) the frequency of the examinations; and

(C) the length of time of the examinations;

(6) the substantive differences in the regulation of brokers, dealers, and investment advisers, when providing personalized investment advice and recommendations about securities to retail customers;

(7) the specific instances related to the provision of personalized investment advice about securities in which—

(A) the regulation and oversight of investment advisers provide greater protection to retail customers than the regulation and oversight of brokers and dealers; and

(B) the regulation and oversight of brokers and dealers provide greater protection to retail customers than the regulation and oversight of investment advisers;

(8) the existing legal or regulatory standards of State securities regulators and other regulators intended to protect retail customers;

(9) the potential impact on retail customers, including the potential impact on access of retail customers to the range of products and services offered by brokers and dealers, of imposing upon brokers, dealers, and persons associated with brokers or dealers—

(A) the standard of care applied under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.) for providing personalized investment advice about securities to retail customers of investment advisers, as interpreted by the Commission and the courts; and

(B) other requirements of the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.);

(10) the potential impact of eliminating the broker and dealer exclusion from the definition of "investment adviser" under section 202(a)(11)(C) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(11)(C)), in terms of—

(A) the impact and potential benefits and harm to retail customers that could result from such a change, including any potential impact on access to personalized investment advice and recommendations about securities to retail customers or the availability of such advice and recommendations;

(B) the number of additional entities and individuals that would be required to register under, or become subject to, the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.), and the additional requirements to which brokers, dealers, and persons associated with brokers and dealers would become subject, including—

(i) any potential additional associated person licensing, registration, and examination requirements; and

(ii) the additional costs, if any, to the additional entities and individuals; and

(C) the impact on Commission and State resources to—

(i) conduct examinations of registered investment advisers and the representatives of registered investment advisers, including the impact on the examination cycle; and

(ii) enforce the standard of care and other applicable requirements imposed under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.);

(11) the varying level of services provided by brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers to retail customers and the varying scope and terms of retail customer relationships of brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers with such retail customers;

(12) the potential impact upon retail customers that could result from potential changes in the regulatory requirements

or legal standards of care affecting brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers relating to their obligations to retail customers regarding the provision of investment advice, including any potential impact on—

(A) protection from fraud;

(B) access to personalized investment advice, and recommendations about securities to retail customers; or

(C) the availability of such advice and recommendations;

(13) the potential additional costs and expenses to—

(A) retail customers regarding and the potential impact on the profitability of their investment decisions; and

(B) brokers, dealers, and investment advisers resulting from potential changes in the regulatory requirements or legal standards affecting brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers relating to their obligations, including duty of care, to retail customers; and

(14) any other consideration that the Commission considers necessary and appropriate in determining whether to conduct a rulemaking under subsection (f).

(d) REPORT.—

(1) IN GENERAL.—Not later than 6 months after the date of enactment of this Act, the Commission shall submit a report on the study required under subsection (b) to—

(A) the Committee on Banking, Housing, and Urban Affairs of the Senate; and

(B) the Committee on Financial Services of the House of Representatives.

(2) CONTENT REQUIREMENTS.—The report required under paragraph (1) shall describe the findings, conclusions, and recommendations of the Commission from the study required under subsection (b), including—

(A) a description of the considerations, analysis, and public and industry input that the Commission considered, as required under subsection (b), to make such findings, conclusions, and policy recommendations; and

(B) an analysis of whether any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.

(e) PUBLIC COMMENT.—The Commission shall seek and consider public input, comments, and data in order to prepare the report required under subsection (d).

(f) RULEMAKING.—The Commission may commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers (and such other customers as the Commission may by rule provide), to address the legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to such retail customers. The Commission shall consider the findings conclusions, and recommendations of the study required under subsection (b).

(g) AUTHORITY TO ESTABLISH A FIDUCIARY DUTY FOR BROKERS AND DEALERS.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended by adding at the end the following:

"(k) STANDARD OF CONDUCT.—

"(1) IN GENERAL.—Notwithstanding any other provision of this Act or the Investment Advisers Act of 1940, the Commission may promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer (and such other customers as the Commission may by rule provide), the standard of conduct for such broker or dealer with respect to such customer shall be the same as the standard of conduct applicable to an investment adviser under section 211 of the Investment Advisers Act of 1940. The receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer. Nothing in this section shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities.

"(2) DISCLOSURE OF RANGE OF PRODUCTS OFFERED.—Where a broker or dealer sells only proprietary or other limited range of products, as determined by the Commission, the Commission may by rule require that such broker or dealer provide notice to each retail customer and obtain the consent or acknowledgment of the customer. The sale of only proprietary or other limited range of products by a broker or dealer shall not, in and of itself, be considered a violation of the standard set forth in paragraph (1).

"(l) OTHER MATTERS.—The Commission shall—

"(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and

"(2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.".

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 211 of the Investment Advisers Act of 1940, is further amended by adding at the end the following new subsections:

"(g) STANDARD OF CONDUCT.—

"(1) IN GENERAL.—The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice. In accordance with such rules, any material conflicts of interest shall be disclosed and may be consented to by the customer. Such rules shall provide that such standard of conduct shall be no less stringent than the standard applicable to investment advisers under section 206(1) and (2) of this Act when providing personalized investment advice about securities, except the Commission shall not ascribe a meaning to the term 'customer' that would include an investor in a private fund managed by an investment adviser, where such private fund has entered into an advisory contract with such adviser. The receipt of compensation based on commission or fees shall not, in and of itself, be considered a violation of such standard applied to a broker, dealer, or investment adviser.

"(2) RETAIL CUSTOMER DEFINED.—For purposes of this subsection, the term 'retail customer' means a natural person, or the legal representative of such natural person, who—

"(A) receives personalized investment advice about securities from a broker, dealer, or investment adviser; and

"(B) uses such advice primarily for personal, family, or household purposes.

"(h) OTHER MATTERS.—The Commission shall—

"(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and

"(2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.".

(h) HARMONIZATION OF ENFORCEMENT.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 15 of the Securities Exchange Act of 1934, as amended by subsection (g)(1), is further amended by adding at the end the following new subsection:

"(m) HARMONIZATION OF ENFORCEMENT.—The enforcement authority of the Commission with respect to violations of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer shall include—

"(1) the enforcement authority of the Commission with respect to such violations provided under this Act; and

"(2) the enforcement authority of the Commission with respect to violations of the standard of conduct applicable to an investment adviser under the Investment Advisers Act of 1940, including the authority to impose sanctions for such violations, and

the Commission shall seek to prosecute and sanction violators of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under this Act to same extent as the Commission prosecutes and sanctions violators of the standard of conduct applicable to an investment advisor under the Investment Advisers Act of 1940.".

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 211 of the Investment Advisers Act of 1940, as amended by subsection

(g)(2), is further amended by adding at the end the following new subsection:

"(i) HARMONIZATION OF ENFORCEMENT.—The enforcement authority of the Commission with respect to violations of the standard of conduct applicable to an investment adviser shall include—

"(1) the enforcement authority of the Commission with respect to such violations provided under this Act; and

"(2) the enforcement authority of the Commission with respect to violations of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under the Securities Exchange Act of 1934, including the authority to impose sanctions for such violations, and

the Commission shall seek to prosecute and sanction violators of the standard of conduct applicable to an investment adviser under this Act to same extent as the Commission prosecutes and sanctions violators of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under the Securities Exchange Act of 1934.".

SEC. 914. STUDY ON ENHANCING INVESTMENT ADVISER EXAMINATIONS.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—The Commission shall review and analyze the need for enhanced examination and enforcement resources for investment advisers.

(2) AREAS OF CONSIDERATION.—The study required by this subsection shall examine—

(A) the number and frequency of examinations of investment advisers by the Commission over the 5 years preceding the date of the enactment of this subtitle;

(B) the extent to which having Congress authorize the Commission to designate one or more self-regulatory organizations to augment the Commission's efforts in overseeing investment advisers would improve the frequency of examinations of investment advisers; and

(C) current and potential approaches to examining the investment advisory activities of dually registered broker-dealers and investment advisers or affiliated broker-dealers and investment advisers.

(b) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, not later than 180 days after the date of enactment of this subtitle, and shall use such findings to revise its rules and regulations, as necessary. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 915. OFFICE OF THE INVESTOR ADVOCATE.

Section 4 of the Securities Exchange Act of 1934 (15 U.S.C. 78d) is amended by adding at the end the following:

"(g) OFFICE OF THE INVESTOR ADVOCATE.—

"(1) OFFICE ESTABLISHED.—There is established within the Commission the Office of the Investor Advocate (in this subsection referred to as the 'Office').

"(2) INVESTOR ADVOCATE.—

"(A) IN GENERAL.—The head of the Office shall be the Investor Advocate, who shall—

"(i) report directly to the Chairman; and

"(ii) be appointed by the Chairman, in consultation with the Commission, from among individuals having experience in advocating for the interests of investors in securities and investor protection issues, from the perspective of investors.

"(B) COMPENSATION.—The annual rate of pay for the Investor Advocate shall be equal to the highest rate of annual pay for other senior executives who report to the Chairman of the Commission.

"(C) LIMITATION ON SERVICE.—An individual who serves as the Investor Advocate may not be employed by the Commission—

"(i) during the 2-year period ending on the date of appointment as Investor Advocate; or

"(ii) during the 5-year period beginning on the date on which the person ceases to serve as the Investor Advocate.

"(3) STAFF OF OFFICE.—The Investor Advocate, after consultation with the Chairman of the Commission, may retain or employ independent counsel, research staff, and service staff, as the Investor Advocate deems necessary to carry out the functions, powers, and duties of the Office.

"(4) FUNCTIONS OF THE INVESTOR ADVOCATE.—The Investor Advocate shall—

"(A) assist retail investors in resolving significant problems such investors may have with the Commission or with self-regulatory organizations;

"(B) identify areas in which investors would benefit from changes in the regulations of the Commission or the rules of self-regulatory organizations;

"(C) identify problems that investors have with financial service providers and investment products;

"(D) analyze the potential impact on investors of—

"(i) proposed regulations of the Commission; and

"(ii) proposed rules of self-regulatory organizations registered under this title; and

"(E) to the extent practicable, propose to the Commission changes in the regulations or orders of the Commission and to Congress any legislative, administrative, or personnel changes that may be appropriate to mitigate problems identified under this paragraph and to promote the interests of investors.

"(5) ACCESS TO DOCUMENTS.—The Commission shall ensure that the Investor Advocate has full access to the documents of the Commission and any self-regulatory organization, as necessary to carry out the functions of the Office.

"(6) ANNUAL REPORTS.—

"(A) REPORT ON OBJECTIVES.—

"(i) IN GENERAL.—Not later than June 30 of each year after 2010, the Investor Advocate shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the objectives of the Investor Advocate for the following fiscal year.

"(ii) CONTENTS.—Each report required under clause (i) shall contain full and substantive analysis and explanation.

"(B) REPORT ON ACTIVITIES.—

"(i) IN GENERAL.—Not later than December 31 of each year after 2010, the Investor Advocate shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the activities of the Investor Advocate during the immediately preceding fiscal year.

"(ii) CONTENTS.—Each report required under clause (i) shall include—

"(I) appropriate statistical information and full and substantive analysis;

"(II) information on steps that the Investor Advocate has taken during the reporting period to improve investor services and the responsiveness of the Commission and self-regulatory organizations to investor concerns;

"(III) a summary of the most serious problems encountered by investors during the reporting period;

"(IV) an inventory of the items described in subclause (III) that includes—

"(aa) identification of any action taken by the Commission or the self-regulatory organization and the result of such action;

"(bb) the length of time that each item has remained on such inventory; and

"(cc) for items on which no action has been taken, the reasons for inaction, and an identification of any official who is responsible for such action;

"(V) recommendations for such administrative and legislative actions as may be appropriate to resolve problems encountered by investors; and

"(VI) any other information, as determined appropriate by the Investor Advocate.

"(iii) INDEPENDENCE.—Each report required under this paragraph shall be provided directly to the Committees listed in clause (i) without any prior review or comment from the Commission, any commissioner, any other officer or employee of the Commission, or the Office of Management and Budget.

"(iv) CONFIDENTIALITY.—No report required under clause (i) may contain confidential information.

"(7) REGULATIONS.—The Commission shall, by regulation, establish procedures requiring a formal response to all recommendations submitted to the Commission by the Investor Advocate, not later than 3 months after the date of such submission.".

SEC. 916. STREAMLINING OF FILING PROCEDURES FOR SELF-REGULATORY ORGANIZATIONS.

(a) FILING PROCEDURES.—Section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) is amended by striking paragraph (2) (including the undesignated matter immediately following subparagraph (B)) and inserting the following:

"(2) APPROVAL PROCESS.—

"(A) APPROVAL PROCESS ESTABLISHED.—

"(i) IN GENERAL.—Except as provided in clause (ii), not later than 45 days after the date of publication of a proposed rule change under paragraph (1), the Commission shall—

"(I) by order, approve or disapprove the proposed rule change; or

"(II) institute proceedings under subparagraph (B) to determine whether the proposed rule change should be disapproved.

"(ii) EXTENSION OF TIME PERIOD.—The Commission may extend the period established under clause (i) by not more than an additional 45 days, if—

"(I) the Commission determines that a longer period is appropriate and publishes the reasons for such determination; or

"(II) the self-regulatory organization that filed the proposed rule change consents to the longer period.

"(B) PROCEEDINGS.—

"(i) NOTICE AND HEARING.—If the Commission does not approve or disapprove a proposed rule change under subparagraph (A), the Commission shall provide to the self-regulatory organization that filed the proposed rule change—

"(I) notice of the grounds for disapproval under consideration; and

"(II) opportunity for hearing, to be concluded not later than 180 days after the date of publication of notice of the filing of the proposed rule change.

"(ii) ORDER OF APPROVAL OR DISAPPROVAL.—

"(I) IN GENERAL.—Except as provided in subclause (II), not later than 180 days after the date of publication under paragraph (1), the Commission shall issue an order approving or disapproving the proposed rule change.

"(II) EXTENSION OF TIME PERIOD.—The Commission may extend the period for issuance under clause (I) by not more than 60 days, if—

"(aa) the Commission determines that a longer period is appropriate and publishes the reasons for such determination; or

"(bb) the self-regulatory organization that filed the proposed rule change consents to the longer period.

"(C) STANDARDS FOR APPROVAL AND DISAPPROVAL.—

"(i) APPROVAL.—The Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this title and the rules and regulations issued under this title that are applicable to such organization.

"(ii) DISAPPROVAL.—The Commission shall disapprove a proposed rule change of a self-regulatory organization if it does not make a finding described in clause (i).

"(iii) TIME FOR APPROVAL.—The Commission may not approve a proposed rule change earlier than 30 days after the date of publication under paragraph (1), unless the Commission finds good cause for so doing and publishes the reason for the finding.

"(D) RESULT OF FAILURE TO INSTITUTE OR CONCLUDE PROCEEDINGS.—A proposed rule change shall be deemed to have been approved by the Commission, if—

"(i) the Commission does not approve or disapprove the proposed rule change or begin proceedings under subparagraph (B) within the period described in subparagraph (A); or

"(ii) the Commission does not issue an order approving or disapproving the proposed rule change under subparagraph (B) within the period described in subparagraph (B)(ii).

"(E) PUBLICATION DATE BASED ON FEDERAL REGISTER PUBLISHING.—For purposes of this paragraph, if, after filing a proposed rule change with the Commission pursuant to paragraph (1), a self-regulatory organization publishes a notice of the filing of such proposed rule change, together with the substantive terms of such proposed rule change, on a publicly accessible website, the Commission shall thereafter send the notice to the Federal Register for publication thereof under paragraph (1) within 15 days of the date on which such website publication is made. If the Commission fails to send the notice for publication thereof within such 15 day period, then the date of publication shall be deemed to be the date on which such website publication was made.

"(F) RULEMAKING.—

"(i) IN GENERAL.—Not later than 180 days after the date of enactment of the Investor Protection and Securities Reform Act of 2010, after consultation with other regulatory agencies, the Commission shall promulgate rules setting forth the procedural requirements of the proceedings required under this paragraph.

"(ii) NOTICE AND COMMENT NOT REQUIRED.—The rules promulgated by the Commission under clause (i) are not required to include republication of proposed rule changes or solicitation of public comment.".

(b) CLARIFICATION OF FILING DATE.—

(1) RULE OF CONSTRUCTION.—Section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) is amended by adding at the end the following:

"(10) RULE OF CONSTRUCTION RELATING TO FILING DATE OF PROPOSED RULE CHANGES.—

"(A) IN GENERAL.—For purposes of this subsection, the date of filing of a proposed rule change shall be deemed to be the date on which the Commission receives the proposed rule change.

"(B) EXCEPTION.—A proposed rule change has not been received by the Commission for purposes of subparagraph (A) if, not later than 7 business days after the date of receipt by the Commission, the Commission notifies the self-regulatory organization that such proposed rule change does not comply with the rules of the Commission relating to the required form of a proposed rule change, except that if the Commission determines that the proposed rule change is unusually lengthy and is complex or raises novel regulatory issues, the Commission shall inform the self-regulatory organization of such determination not later than 7 business days after the date of receipt by the Commission and, for the purposes of subparagraph (A), a proposed rule change has not been received by the Commission, if, not later than 21 days after the date of receipt by the Commission, the Commission notifies the self-regulatory organization that such proposed rule change does not comply with the rules of the Commission relating to the required form of a proposed rule change.".

(2) PUBLICATION.—Section 19(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)(1)) is amended by striking "upon" and inserting "as soon as practicable after the date of".

(c) EFFECTIVE DATE OF PROPOSED RULES.—Section 19(b)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)(3)) is amended—

(1) in subparagraph (A)—

(A) by striking "may take effect" and inserting "shall take effect"; and

(B) by inserting "on any person, whether or not the person is a member of the self-regulatory organization" after "charge imposed by the self-regulatory organization"; and

(2) in subparagraph (C)—

(A) by amending the second sentence to read as follows: "At any time within the 60-day period beginning on the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1), the Commission summarily may temporarily suspend the change in the rules of the self-regulatory organization made thereby, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title.";

(B) by inserting after the second sentence the following: "If the Commission takes such action, the Commission shall institute proceedings under paragraph (2)(B) to determine whether the proposed rule should be approved or disapproved."; and

(C) in the third sentence, by striking "the preceding sentence" and inserting "this subparagraph".

(d) CONFORMING CHANGE.—Section 19(b)(4)(D) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)(4)(D)) is amended to read as follows:

"(D)(i) The Commission shall order the temporary suspension of any change in the rules of a clearing agency made by a proposed rule change that has taken effect under paragraph (3), if the appropriate regulatory agency for the clearing agency notifies the Commission not later than 30 days after the date on which the proposed rule change was filed of—

"(I) the determination by the appropriate regulatory agency that the rules of such clearing agency, as so changed, may be inconsistent with the safeguarding of securities or funds in the custody or control of such clearing agency or for which it is responsible; and

"(II) the reasons for the determination described in subclause (I).

"(ii) If the Commission takes action under clause (i), the Commission shall institute proceedings under paragraph (2)(B) to determine if the proposed rule change should be approved or disapproved.".

SEC. 917. STUDY REGARDING FINANCIAL LITERACY AMONG INVESTORS.

(a) IN GENERAL.—The Commission shall conduct a study to identify—

(1) the existing level of financial literacy among retail investors, including subgroups of investors identified by the Commission;

(2) methods to improve the timing, content, and format of disclosures to investors with respect to financial intermediaries, investment products, and investment services;

(3) the most useful and understandable relevant information that retail investors need to make informed financial decisions before engaging a financial intermediary or purchasing an investment product or service that is typically sold to retail investors, including shares of open-end companies, as that term is defined in section 5 of the Investment Company Act of 1940 (15 U.S.C. 80a–5) that are registered under section 8 of that Act;

(4) methods to increase the transparency of expenses and conflicts of interests in transactions involving investment services and products, including shares of open-end companies described in paragraph (3);

(5) the most effective existing private and public efforts to educate investors; and

(6) in consultation with the Financial Literacy and Education Commission, a strategy (including, to the extent practicable, measurable goals and objectives) to increase the financial literacy of investors in order to bring about a positive change in investor behavior.

(b) REPORT.—Not later than 2 years after the date of enactment of this Act, the Commission shall submit a report on the study required under subsection (a) to—

(1) the Committee on Banking, Housing, and Urban Affairs of the Senate; and

(2) the Committee on Financial Services of the House of Representatives.

SEC. 918. STUDY REGARDING MUTUAL FUND ADVERTISING.

(a) IN GENERAL.—The Comptroller General of the United States shall conduct a study on mutual fund advertising to identify—

(1) existing and proposed regulatory requirements for open-end investment company advertisements;

(2) current marketing practices for the sale of open-end investment company shares, including the use of past performance data, funds that have merged, and incubator funds;

(3) the impact of such advertising on consumers; and

(4) recommendations to improve investor protections in mutual fund advertising and additional information necessary to ensure that investors can make informed financial decisions when purchasing shares.

(b) REPORT.—Not later than 18 months after the date of enactment of this Act, the Comptroller General of the United States shall submit a report on the results of the study conducted under subsection (a) to—

(1) the Committee on Banking, Housing, and Urban Affairs of the United States Senate; and

(2) the Committee on Financial Services of the House of Representatives.

SEC. 919. CLARIFICATION OF COMMISSION AUTHORITY TO REQUIRE INVESTOR DISCLOSURES BEFORE PURCHASE OF INVESTMENT PRODUCTS AND SERVICES.

Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended by adding at the end the following:

"(n) DISCLOSURES TO RETAIL INVESTORS.—

"(1) IN GENERAL.—Notwithstanding any other provision of the securities laws, the Commission may issue rules designating documents or information that shall be provided by a broker or dealer to a retail investor before the purchase of an investment product or service by the retail investor.

"(2) CONSIDERATIONS.—In developing any rules under paragraph (1), the Commission shall consider whether the rules will promote investor protection, efficiency, competition, and capital formation.

"(3) FORM AND CONTENTS OF DOCUMENTS AND INFORMATION.—Any documents or information designated under a rule promulgated under paragraph (1) shall—

"(A) be in a summary format; and

"(B) contain clear and concise information about—

"(i) investment objectives, strategies, costs, and risks; and

"(ii) any compensation or other financial incentive received by a broker, dealer, or other intermediary in connection with the purchase of retail investment products.".

SEC. 919A. STUDY ON CONFLICTS OF INTEREST.

(a) IN GENERAL.—The Comptroller General of the United States shall conduct a study—

(1) to identify and examine potential conflicts of interest that exist between the staffs of the investment banking and equity and fixed income securities analyst functions within the same firm; and

(2) to make recommendations to Congress designed to protect investors in light of such conflicts.

(b) CONSIDERATIONS.—In conducting the study under subsection (a), the Comptroller General shall—

(1) consider—

(A) the potential for investor harm resulting from conflicts, including consideration of the forms of misconduct engaged in by the several securities firms and individuals that entered into the Global Analyst Research Settlements in 2003 (also known as the "Global Settlement");

(B) the nature and benefits of the undertakings to which those firms agreed in enforcement proceedings, including firewalls between research and investment banking, separate reporting lines, dedicated legal and compliance staffs, allocation of budget, physical separation, compensation, employee performance evaluations, coverage decisions, limitations on soliciting investment banking business, disclosures, transparency, and other measures;

(C) whether any such undertakings should be codified and applied permanently to securities firms, or whether the Commission should adopt rules applying any such undertakings to securities firms; and

(D) whether to recommend regulatory or legislative measures designed to mitigate possible adverse consequences to investors arising from the conflicts of interest or to enhance investor protection or confidence in the integrity of the securities markets; and

(2) consult with State attorneys general, State securities officials, the Commission, the Financial Industry Regulatory Authority ("FINRA"), NYSE Regulation, investor advocates, brokers, dealers, retail investors, institutional investors, and academics.

(c) REPORT.—The Comptroller General shall submit a report on the results of the study required by this section to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, not later than 18 months after the date of enactment of this Act.

SEC. 919B. STUDY ON IMPROVED INVESTOR ACCESS TO INFORMATION ON INVESTMENT ADVISERS AND BROKER-DEALERS.

(a) STUDY.—

(1) IN GENERAL.—Not later than 6 months after the date of enactment of this Act, the Commission shall complete a study, including recommendations, of ways to improve the access of investors to registration information (including disciplinary actions, regulatory, judicial, and arbitration proceedings, and other information) about registered and previously registered investment advisers, associated persons of investment advisers, brokers and dealers and their associated persons on the existing Central Registration Depository and Investment Adviser Registration Depository systems, as well as identify additional information that should be made publicly available.

(2) CONTENTS.—The study required by subsection (a) shall include an analysis of the advantages and disadvantages of further centralizing access to the information contained in the 2 systems, including—

(A) identification of those data pertinent to investors; and

(B) the identification of the method and format for displaying and publishing such data to enhance accessibility by and utility to investors.

(b) IMPLEMENTATION.—Not later than 18 months after the date of completion of the study required by subsection (a), the Commission shall implement any recommendations of the study.

SEC. 919C. STUDY ON FINANCIAL PLANNERS AND THE USE OF FINANCIAL DESIGNATIONS.

(a) IN GENERAL.—The Comptroller General of the United States shall conduct a study to evaluate—

(1) the effectiveness of State and Federal regulations to protect investors and other consumers from individuals who hold themselves out as financial planners through the use of misleading titles, designations, or marketing materials;

(2) current State and Federal oversight structure and regulations for financial planners; and

(3) legal or regulatory gaps in the regulation of financial planners and other individuals who provide or offer to provide financial planning services to consumers.

(b) CONSIDERATIONS.—In conducting the study required under subsection (a), the Comptroller General shall consider—

(1) the role of financial planners in providing advice regarding the management of financial resources, including investment planning, income tax planning, education planning, retirement planning, estate planning, and risk management;

(2) whether current regulations at the State and Federal level provide adequate ethical and professional standards for financial planners;

(3) the possible risk posed to investors and other consumers by individuals who hold themselves out as financial planners or as otherwise providing financial planning services in connection with the sale of financial products, including insurance and securities;

(4) the possible risk posed to investors and other consumers by individuals who otherwise use titles, designations, or marketing materials in a misleading way in connection with the delivery of financial advice;

(6) the ability of investors and other consumers to understand licensing requirements and standards of care that apply to individuals who hold themselves out as financial planners or as otherwise providing financial planning services;

(7) the possible benefits to investors and other consumers of regulation and professional oversight of financial planners; and

(8) any other consideration that the Comptroller General deems necessary or appropriate to effectively execute the study required under subsection (a).

(c) RECOMMENDATIONS.—In providing recommendations for the appropriate regulation of financial planners and other individuals who provide or offer to provide financial planning services, in order to protect investors and other consumers of financial planning services, the Comptroller General shall consider—

(1) the appropriate structure for regulation of financial planners and individuals providing financial planning services; and

(2) the appropriate scope of the regulations needed to protect investors and other consumers, including but not limited to the need to establish competency standards, practice standards, ethical guidelines, disciplinary authority, and transparency to investors and other consumers.

(d) REPORT.—

(1) IN GENERAL.—Not later than 180 days after the date of enactment of this Act, the Comptroller General shall submit a report on the study required under subsection (a) to—

(A) the Committee on Banking, Housing, and Urban Affairs of the Senate;

(B) the Special Committee on Aging of the Senate; and

(C) the Committee on Financial Services of the House of Representatives.

(2) CONTENT REQUIREMENTS.—The report required under paragraph (1) shall describe the findings and determinations made by the Comptroller General in carrying out the study required under subsection (a), including a description of the considerations, analysis, and government, public, industry, nonprofit and consumer input that the Comptroller General considered to make such findings, conclusions, and legislative, regulatory, or other recommendations.

SEC. 919D. OMBUDSMAN.

Section 4(g) of the Securities Exchange Act of 1934, as added by section 914, is amended by adding at the end the following:

"(8) OMBUDSMAN.—

"(A) APPOINTMENT.—Not later than 180 days after the date on which the first Investor Advocate is appointed under paragraph (2)(A)(i), the Investor Advocate shall appoint an Ombudsman, who shall report directly to the Investor Advocate.

"(B) DUTIES.—The Ombudsman appointed under subparagraph (A) shall—

"(i) act as a liaison between the Commission and any retail investor in resolving problems that retail investors may have with the Commission or with self-regulatory organizations;

"(ii) review and make recommendations regarding policies and procedures to encourage persons to present questions to the Investor Advocate regarding compliance with the securities laws; and

"(iii) establish safeguards to maintain the confidentiality of communications between the persons described in clause (ii) and the Ombudsman.

"(C) LIMITATION.—In carrying out the duties of the Ombudsman under subparagraph (B), the Ombudsman shall utilize personnel of the Commission to the extent practicable. Nothing in this paragraph shall be construed as replacing, altering, or diminishing the activities of any ombudsman or similar office of any other agency.

"(D) REPORT.—The Ombudsman shall submit a semiannual report to the Investor Advocate that describes the activities and evaluates the effectiveness of the Ombudsman during the preceding year. The Investor Advocate shall include the reports required under this section in the reports required to be submitted by the Inspector Advocate under paragraph (6).''.

Subtitle B—Increasing Regulatory Enforcement and Remedies

SEC. 921. AUTHORITY TO RESTRICT MANDATORY PRE-DISPUTE ARBITRATION.

(a) AMENDMENT TO SECURITIES EXCHANGE ACT OF 1934.—Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o), as amended by this title, is further amended by adding at the end the following new subsection:

''(o) AUTHORITY TO RESTRICT MANDATORY PRE-DISPUTE ARBITRATION.—The Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any broker, dealer, or municipal securities dealer to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.''.

(b) AMENDMENT TO INVESTMENT ADVISERS ACT OF 1940.—Section 205 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–5) is amended by adding at the end the following new subsection:

''(f) AUTHORITY TO RESTRICT MANDATORY PRE-DISPUTE ARBITRATION.—The Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any investment adviser to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.''.

SEC. 922. WHISTLEBLOWER PROTECTION.

(a) IN GENERAL.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 21E the following:

''SEC. 21F. SECURITIES WHISTLEBLOWER INCENTIVES AND PROTECTION.

''(a) DEFINITIONS.—In this section the following definitions shall apply:

''(1) COVERED JUDICIAL OR ADMINISTRATIVE ACTION.—The term 'covered judicial or administrative action' means any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1,000,000.

''(2) FUND.—The term 'Fund' means the Securities and Exchange Commission Investor Protection Fund.

''(3) ORIGINAL INFORMATION.—The term 'original information' means information that—

"(A) is derived from the independent knowledge or analysis of a whistleblower;

"(B) is not known to the Commission from any other source, unless the whistleblower is the original source of the information; and

"(C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information.

"(4) MONETARY SANCTIONS.—The term 'monetary sanctions', when used with respect to any judicial or administrative action, means—

"(A) any monies, including penalties, disgorgement, and interest, ordered to be paid; and

"(B) any monies deposited into a disgorgement fund or other fund pursuant to section 308(b) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246(b)), as a result of such action or any settlement of such action.

"(5) RELATED ACTION.—The term 'related action', when used with respect to any judicial or administrative action brought by the Commission under the securities laws, means any judicial or administrative action brought by an entity described in subclauses (I) through (IV) of subsection (h)(2)(D)(i) that is based upon the original information provided by a whistleblower pursuant to subsection (a) that led to the successful enforcement of the Commission action.

"(6) WHISTLEBLOWER.—The term 'whistleblower' means any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission.

"(b) AWARDS.—

"(1) IN GENERAL.—In any covered judicial or administrative action, or related action, the Commission, under regulations prescribed by the Commission and subject to subsection (c), shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action, in an aggregate amount equal to—

"(A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions; and

"(B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions.

"(2) PAYMENT OF AWARDS.—Any amount paid under paragraph (1) shall be paid from the Fund.

"(c) DETERMINATION OF AMOUNT OF AWARD; DENIAL OF AWARD.—

"(1) DETERMINATION OF AMOUNT OF AWARD.—

"(A) DISCRETION.—The determination of the amount of an award made under subsection (b) shall be in the discretion of the Commission.

"(B) CRITERIA.—In determining the amount of an award made under subsection (b), the Commission—

"(i) shall take into consideration—

"(I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action;

"(II) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action;

"(III) the programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers who provide information that lead to the successful enforcement of such laws; and

"(IV) such additional relevant factors as the Commission may establish by rule or regulation; and

"(ii) shall not take into consideration the balance of the Fund.

"(2) DENIAL OF AWARD.—No award under subsection (b) shall be made—

"(A) to any whistleblower who is, or was at the time the whistleblower acquired the original information submitted to the Commission, a member, officer, or employee of—

"(i) an appropriate regulatory agency;

"(ii) the Department of Justice;

"(iii) a self-regulatory organization;

"(iv) the Public Company Accounting Oversight Board; or

"(v) a law enforcement organization;

"(B) to any whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award under this section;

"(C) to any whistleblower who gains the information through the performance of an audit of financial statements required under the securities laws and for whom such submission would be contrary to the requirements of section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1); or

"(D) to any whistleblower who fails to submit information to the Commission in such form as the Commission may, by rule, require.

"(d) REPRESENTATION.—

"(1) PERMITTED REPRESENTATION.—Any whistleblower who makes a claim for an award under subsection (b) may be represented by counsel.

"(2) REQUIRED REPRESENTATION.—

"(A) IN GENERAL.—Any whistleblower who anonymously makes a claim for an award under subsection (b) shall be represented by counsel if the whistleblower anonymously submits the information upon which the claim is based.

"(B) DISCLOSURE OF IDENTITY.—Prior to the payment of an award, a whistleblower shall disclose the identity of the whistleblower and provide such other information as the Commission may require, directly or through counsel for the whistleblower.

"(e) NO CONTRACT NECESSARY.—No contract with the Commission is necessary for any whistleblower to receive an award under subsection (b), unless otherwise required by the Commission by rule or regulation.

"(f) APPEALS.—Any determination made under this section, including whether, to whom, or in what amount to make awards, shall be in the discretion of the Commission. Any such determination, except the determination of the amount of an award if the award was made in accordance with subsection (b), may be appealed to the appropriate court of appeals of the United States not more than 30 days after the determination is issued by the Commission. The court shall review the determination made by the Commission in accordance with section 706 of title 5, United States Code.

"(g) INVESTOR PROTECTION FUND.—

"(1) FUND ESTABLISHED.—There is established in the Treasury of the United States a fund to be known as the 'Securities and Exchange Commission Investor Protection Fund'.

"(2) USE OF FUND.—The Fund shall be available to the Commission, without further appropriation or fiscal year limitation, for—

"(A) paying awards to whistleblowers as provided in subsection (b); and

"(B) funding the activities of the Inspector General of the Commission under section 4(i).

"(3) DEPOSITS AND CREDITS.—

"(A) IN GENERAL.—There shall be deposited into or credited to the Fund an amount equal to—

"(i) any monetary sanction collected by the Commission in any judicial or administrative action brought by the Commission under the securities laws that is not added to a disgorgement fund or other fund under section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) or otherwise distributed to victims of a violation of the securities laws, or the rules and regulations thereunder, underlying such action, unless the balance of the Fund at the time the monetary sanction is collected exceeds $300,000,000;

"(ii) any monetary sanction added to a disgorgement fund or other fund under section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) that is not distributed to the victims for whom the Fund was established, unless the balance of the disgorgement fund at the time the determination is made not to distribute the monetary sanction to such victims exceeds $200,000,000; and

"(iii) all income from investments made under paragraph (4).

"(B) ADDITIONAL AMOUNTS.—If the amounts deposited into or credited to the Fund under subparagraph (A) are not sufficient to satisfy an award made under subsection (b), there shall be deposited into or credited to the Fund an amount equal to the unsatisfied portion of the award from any monetary sanction collected by the Commission in the covered judicial or administrative action on which the award is based.

"(4) INVESTMENTS.—

"(A) AMOUNTS IN FUND MAY BE INVESTED.—The Commission may request the Secretary of the Treasury to invest the portion of the Fund that is not, in the discretion of the Commission, required to meet the current needs of the Fund.

"(B) ELIGIBLE INVESTMENTS.—Investments shall be made by the Secretary of the Treasury in obligations of the United States or obligations that are guaranteed as to principal and interest by the United States, with maturities suitable to the needs of the Fund as determined by the Commission on the record.

"(C) INTEREST AND PROCEEDS CREDITED.—The interest on, and the proceeds from the sale or redemption of, any obligations held in the Fund shall be credited to the Fund.

"(5) REPORTS TO CONGRESS.—Not later than October 30 of each fiscal year beginning after the date of enactment of this subsection, the Commission shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives a report on—

"(A) the whistleblower award program, established under this section, including—

"(i) a description of the number of awards granted; and

"(ii) the types of cases in which awards were granted during the preceding fiscal year;

"(B) the balance of the Fund at the beginning of the preceding fiscal year;

"(C) the amounts deposited into or credited to the Fund during the preceding fiscal year;

"(D) the amount of earnings on investments made under paragraph (4) during the preceding fiscal year;

"(E) the amount paid from the Fund during the preceding fiscal year to whistleblowers pursuant to subsection (b);

"(F) the balance of the Fund at the end of the preceding fiscal year; and

"(G) a complete set of audited financial statements, including—

"(i) a balance sheet;

"(ii) income statement; and

"(iii) cash flow analysis.

"(h) PROTECTION OF WHISTLEBLOWERS.—

"(1) PROHIBITION AGAINST RETALIATION.—

"(A) IN GENERAL.—No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower—

"(i) in providing information to the Commission in accordance with this section;

"(ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or

"(iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), including section 10A(m) of such Act (15 U.S.C. 78f(m)), section 1513(e) of title 18, United States Code, and any other law, rule, or regulation subject to the jurisdiction of the Commission.

"(B) ENFORCEMENT.—

"(i) CAUSE OF ACTION.—An individual who alleges discharge or other discrimination in violation of subparagraph (A) may bring an action under this subsection in the appropriate district court of the United States for the relief provided in subparagraph (C).

"(ii) SUBPOENAS.—A subpoena requiring the attendance of a witness at a trial or hearing conducted under this section may be served at any place in the United States.

"(iii) STATUTE OF LIMITATIONS.—

"(I) IN GENERAL.—An action under this subsection may not be brought—

"(aa) more than 6 years after the date on which the violation of subparagraph (A) occurred; or

"(bb) more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the employee alleging a violation of subparagraph (A).

"(II) REQUIRED ACTION WITHIN 10 YEARS.—Notwithstanding subclause (I), an action under this subsection may not in any circumstance be brought more than 10 years after the date on which the violation occurs.

"(C) RELIEF.—Relief for an individual prevailing in an action brought under subparagraph (B) shall include—

"(i) reinstatement with the same seniority status that the individual would have had, but for the discrimination;

"(ii) 2 times the amount of back pay otherwise owed to the individual, with interest; and

"(iii) compensation for litigation costs, expert witness fees, and reasonable attorneys' fees.

"(2) CONFIDENTIALITY.—

"(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), the Commission and any officer or employee of the Commission shall not disclose any information, including information provided by a whistleblower to the Commission, which could reasonably be expected to reveal the identity of a whistleblower, except in accordance with the provisions of section 552a of title 5, United States Code, unless and until required to be disclosed to a defendant or respondent in connection with a public proceeding instituted by the Commission or any entity described in subparagraph (C). For purposes of section

552 of title 5, United States Code, this paragraph shall be considered a statute described in subsection (b)(3)(B) of such section.

“(B) EXEMPTED STATUTE.—For purposes of section 552 of title 5, United States Code, this paragraph shall be considered a statute described in subsection (b)(3)(B) of such section 552.

“(C) RULE OF CONSTRUCTION.—Nothing in this section is intended to limit, or shall be construed to limit, the ability of the Attorney General to present such evidence to a grand jury or to share such evidence with potential witnesses or defendants in the course of an ongoing criminal investigation.

“(D) AVAILABILITY TO GOVERNMENT AGENCIES.—

“(i) IN GENERAL.—Without the loss of its status as confidential in the hands of the Commission, all information referred to in subparagraph (A) may, in the discretion of the Commission, when determined by the Commission to be necessary to accomplish the purposes of this Act and to protect investors, be made available to—

“(I) the Attorney General of the United States;

“(II) an appropriate regulatory authority;

“(III) a self-regulatory organization;

“(IV) a State attorney general in connection with any criminal investigation;

“(V) any appropriate State regulatory authority;

“(VI) the Public Company Accounting Oversight Board;

“(VII) a foreign securities authority; and

“(VIII) a foreign law enforcement authority.

“(ii) CONFIDENTIALITY.—

“(I) IN GENERAL.—Each of the entities described in subclauses (I) through (VI) of clause (i) shall maintain such information as confidential in accordance with the requirements established under subparagraph (A).

“(II) FOREIGN AUTHORITIES.—Each of the entities described in subclauses (VII) and (VIII) of clause (i) shall maintain such information in accordance with such assurances of confidentiality as the Commission determines appropriate.

“(3) RIGHTS RETAINED.—Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any whistleblower under any Federal or State law, or under any collective bargaining agreement.

“(i) PROVISION OF FALSE INFORMATION.—A whistleblower shall not be entitled to an award under this section if the whistleblower—

“(1) knowingly and willfully makes any false, fictitious, or fraudulent statement or representation; or

“(2) uses any false writing or document knowing the writing or document contains any false, fictitious, or fraudulent statement or entry.

“(j) RULEMAKING AUTHORITY.—The Commission shall have the authority to issue such rules and regulations as may be necessary or appropriate to implement the provisions of this section consistent with the purposes of this section.".

(b) PROTECTION FOR EMPLOYEES OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS.—Section 1514A(a) of title 18, United States Code, is amended—

(1) by inserting "or nationally recognized statistical rating organization (as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c)," after "78o(d)),"; and

(2) by inserting "or nationally recognized statistical rating organization" after "such company".

(c) SECTION 1514A OF TITLE 18, UNITED STATES CODE.—

(1) STATUTE OF LIMITATIONS; JURY TRIAL.—Section 1514A(b)(2) of title 18, United States Code, is amended—

(A) in subparagraph (D)—

(i) by striking "90" and inserting "180"; and

(ii) by striking the period at the end and inserting ", or after the date on which the employee became aware of the violation."; and

(B) by adding at the end the following:

"(E) JURY TRIAL.—A party to an action brought under paragraph (1)(B) shall be entitled to trial by jury.".

(2) PRIVATE SECURITIES LITIGATION WITNESSES; NONENFORCEABILITY; INFORMATION.—Section 1514A of title 18, United States Code, is amended by adding at the end the following:

"(e) NONENFORCEABILITY OF CERTAIN PROVISIONS WAIVING RIGHTS AND REMEDIES OR REQUIRING ARBITRATION OF DISPUTES.—

"(1) WAIVER OF RIGHTS AND REMEDIES.—The rights and remedies provided for in this section may not be waived by any agreement, policy form, or condition of employment, including by a predispute arbitration agreement.

"(2) PREDISPUTE ARBITRATION AGREEMENTS.—No predispute arbitration agreement shall be valid or enforceable, if the agreement requires arbitration of a dispute arising under this section.".

(d) STUDY OF WHISTLEBLOWER PROTECTION PROGRAM.—

(1) STUDY.—The Inspector General of the Commission shall conduct a study of the whistleblower protections established under the amendments made by this section, including—

(A) whether the final rules and regulation issued under the amendments made by this section have made the whistleblower protection program (referred to in this subsection as the "program") clearly defined and user-friendly;

(B) whether the program is promoted on the website of the Commission and has been widely publicized;

(C) whether the Commission is prompt in—

(i) responding to—

(I) information provided by whistleblowers; and

(II) applications for awards filed by whistleblowers;

(ii) updating whistleblowers about the status of their applications; and

(iii) otherwise communicating with the interested parties;

(D) whether the minimum and maximum reward levels are adequate to entice whistleblowers to come forward with information and whether the reward levels are so high as to encourage illegitimate whistleblower claims;

(E) whether the appeals process has been unduly burdensome for the Commission;

(F) whether the funding mechanism for the Investor Protection Fund is adequate;

(G) whether, in the interest of protecting investors and identifying and preventing fraud, it would be useful for Congress to consider empowering whistleblowers or other individuals, who have already attempted to pursue the case through the Commission, to have a private right of action to bring suit based on the facts of the same case, on behalf of the Government and themselves, against persons who have committee securities fraud;

(H)(i) whether the exemption under section 552(b)(3) of title 5 (known as the Freedom of Information Act) established in section 21F(h)(2)(A) of the Securities Exchange Act of 1934, as added by this Act, aids whistleblowers in disclosing information to the Commission;

(ii) what impact the exemption described in clause (i) has had on the ability of the public to access information about the regulation and enforcement by the Commission of securities; and

(iii) any recommendations on whether the exemption described in clause (i) should remain in effect; and

(I) such other matters as the Inspector General deems appropriate.

(2) REPORT.—Not later than 30 months after the date of enactment of this Act, the Inspector General shall—

(A) submit a report on the findings of the study required under paragraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House; and

(B) make the report described in subparagraph (A) available to the public through publication of the report on the website of the Commission.

SEC. 923. CONFORMING AMENDMENTS FOR WHISTLEBLOWER PROTECTION.

(a) IN GENERAL.—

(1) SECURITIES ACT OF 1933.—Section 20(d)(3)(A) of the Securities Act of 1933 (15 U.S.C. 77t(d)(3)(A)) is amended by inserting "and section 21F of the Securities Exchange Act of 1934" after "the Sarbanes-Oxley Act of 2002".

(2) INVESTMENT COMPANY ACT OF 1940.—Section 42(e)(3)(A) of the Investment Company Act of 1940 (15 U.S.C. 80a–41(e)(3)(A)) is amended by inserting "and section 21F of the Securities Exchange Act of 1934" after "the Sarbanes-Oxley Act of 2002".

(3) INVESTMENT ADVISERS ACT OF 1940.—Section 209(e)(3)(A) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–9(e)(3)(A)) is amended by inserting "and section 21F of the Securities Exchange Act of 1934" after "the Sarbanes-Oxley Act of 2002".

(b) SECURITIES EXCHANGE ACT.—

(1) SECTION 21.—Section 21(d)(3)(C)(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(3)(C)(i)) is amended

by inserting "and section 21F of this title" after "the Sarbanes-Oxley Act of 2002".

(2) SECTION 21A.—Section 21A of the Securities Exchange Act of 1934 (15 U.S.C. 78u–1) is amended—

(A) in subsection (d)(1) by—

(i) striking "(subject to subsection (e))"; and

(ii) inserting "and section 21F of this title" after "the Sarbanes-Oxley Act of 2002";

(B) by striking subsection (e); and

(C) by redesignating subsections (f) and (g) as subsections (e) and (f), respectively.

SEC. 924. IMPLEMENTATION AND TRANSITION PROVISIONS FOR WHISTLEBLOWER PROTECTION.

(a) IMPLEMENTING RULES.—The Commission shall issue final regulations implementing the provisions of section 21F of the Securities Exchange Act of 1934, as added by this subtitle, not later than 270 days after the date of enactment of this Act.

(b) ORIGINAL INFORMATION.—Information provided to the Commission in writing by a whistleblower shall not lose the status of original information (as defined in section 21F(a)(3) of the Securities Exchange Act of 1934, as added by this subtitle) solely because the whistleblower provided the information prior to the effective date of the regulations, if the information is provided by the whistleblower after the date of enactment of this subtitle.

(c) AWARDS.—A whistleblower may receive an award pursuant to section 21F of the Securities Exchange Act of 1934, as added by this subtitle, regardless of whether any violation of a provision of the securities laws, or a rule or regulation thereunder, underlying the judicial or administrative action upon which the award is based, occurred prior to the date of enactment of this subtitle.

(d) ADMINISTRATION AND ENFORCEMENT.—The Securities and Exchange Commission shall establish a separate office within the Commission to administer and enforce the provisions of section 21F of the Securities Exchange Act of 1934 (as add by section 922(a)). Such office shall report annually to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on its activities, whistleblower complaints, and the response of the Commission to such complaints.

SEC. 925. COLLATERAL BARS.

(a) SECURITIES EXCHANGE ACT OF 1934.—

(1) SECTION 15.—Section 15(b)(6)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)(6)(A)) is amended by striking "12 months, or bar such person from being associated with a broker or dealer," and inserting "12 months, or bar any such person from being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization,".

(2) SECTION 15B.—Section 15B(c)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4(c)(4)) is amended by striking "twelve months or bar any such person from being associated with a municipal securities dealer," and inserting "12 months or bar any such person from being associated with a broker, dealer, investment adviser, municipal securities

dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization,".

(3) SECTION 17A.—Section 17A(c)(4)(C) of the Securities Exchange Act of 1934 (15 U.S.C. 78q–1(c)(4)(C)) is amended by striking "twelve months or bar any such person from being associated with the transfer agent," and inserting "12 months or bar any such person from being associated with any transfer agent, broker, dealer, investment adviser, municipal securities dealer, municipal advisor, or nationally recognized statistical rating organization,".

(b) INVESTMENT ADVISERS ACT OF 1940.—Section 203(f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(f)) is amended by striking "twelve months or bar any such person from being associated with an investment adviser," and inserting "12 months or bar any such person from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization,".

SEC. 926. DISQUALIFYING FELONS AND OTHER "BAD ACTORS" FROM REGULATION D OFFERINGS.

Not later than 1 year after the date of enactment of this Act, the Commission shall issue rules for the disqualification of offerings and sales of securities made under section 230.506 of title 17, Code of Federal Regulations, that—

(1) are substantially similar to the provisions of section 230.262 of title 17, Code of Federal Regulations, or any successor thereto; and

(2) disqualify any offering or sale of securities by a person that—

(A) is subject to a final order of a State securities commission (or an agency or officer of a State performing like functions), a State authority that supervises or examines banks, savings associations, or credit unions, a State insurance commission (or an agency or officer of a State performing like functions), an appropriate Federal banking agency, or the National Credit Union Administration, that—

(i) bars the person from—

(I) association with an entity regulated by such commission, authority, agency, or officer;

(II) engaging in the business of securities, insurance, or banking; or

(III) engaging in savings association or credit union activities; or

(ii) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the date of the filing of the offer or sale; or

(B) has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the Commission.

SEC. 927. EQUAL TREATMENT OF SELF-REGULATORY ORGANIZATION RULES.

Section 29(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78cc(a)) is amended by striking "an exchange required thereby" and inserting "a self-regulatory organization,".

SEC. 928. CLARIFICATION THAT SECTION 205 OF THE INVESTMENT ADVISERS ACT OF 1940 DOES NOT APPLY TO STATE-REGISTERED ADVISERS.

Section 205(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–5(a)) is amended, in the matter preceding paragraph (1)—

(1) by striking ", unless exempt from registration pursuant to section 203(b)," and inserting "registered or required to be registered with the Commission";

(2) by striking "make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to"; and

(3) by striking "to" after "in any way".

SEC. 929. UNLAWFUL MARGIN LENDING.

Section 7(c)(1)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78g(c)(1)(A)) is amended by striking "; and" and inserting "; or".

SEC. 929A. PROTECTION FOR EMPLOYEES OF SUBSIDIARIES AND AFFILIATES OF PUBLICLY TRADED COMPANIES.

Section 1514A of title 18, United States Code, is amended by inserting "including any subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company" after "the Securities Exchange Act of 1934 (15 U.S.C. 78o(d))".

SEC. 929B. FAIR FUND AMENDMENTS.

Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246(a)) is amended—

(1) by striking subsection (a) and inserting the following:

"(a) CIVIL PENALTIES TO BE USED FOR THE RELIEF OF VICTIMS.—If, in any judicial or administrative action brought by the Commission under the securities laws, the Commission obtains a civil penalty against any person for a violation of such laws, or such person agrees, in settlement of any such action, to such civil penalty, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of a disgorgement fund or other fund established for the benefit of the victims of such violation.";

(2) in subsection (b)—

(A) by striking "for a disgorgement fund described in subsection (a)" and inserting "for a disgorgement fund or other fund described in subsection (a)"; and

(B) by striking "in the disgorgement fund" and inserting "in such fund"; and

(3) by striking subsection (e).

SEC. 929C. INCREASING THE BORROWING LIMIT ON TREASURY LOANS.

Section 4(h) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78ddd(h)) is amended in the first sentence, by striking "$1,000,000,000" and inserting "$2,500,000,000".

SEC. 929D. LOST AND STOLEN SECURITIES.

Section 17(f)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(f)(1)) is amended—

(1) in subparagraph (A), by striking "missing, lost, counterfeit, or stolen securities" and inserting "securities that are missing, lost, counterfeit, stolen, or cancelled"; and

(2) in subparagraph (B), by striking "or stolen" and inserting "stolen, cancelled, or reported in such other manner as the Commission, by rule, may prescribe".

SEC. 929E. NATIONWIDE SERVICE OF SUBPOENAS.

(a) SECURITIES ACT OF 1933.—Section 22(a) of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended by inserting after the second sentence the following: "In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, a subpoena issued to compel the attendance of a witness or the production of documents or tangible things (or both) at a hearing or trial may be served at any place within the United States. Rule 45(c)(3)(A)(ii) of the Federal Rules of Civil Procedure shall not apply to a subpoena issued under the preceding sentence.".

(b) SECURITIES EXCHANGE ACT OF 1934.—Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) is amended by inserting after the third sentence the following: "In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, a subpoena issued to compel the attendance of a witness or the production of documents or tangible things (or both) at a hearing or trial may be served at any place within the United States. Rule 45(c)(3)(A)(ii) of the Federal Rules of Civil Procedure shall not apply to a subpoena issued under the preceding sentence.".

(c) INVESTMENT COMPANY ACT OF 1940.—Section 44 of the Investment Company Act of 1940 (15 U.S.C. 80a–43) is amended by inserting after the fourth sentence the following: "In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, a subpoena issued to compel the attendance of a witness or the production of documents or tangible things (or both) at a hearing or trial may be served at any place within the United States. Rule 45(c)(3)(A)(ii) of the Federal Rules of Civil Procedure shall not apply to a subpoena issued under the preceding sentence.".

(d) INVESTMENT ADVISERS ACT OF 1940.—Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–14) is amended by inserting after the third sentence the following: "In any action or proceeding instituted by the Commission under this title in a United States district court for any judicial district, a subpoena issued to compel the attendance of a witness or the production of documents or tangible things (or both) at a hearing or trial may be served at any place within the United States. Rule 45(c)(3)(A)(ii) of the Federal Rules of Civil Procedure shall not apply to a subpoena issued under the preceding sentence.".

SEC. 929F. FORMERLY ASSOCIATED PERSONS.

(a) MEMBER OR EMPLOYEE OF THE MUNICIPAL SECURITIES RULEMAKING BOARD.—Section 15B(c)(8) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4(c)(8)) is amended by striking "any member or employee" and inserting "any person who is, or at the time of the alleged violation or abuse was, a member or employee".

(b) PERSON ASSOCIATED WITH A GOVERNMENT SECURITIES BROKER OR DEALER.—Section 15C(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–5(c)) is amended—

(1) in paragraph (1)(C), by striking "any person associated, or seeking to become associated," and inserting "any person who is, or at the time of the alleged misconduct was, associated or seeking to become associated"; and

(2) in paragraph (2)—

(A) in subparagraph (A), by inserting ", seeking to become associated, or, at the time of the alleged misconduct, associated or seeking to become associated" after "any person associated"; and

(B) in subparagraph (B), by inserting ", seeking to become associated, or, at the time of the alleged misconduct, associated or seeking to become associated" after "any person associated".

(c) PERSON ASSOCIATED WITH A MEMBER OF A NATIONAL SECURITIES EXCHANGE OR REGISTERED SECURITIES ASSOCIATION.—Section 21(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(a)(1)) is amended, in the first sentence, by inserting ", or, as to any act or practice, or omission to act, while associated with a member, formerly associated" after "member or a person associated".

(d) PARTICIPANT OF A REGISTERED CLEARING AGENCY.—Section 21(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(a)(1)) is amended, in the first sentence, by inserting "or, as to any act or practice, or omission to act, while a participant, was a participant," after "in which such person is a participant,".

(e) OFFICER OR DIRECTOR OF A SELF-REGULATORY ORGANIZATION.—Section 19(h)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(h)(4)) is amended—

(1) by striking "any officer or director" and inserting "any person who is, or at the time of the alleged misconduct was, an officer or director"; and

(2) by striking "such officer or director" and inserting "such person".

(f) OFFICER OR DIRECTOR OF AN INVESTMENT COMPANY.—Section 36(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–35(a)) is amended—

(1) by striking "a person serving or acting" and inserting "a person who is, or at the time of the alleged misconduct was, serving or acting"; and

(2) by striking "such person so serves or acts" and inserting "such person so serves or acts, or at the time of the alleged misconduct, so served or acted".

(g) PERSON ASSOCIATED WITH A PUBLIC ACCOUNTING FIRM.—

(1) SARBANES-OXLEY ACT OF 2002 AMENDMENT.—Section 2(a)(9) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201(9)) is amended by adding at the end the following:

"(C) INVESTIGATIVE AND ENFORCEMENT AUTHORITY.—For purposes of sections 3(c), 101(c), 105, and 107(c) and the rules of the Board and Commission issued thereunder, except to the extent specifically excepted by such rules, the terms defined in subparagraph (A) shall include any person associated, seeking to become associated, or formerly associated with a public accounting firm, except that—

"(i) the authority to conduct an investigation of such person under section 105(b) shall apply only with respect to any act or practice, or omission to act, by the person while such person was associated or seeking to become associated with a registered public accounting firm; and

"(ii) the authority to commence a disciplinary proceeding under section 105(c)(1), or impose sanctions under section 105(c)(4), against such person shall apply only with respect to—

"(I) conduct occurring while such person was associated or seeking to become associated with a registered public accounting firm; or

"(II) non-cooperation, as described in section 105(b)(3), with respect to a demand in a Board investigation for testimony, documents, or other information relating to a period when such person was associated or seeking to become associated with a registered public accounting firm.".

(2) SECURITIES EXCHANGE ACT OF 1934 AMENDMENT.—Section 21(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(a)(1)) is amended by striking "or a person associated with such a firm" and inserting ", a person associated with such a firm, or, as to any act, practice, or omission to act, while associated with such firm, a person formerly associated with such a firm".

(h) SUPERVISORY PERSONNEL OF AN AUDIT FIRM.—Section 105(c)(6) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7215(c)(6)) is amended—

(1) in subparagraph (A), by striking "the supervisory personnel" and inserting "any person who is, or at the time of the alleged failure reasonably to supervise was, a supervisory person"; and

(2) in subparagraph (B)—

(A) by striking "No associated person" and inserting "No current or former supervisory person"; and

(B) by striking "any other person" and inserting "any associated person".

(i) MEMBER OF THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD.—Section 107(d)(3) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7217(d)(3)) is amended by striking "any member" and inserting "any person who is, or at the time of the alleged misconduct was, a member".

SEC. 929G. STREAMLINED HIRING AUTHORITY FOR MARKET SPECIALISTS.

(a) APPOINTMENT AUTHORITY.—Section 3114 of title 5, United States Code, is amended by striking the section heading and all that follows through the end of subsection (a) and inserting the following:

"§ 3114. Appointment of candidates to certain positions in the competitive service by the Securities and Exchange Commission

"(a) APPLICABILITY.—This section applies with respect to any position of accountant, economist, and securities compliance examiner at the Commission that is in the competitive service, and any position at the Commission in the competitive service that requires specialized knowledge of financial and capital market formation or regulation, financial market structures or surveillance, or information technology.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 31 of title 5, United States Code, is amended by striking the item relating to section 3114 and inserting the following:

"3114. Appointment of candidates to positions in the competitive service by the Securities and Exchange Commission.".

(c) PAY AUTHORITY.—The Commission may set the rate of pay for experts and consultants appointed under the authority of section 3109 of title 5, United States Code, in the same manner in which it sets the rate of pay for employees of the Commission.

SEC. 929H. SIPC REFORMS.

(a) INCREASING THE CASH LIMIT OF PROTECTION.—Section 9 of the Securities Investor Protection Act of 1970 (15 U.S.C. 78fff–3) is amended—

(1) in subsection (a)(1), by striking "$100,000 for each such customer" and inserting "the standard maximum cash advance amount for each such customer, as determined in accordance with subsection (d)"; and

(2) by adding the following new subsections:

"(d) STANDARD MAXIMUM CASH ADVANCE AMOUNT DEFINED.—For purposes of this section, the term 'standard maximum cash advance amount' means $250,000, as such amount may be adjusted after December 31, 2010, as provided under subsection (e).

"(e) INFLATION ADJUSTMENT.—

"(1) IN GENERAL.—Not later than January 1, 2011, and every 5 years thereafter, and subject to the approval of the Commission as provided under section 3(e)(2), the Board of Directors of SIPC shall determine whether an inflation adjustment to the standard maximum cash advance amount is appropriate. If the Board of Directors of SIPC determines such an adjustment is appropriate, then the standard maximum cash advance amount shall be an amount equal to—

"(A) $250,000 multiplied by—

"(B) the ratio of the annual value of the Personal Consumption Expenditures Chain-Type Price Index (or any successor index thereto), published by the Department of Commerce, for the calendar year preceding the year in which such determination is made, to the published annual value of such index for the calendar year preceding the year in which this subsection was enacted.

The index values used in calculations under this paragraph shall be, as of the date of the calculation, the values most recently published by the Department of Commerce.

"(2) ROUNDING.—If the standard maximum cash advance amount determined under paragraph (1) for any period is not a multiple of $10,000, the amount so determined shall be rounded down to the nearest $10,000.

"(3) PUBLICATION AND REPORT TO THE CONGRESS.—Not later than April 5 of any calendar year in which a determination is required to be made under paragraph (1)—

"(A) the Commission shall publish in the Federal Register the standard maximum cash advance amount; and

"(B) the Board of Directors of SIPC shall submit a report to the Congress stating the standard maximum cash advance amount.

"(4) IMPLEMENTATION PERIOD.—Any adjustment to the standard maximum cash advance amount shall take effect on January 1 of the year immediately succeeding the calendar year in which such adjustment is made.

"(5) INFLATION ADJUSTMENT CONSIDERATIONS.—In making any determination under paragraph (1) to increase the standard maximum cash advance amount, the Board of Directors of SIPC shall consider—

"(A) the overall state of the fund and the economic conditions affecting members of SIPC;

"(B) the potential problems affecting members of SIPC; and

"(C) such other factors as the Board of Directors of SIPC may determine appropriate.".

(b) LIQUIDATION OF A CARRYING BROKER-DEALER.—Section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)) is amended—

(1) by striking the undesignated matter immediately following subparagraph (B);

(2) in subparagraph (A), by striking "any member of SIPC" and inserting "the member";

(3) in subparagraph (B), by striking the comma at the end and inserting a period;

(4) by striking "If SIPC" and inserting the following:

"(A) IN GENERAL.—SIPC may, upon notice to a member of SIPC, file an application for a protective decree with any court of competent jurisdiction specified in section 21(e) or 27 of the Securities Exchange Act of 1934, except that no such application shall be filed with respect to a member, the only customers of which are persons whose claims could not be satisfied by SIPC advances pursuant to section 9, if SIPC"; and

(5) by adding at the end the following:

"(B) CONSENT REQUIRED.—No member of SIPC that has a customer may enter into an insolvency, receivership, or bankruptcy proceeding, under Federal or State law, without the specific consent of SIPC, except as provided in title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act.".

SEC. 929I. PROTECTING CONFIDENTIALITY OF MATERIALS SUBMITTED TO THE COMMISSION.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 24 of the Securities Exchange Act of 1934 (15 U.S.C. 78x) is amended—

(1) in subsection (d), by striking "subsection (e)" and inserting "subsection (f)";

(2) by redesignating subsection (e) as subsection (f); and

(3) by inserting after subsection (d) the following:

"(e) RECORDS OBTAINED FROM REGISTERED PERSONS.—

"(1) IN GENERAL.—Except as provided in subsection (f), the Commission shall not be compelled to disclose records or information obtained pursuant to section 17(b), or records or information based upon or derived from such records or information, if such records or information have been obtained by the Commission for use in furtherance of the purposes of this title, including surveillance, risk assessments, or other regulatory and oversight activities.

"(2) TREATMENT OF INFORMATION.—For purposes of section 552 of title 5, United States Code, this subsection shall be considered a statute described in subsection (b)(3)(B) of such section 552. Collection of information pursuant to section 17 shall be an administrative action involving an agency against specific individuals or agencies pursuant to section 3518(c)(1) of title 44, United States Code.".

(b) INVESTMENT COMPANY ACT OF 1940.—Section 31 of the Investment Company Act of 1940 (15 U.S.C. 80a-30) is amended—

(1) by striking subsection (c) and inserting the following:

"(c) LIMITATIONS ON DISCLOSURE BY COMMISSION.—Notwithstanding any other provision of law, the Commission shall not be compelled to disclose any records or information provided to the Commission under this section, or records or information based upon or derived from such records or information, if such records or information have been obtained by the Commission for use in furtherance of the purposes of this title, including surveillance, risk assessments, or other regulatory and oversight activities. Nothing in this subsection authorizes the Commission to withhold information from the Congress or prevent the Commission from complying with a request for information from any other Federal department or agency requesting the information for purposes within the scope of jurisdiction of that department or agency, or complying with an order of a court of the United States in an action brought by the United States or the Commission. For purposes of section 552 of title 5, United States Code, this section shall be considered a statute described in subsection (b)(3)(B) of such section 552. Collection of information pursuant to section 31 shall be an administrative action involving an agency against specific individuals or agencies pursuant to section 3518(c)(1) of title 44, United States Code.";

(2) by striking subsection (d); and

(3) by redesignating subsections (e) and (f) as subsections (d) and (e), respectively.

(c) INVESTMENT ADVISERS ACT OF 1940.—Section 210 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-10) is amended by adding at the end the following:

"(d) LIMITATIONS ON DISCLOSURE BY THE COMMISSION.—Notwithstanding any other provision of law, the Commission shall not be compelled to disclose any records or information provided to the Commission under section 204, or records or information based upon or derived from such records or information, if such records or information have been obtained by the Commission for use in furtherance of the purposes of this title, including surveillance, risk assessments, or other regulatory and oversight activities. Nothing in this subsection authorizes the Commission to withhold information from the Congress or prevent the Commission from complying with a request for information from any other Federal department or agency requesting the information for purposes within the scope of jurisdiction of that department or agency, or complying with an order of a court of the United States in an action brought by the United States or the Commission. For purposes of section 552 of title 5, United States Code, this subsection shall be considered a statute described in subsection (b)(3)(B) of such section 552. Collection of information pursuant to section 204 shall be an administrative action involving an agency against specific individuals or agencies pursuant to section 3518(c)(1) of title 44, United States Code.''.

SEC. 929J. EXPANSION OF AUDIT INFORMATION TO BE PRODUCED AND EXCHANGED.

Section 106 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7216) is amended—

(1) by striking subsection (b) and inserting the following:

''(b) PRODUCTION OF DOCUMENTS.—

''(1) PRODUCTION BY FOREIGN FIRMS.—If a foreign public accounting firm performs material services upon which a registered public accounting firm relies in the conduct of an audit or interim review, issues an audit report, performs audit work, or conducts interim reviews, the foreign public accounting firm shall—

''(A) produce the audit work papers of the foreign public accounting firm and all other documents of the firm related to any such audit work or interim review to the Commission or the Board, upon request of the Commission or the Board; and

''(B) be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for such documents.

''(2) OTHER PRODUCTION.—Any registered public accounting firm that relies, in whole or in part, on the work of a foreign public accounting firm in issuing an audit report, performing audit work, or conducting an interim review, shall—

''(A) produce the audit work papers of the foreign public accounting firm and all other documents related to any such work in response to a request for production by the Commission or the Board; and

''(B) secure the agreement of any foreign public accounting firm to such production, as a condition of the reliance by the registered public accounting firm on the work of that foreign public accounting firm.'';

(2) by redesignating subsection (d) as subsection (g); and

(3) by inserting after subsection (c) the following:

''(d) SERVICE OF REQUESTS OR PROCESS.—

''(1) IN GENERAL.—Any foreign public accounting firm that performs work for a domestic registered public accounting firm shall furnish to the domestic registered public accounting firm a written irrevocable consent and power of attorney that designates the domestic registered public accounting firm as an agent upon whom may be served any request by the Commission or the Board under this section or upon whom may be served any process, pleadings, or other papers in any action brought to enforce this section.

"(2) SPECIFIC AUDIT WORK.—Any foreign public accounting firm that performs material services upon which a registered public accounting firm relies in the conduct of an audit or interim review, issues an audit report, performs audit work, or, performs interim reviews, shall designate to the Commission or the Board an agent in the United States upon whom may be served any request by the Commission or the Board under this section or upon whom may be served any process, pleading, or other papers in any action brought to enforce this section.

"(e) SANCTIONS.—A willful refusal to comply, in whole in or in part, with any request by the Commission or the Board under this section, shall be deemed a violation of this Act.

"(f) OTHER MEANS OF SATISFYING PRODUCTION OBLIGATIONS.—Notwithstanding any other provisions of this section, the staff of the Commission or the Board may allow a foreign public accounting firm that is subject to this section to meet production obligations under this section through alternate means, such as through foreign counterparts of the Commission or the Board.".

SEC. 929K. SHARING PRIVILEGED INFORMATION WITH OTHER AUTHORITIES.

Section 24 of the Securities Exchange Act of 1934 (15 U.S.C. 78x) is amended—

(1) in subsection (d), as amended by subsection (d)(1)(A), by striking "subsection (f)" and inserting "subsection (g)";

(2) in subsection (e), as added by subsection (d)(1)(C), by striking "subsection (f)" and inserting "subsection (g)";

(3) by redesignating subsection (f) as subsection (g); and

(4) by inserting after subsection (e) the following:

"(f) SHARING PRIVILEGED INFORMATION WITH OTHER AUTHORITIES.—

"(1) PRIVILEGED INFORMATION PROVIDED BY THE COMMISSION.—The Commission shall not be deemed to have waived any privilege applicable to any information by transferring that information to or permitting that information to be used by—

"(A) any agency (as defined in section 6 of title 18, United States Code);

"(B) the Public Company Accounting Oversight Board;

"(C) any self-regulatory organization;

"(D) any foreign securities authority;

"(E) any foreign law enforcement authority; or

"(F) any State securities or law enforcement authority.

"(2) NONDISCLOSURE OF PRIVILEGED INFORMATION PROVIDED TO THE COMMISSION.—The Commission shall not be compelled to disclose privileged information obtained from any foreign securities authority, or foreign law enforcement authority, if the authority has in good faith determined and represented to the Commission that the information is privileged.

"(3) NONWAIVER OF PRIVILEGED INFORMATION PROVIDED TO THE COMMISSION.—

"(A) IN GENERAL.—Federal agencies, State securities and law enforcement authorities, self-regulatory organizations, and the Public Company Accounting Oversight Board shall not be deemed to have waived any privilege applicable to any information by transferring that information to or permitting that information to be used by the Commission.

"(B) EXCEPTION.—The provisions of subparagraph (A) shall not apply to a self-regulatory organization or the Public Company Accounting Oversight Board with respect to information used by the Commission in an action against such organization.

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) the term 'privilege' includes any work-product privilege, attorney-client privilege, governmental privilege, or other privilege recognized under Federal, State, or foreign law;

"(B) the term 'foreign law enforcement authority' means any foreign authority that is empowered under foreign law to detect, investigate or prosecute potential violations of law; and

"(C) the term 'State securities or law enforcement authority' means the authority of any State or territory that is empowered under State or territory law to detect, investigate, or prosecute potential violations of law.".

SEC. 929L. ENHANCED APPLICATION OF ANTIFRAUD PROVISIONS.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 9—

(A) by striking "registered on a national securities exchange" each place that term appears and inserting "other than a government security";

(B) in subsection (b), by striking "by use of any facility of a national securities exchange,"; and

(C) in subsection (c), by inserting after "unlawful for any" the following: "broker, dealer, or";

(2) in section 10(a)(1), by striking "registered on a national securities exchange" and inserting "other than a government security"; and

(3) in section 15(c)(1)(A), by striking "otherwise than on a national securities exchange of which it is a member".

SEC. 929M. AIDING AND ABETTING AUTHORITY UNDER THE SECURITIES ACT AND THE INVESTMENT COMPANY ACT.

(a) UNDER THE SECURITIES ACT OF 1933.—Section 15 of the Securities Act of 1933 (15 U.S.C. 77o) is amended—

(1) by striking "Every person who" and inserting "(a) CONTROLLING PERSONS.—Every person who"; and

(2) by adding at the end the following:

"(b) PROSECUTION OF PERSONS WHO AID AND ABET VIOLATIONS.—For purposes of any action brought by the Commission under subparagraph (b) or (d) of section 20, any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of this Act, or of any rule or regulation issued under this Act, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.".

(b) UNDER THE INVESTMENT COMPANY ACT OF 1940.—Section 48 of the Investment Company Act of 1940 (15 U.S.C. 80a–48) is amended by redesignating subsection (b) as subsection (c) and inserting after subsection (a) the following:

"(b) For purposes of any action brought by the Commission under subsection (d) or (e) of section 42, any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of this Act, or of any rule or regulation issued under this Act, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.''.

SEC. 929N. AUTHORITY TO IMPOSE PENALTIES FOR AIDING AND ABETTING VIOLATIONS OF THE INVESTMENT ADVISERS ACT.

Section 209 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–9) is amended by inserting at the end the following new subsection:

''(f) AIDING AND ABETTING.—For purposes of any action brought by the Commission under subsection (e), any person that knowingly or recklessly has aided, abetted, counseled, commanded, induced, or procured a violation of any provision of this Act, or of any rule, regulation, or order hereunder, shall be deemed to be in violation of such provision, rule, regulation, or order to the same extent as the person that committed such violation.''.

SEC. 929O. AIDING AND ABETTING STANDARD OF KNOWLEDGE SATISFIED BY RECKLESSNESS.

Section 20(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78t(e)) is amended by inserting ''or recklessly'' after ''knowingly''.

SEC. 929P. STRENGTHENING ENFORCEMENT BY THE COMMISSION.

(a) AUTHORITY TO IMPOSE CIVIL PENALTIES IN CEASE AND DESIST PROCEEDINGS.—

(1) UNDER THE SECURITIES ACT OF 1933.—Section 8A of the Securities Act of 1933 (15 U.S.C. 77h–1) is amended by adding at the end the following new subsection:

''(g) AUTHORITY TO IMPOSE MONEY PENALTIES.—

''(1) GROUNDS.—In any cease-and-desist proceeding under subsection (a), the Commission may impose a civil penalty on a person if the Commission finds, on the record, after notice and opportunity for hearing, that—

''(A) such person—

''(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

''(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation thereunder; and

''(B) such penalty is in the public interest.

''(2) MAXIMUM AMOUNT OF PENALTY.—

''(A) FIRST TIER.—The maximum amount of a penalty for each act or omission described in paragraph (1) shall be $7,500 for a natural person or $75,000 for any other person.

''(B) SECOND TIER.—Notwithstanding subparagraph (A), the maximum amount of penalty for each such act or omission shall be $75,000 for a natural person or $375,000 for any other person, if the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

''(C) THIRD TIER.—Notwithstanding subparagraphs (A) and (B), the maximum amount of penalty for each such act or omission shall be $150,000 for a natural person or $725,000 for any other person, if—

"(i) the act or omission described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

"(ii) such act or omission directly or indirectly resulted in—

"(I) substantial losses or created a significant risk of substantial losses to other persons; or

"(II) substantial pecuniary gain to the person who committed the act or omission.

"(3) EVIDENCE CONCERNING ABILITY TO PAY.—In any proceeding in which the Commission may impose a penalty under this section, a respondent may present evidence of the ability of the respondent to pay such penalty. The Commission may, in its discretion, consider such evidence in determining whether such penalty is in the public interest. Such evidence may relate to the extent of the ability of the respondent to continue in business and the collectability of a penalty, taking into account any other claims of the United States or third parties upon the assets of the respondent and the amount of the assets of the respondent.".

(2) UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Section 21B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–2(a)) is amended—

(A) by striking the matter following paragraph (4);

(B) in the matter preceding paragraph (1), by inserting after "opportunity for hearing," the following: "that such penalty is in the public interest and";

(C) by redesignating paragraphs (1) through (4) as subparagraphs (A) through (D), respectively, and adjusting the margins accordingly;

(D) by striking "In any proceeding" and inserting the following:

"(1) IN GENERAL.—In any proceeding"; and

(E) by adding at the end the following:

"(2) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted under section 21C against any person, the Commission may impose a civil penalty, if the Commission finds, on the record after notice and opportunity for hearing, that such person—

"(A) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(B) is or was a cause of the violation of any provision of this title, or any rule or regulation issued under this title.".

(3) UNDER THE INVESTMENT COMPANY ACT OF 1940.—Section 9(d)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a–9(d)(1)) is amended—

(A) by striking the matter following subparagraph (C);

(B) in the matter preceding subparagraph (A), by inserting after "opportunity for hearing," the following: "that such penalty is in the public interest, and";

(C) by redesignating subparagraphs (A) through (C) as clauses (i) through (iii), respectively, and adjusting the margins accordingly;

(D) by striking "In any proceeding" and inserting the following:

"(A) IN GENERAL.—In any proceeding"; and

(E) by adding at the end the following:

"(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (f) against any person, the Commission may impose a civil penalty if the Commission finds, on the record, after notice and opportunity for hearing, that such person—

"(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation issued under this title.".

(4) UNDER THE INVESTMENT ADVISERS ACT OF 1940.—Section 203(i)(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(i)(1)) is amended—

(A) by striking the matter following subparagraph (D);

(B) in the matter preceding subparagraph (A), by inserting after "opportunity for hearing," the following: "that such penalty is in the public interest and";

(C) by redesignating subparagraphs (A) through (D) as clauses (i) through (iv), respectively, and adjusting the margins accordingly;

(D) by striking "In any proceeding" and inserting the following:

"(A) IN GENERAL.—In any proceeding"; and

(E) by adding at the end the following new subparagraph:

"(B) CEASE-AND-DESIST PROCEEDINGS.—In any proceeding instituted pursuant to subsection (k) against any person, the Commission may impose a civil penalty if the Commission finds, on the record, after notice and opportunity for hearing, that such person—

"(i) is violating or has violated any provision of this title, or any rule or regulation issued under this title; or

"(ii) is or was a cause of the violation of any provision of this title, or any rule or regulation issued under this title.".

(b) EXTRATERRITORIAL JURISDICTION OF THE ANTIFRAUD PROVISIONS OF THE FEDERAL SECURITIES LAWS.—

(1) UNDER THE SECURITIES ACT OF 1933.—Section 22 of the Securities Act of 1933 (15 U.S.C. 77v(a)) is amended by adding at the end the following new subsection:

"(c) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 17(a) involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(2) UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa) is amended—

(A) by striking "The district" and inserting the following:

"(a) IN GENERAL.—The district"; and

(B) by adding at the end the following new subsection:

"(b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of this title involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(3) UNDER THE INVESTMENT ADVISERS ACT OF 1940.—Section 214 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–14) is amended—

(A) by striking "The district" and inserting the following:

"(a) IN GENERAL.—The district"; and

(B) by adding at the end the following new subsection:

"(b) EXTRATERRITORIAL JURISDICTION.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 206 involving—

"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the violation is committed by a foreign adviser and involves only foreign investors; or

"(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.".

(c) CONTROL PERSON LIABILITY UNDER THE SECURITIES EXCHANGE ACT OF 1934.—Section 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78t(a)) is amended by inserting after "controlled person is liable" the following: "(including to the Commission in any action brought under paragraph (1) or (3) of section 21(d))".

SEC. 929Q. REVISION TO RECORDKEEPING RULE.

(a) INVESTMENT COMPANY ACT OF 1940 AMENDMENTS.—Section 31 of the Investment Company Act of 1940 (15 U.S.C. 80a–30) is amended—

(1) in subsection (a)(1), by adding at the end the following: "Each person having custody or use of the securities, deposits, or credits of a registered investment company shall maintain and preserve all records that relate to the custody or use by such person of the securities, deposits, or credits of the registered investment company for such period or periods as the Commission, by rule or regulation, may prescribe, as necessary or appropriate in the public interest or for the protection of investors."; and

(2) in subsection (b), by adding at the end the following:

"(4) RECORDS OF PERSONS WITH CUSTODY OR USE.—

"(A) IN GENERAL.—Records of persons having custody or use of the securities, deposits, or credits of a registered investment company that relate to such custody or use, are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations and other information and document requests by representatives of the Commission, as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

"(B) CERTAIN PERSONS SUBJECT TO OTHER REGULATION.—Any person that is subject to regulation and examination by a Federal financial institution regulatory agency (as such term is defined under section 212(c)(2) of title 18, United States Code) may satisfy any examination request, information request, or document request described under subparagraph (A), by providing to the Commission a detailed listing, in writing, of the securities, deposits, or credits of the registered investment company within the custody or use of such person.".

(b) INVESTMENT ADVISERS ACT OF 1940 AMENDMENT.—Section 204 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–4) is amended by adding at the end the following new subsection:

"(d) RECORDS OF PERSONS WITH CUSTODY OR USE.—

"(1) IN GENERAL.—Records of persons having custody or use of the securities, deposits, or credits of a client, that relate to such custody or use, are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations and other information and document requests by representatives of the Commission, as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

"(2) CERTAIN PERSONS SUBJECT TO OTHER REGULATION.—Any person that is subject to regulation and examination by a Federal financial institution regulatory agency (as such term is defined under section 212(c)(2) of title 18, United States Code) may satisfy any examination request, information request, or document request described under paragraph (1), by providing the Commission with a detailed listing, in writing, of the securities, deposits, or credits of the client within the custody or use of such person.".

SEC. 929R. BENEFICIAL OWNERSHIP AND SHORT-SWING PROFIT REPORTING.

(a) BENEFICIAL OWNERSHIP REPORTING.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended—

(1) in subsection (d)(1)—

(A) by inserting after "within ten days after such acquisition" the following: "or within such shorter time as the Commission may establish by rule"; and

(B) by striking "send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and";

(2) in subsection (d)(2)—

(A) by striking "in the statements to the issuer and the exchange, and"; and

(B) by striking "shall be transmitted to the issuer and the exchange and";

(3) in subsection (g)(1), by striking "shall send to the issuer of the security and"; and

(4) in subsection (g)(2)—

(A) by striking "sent to the issuer and"; and

(B) by striking "shall be transmitted to the issuer and".

(b) SHORT-SWING PROFIT REPORTING.—Section 16(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78p(a)) is amended—

(1) in paragraph (1), by striking "(and, if such security is registered on a national securities exchange, also with the exchange)"; and

(2) in paragraph (2)(B), by inserting after "officer" the following: ", or within such shorter time as the Commission may establish by rule".

SEC. 929S. FINGERPRINTING.

Section 17(f)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(f)(2)) is amended—

(1) in the first sentence, by striking "and registered clearing agency," and inserting "registered clearing agency, registered securities information processor, national securities exchange, and national securities association"; and

(2) in the second sentence, by striking "or clearing agency," and inserting "clearing agency, securities information processor, national securities exchange, or national securities association,".

SEC. 929T. EQUAL TREATMENT OF SELF-REGULATORY ORGANIZATION RULES.

Section 29(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78cc(a)) is amended by striking "an exchange required thereby" and inserting "a self-regulatory organization,".

SEC. 929U. DEADLINE FOR COMPLETING EXAMINATIONS, INSPECTIONS AND ENFORCEMENT ACTIONS.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 4D the following new section:

"SEC. 4E. DEADLINE FOR COMPLETING ENFORCEMENT INVESTIGATIONS AND COMPLIANCE EXAMINATIONS AND INSPECTIONS.

"(a) ENFORCEMENT INVESTIGATIONS.—

"(1) IN GENERAL.—Not later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff shall either file an action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action.

"(2) EXCEPTIONS FOR CERTAIN COMPLEX ACTIONS.—Notwithstanding paragraph (1), if the Director of the Division of Enforcement of the Commission or the Director's designee determines that a particular enforcement investigation is sufficiently complex such that a determination regarding the filing of an action against a person cannot be completed within the deadline specified in paragraph (1), the Director of the Division of Enforcement of the Commission or the Director's designee may, after providing notice to the Chairman of the Commission, extend such deadline as needed for one additional 180-day period. If after the additional 180-day period the Director of the Division of Enforcement of the Commission or the Director's designee determines that a particular enforcement investigation is sufficiently complex such that a determination regarding the filing of an action against a person cannot be completed within the additional 180-day period, the Director of the Division of Enforcement of the Commission or the Director's designee may, after providing notice to and receiving approval of the Commission, extend such deadline as needed for one or more additional successive 180-day periods.

"(b) COMPLIANCE EXAMINATIONS AND INSPECTIONS.—

"(1) IN GENERAL.—Not later than 180 days after the date on which Commission staff completes the on-site portion of its compliance examination or inspection or receives all records requested from the entity being examined or inspected, whichever is later, Commission staff shall provide the entity being examined or inspected with written notification indicating either that the examination or inspection has concluded, has concluded without findings, or that the staff requests the entity undertake corrective action.

"(2) EXCEPTION FOR CERTAIN COMPLEX ACTIONS.—Notwithstanding paragraph (1), if the head of any division or office within the Commission responsible for compliance examinations and inspections or his designee determines that a particular compliance examination or inspection is sufficiently complex such that a determination regarding concluding the examination or inspection, or regarding the staff requests the entity undertake corrective action, cannot be completed within the deadline specified in paragraph (1), the head of any division or office within the Commission responsible for compliance examinations and inspections or his designee may, after providing notice to the Chairman of the Commission, extend such deadline as needed for one additional 180-day period.".

SEC. 929V. SECURITY INVESTOR PROTECTION ACT AMENDMENTS.

(a) INCREASING THE MINIMUM ASSESSMENT PAID BY SIPC MEMBERS.—Section 4(d)(1)(C) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78ddd(d)(1)(C)) is amended by striking "$150 per annum" and inserting the following: "0.02 percent of the gross revenues from the securities business of such member of SIPC".

(b) INCREASING THE FINE FOR PROHIBITED ACTS UNDER SIPA.—Section 14(c) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78jjj(c)) is amended—

(1) in paragraph (1), by striking "$50,000" and inserting "$250,000"; and

(2) in paragraph (2), by striking "$50,000" and inserting "$250,000".

(c) PENALTY FOR MISREPRESENTATION OF SIPC MEMBERSHIP OR PROTECTION.—Section 14 of the Securities Investor Protection Act of 1970 (15 U.S.C. 78jjj) is amended by adding at the end the following new subsection:

"(d) MISREPRESENTATION OF SIPC MEMBERSHIP OR PROTECTION.—

"(1) IN GENERAL.—Any person who falsely represents by any means (including, without limitation, through the Internet or any other medium of mass communication), with actual knowledge of the falsity of the representation and with an intent to deceive or cause injury to another, that such person, or another person, is a member of SIPC or that any person or account is protected or is eligible for protection under this Act or by SIPC, shall be liable for any damages caused thereby and shall be fined not more than $250,000 or imprisoned for not more than 5 years.

"(2) INJUNCTIONS.—Any court having jurisdiction of a civil action arising under this Act may grant temporary injunctions and final injunctions on such terms as the court deems reasonable to prevent or restrain any violation of paragraph (1). Any such injunction may be served anywhere in the United States on the person enjoined, shall be operative throughout the United States, and shall be enforceable, by proceedings in contempt or otherwise, by any United States court having jurisdiction over that person. The clerk of the court granting the injunction shall, when requested by any other court in which enforcement of the injunction is sought, transmit promptly to the other court a certified copy of all papers in the case on file in such clerk's office.".

SEC. 929W. NOTICE TO MISSING SECURITY HOLDERS.

Section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q–1) is amended by adding at the end the following new subsection:

"(g) DUE DILIGENCE FOR THE DELIVERY OF DIVIDENDS, INTEREST, AND OTHER VALUABLE PROPERTY RIGHTS.—

"(1) REVISION OF RULES REQUIRED.—The Commission shall revise its regulations in section 240.17Ad–17 of title 17, Code of Federal Regulations, as in effect on December 8, 1997, to extend the application of such section to brokers and dealers and to provide for the following:

"(A) A requirement that the paying agent provide a single written notification to each missing security holder that the missing security holder has been sent a check that has not yet been negotiated. The written notification may be sent along with a check or other mailing subsequently sent to the missing security holder but must be provided no later than 7 months after the sending of the not yet negotiated check.

"(B) An exclusion for paying agents from the notification requirements when the value of the not yet negotiated check is less than $25.

"(C) A provision clarifying that the requirements described in subparagraph (A) shall have no effect on State escheatment laws.

"(D) For purposes of such revised regulations—

"(i) a security holder shall be considered a 'missing security holder' if a check is sent to the security holder and the check is not negotiated before the earlier of the paying agent sending the next regularly scheduled check or the elapsing of 6 months after the sending of the not yet negotiated check; and

"(ii) the term 'paying agent' includes any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian, or any other person that accepts payments from the issuer of a security and distributes the payments to the holders of the security.

"(2) RULEMAKING.—The Commission shall adopt such rules, regulations, and orders necessary to implement this subsection no later than 1 year after the date of enactment of this subsection. In proposing such rules, the Commission shall seek to minimize disruptions to current systems used by or on behalf of paying agents to process payment to account holders and avoid requiring multiple paying agents to send written notification to a missing security holder regarding the same not yet negotiated check.".

SEC. 929X. SHORT SALE REFORMS.

(a) SHORT SALE DISCLOSURE.—Section 13(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(f)) is amended by redesignating paragraphs (2), (3), (4), and (5) as paragraphs (3), (4), (5), and (6), respectively, and inserting after paragraph (1) the following:

"(2) The Commission shall prescribe rules providing for the public disclosure of the name of the issuer and the title, class, CUSIP number, aggregate amount of the number of short sales of each security, and any additional information determined by the Commission following the end of the reporting period. At a minimum, such public disclosure shall occur every month.".

(b) SHORT SELLING ENFORCEMENT.—Section 9 of the Securities Exchange Act of 1934 (15 U.S.C. 78i) is amended—

(1) by redesignating subsections (d), (e), (f), (g), (h), and (i) as subsections (e), (f), (g), (h), (i), and (j), respectively; and

(2) inserting after subsection (c), the following new subsection:

"(d) TRANSACTIONS RELATING TO SHORT SALES OF SECURITIES.—It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange to effect, alone or with one or more other persons, a manipulative short sale of any security. The Commission shall issue such other rules as are necessary or appropriate to ensure that the appropriate enforcement options and remedies are available for violations of this subsection in the public interest or for the protection of investors.".

(c) INVESTOR NOTIFICATION.—Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended—

(1) by redesignating subsections (e), (f), (g), (h), and (i) as subsections (f), (g), (h), (i), and (j), respectively; and

(2) inserting after subsection (d) the following new subsection:

"(e) NOTICES TO CUSTOMERS REGARDING SECURITIES LENDING.—Every registered broker or dealer shall provide notice to its customers that they may elect not to allow their fully paid securities to be used in connection with short sales. If a broker or dealer uses a customer's securities in connection with short sales, the broker or dealer shall provide notice to its customer that the broker or dealer may receive compensation in connection with lending the customer's securities. The Commission, by rule, as it deems necessary or appropriate in the public interest and for the protection of investors, may prescribe the form, content, time, and manner of delivery of any notice required under this paragraph.''.

SEC. 929Y. STUDY ON EXTRATERRITORIAL PRIVATE RIGHTS OF ACTION.

(a) IN GENERAL.—The Securities and Exchange Commission of the United States shall solicit public comment and thereafter conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Securities and Exchange Act of 1934 (15 U.S.C. 78u-4) should be extended to cover—

(1) conduct within the United States that constitutes a significant step in the furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; and

(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

(b) CONTENTS.—The study shall consider and analyze, among other things—

(1) the scope of such a private right of action, including whether it should extend to all private actors or whether it should be more limited to extend just to institutional investors or otherwise;

(2) what implications such a private right of action would have on international comity;

(3) the economic costs and benefits of extending a private right of action for transnational securities frauds; and

(4) whether a narrower extraterritorial standard should be adopted.

(c) REPORT.—A report of the study shall be submitted and recommendations made to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House not later than 18 months after the date of enactment of this Act.

SEC. 929Z. GAO STUDY ON SECURITIES LITIGATION.

(a) STUDY.—The Comptroller General of the United States shall conduct a study on the impact of authorizing a private right of action against any person who aids or abets another person in violation of the securities laws. To the extent feasible, this study shall include—

(1) a review of the role of secondary actors in companies issuance of securities;

(2) the courts interpretation of the scope of liability for secondary actors under Federal securities laws after January 14, 2008; and

(3) the types of lawsuits decided under the Private Securities Litigation Act of 1995.

(b) REPORT.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to Congress on the findings of the study required under subsection (a).

Subtitle C—Improvements to the Regulation of Credit Rating Agencies

SEC. 931. FINDINGS.

Congress finds the following:

(1) Because of the systemic importance of credit ratings and the reliance placed on credit ratings by individual and institutional investors and financial regulators, the activities and performances of credit rating agencies, including nationally recognized statistical rating organizations, are matters of national public interest, as credit rating agencies are central to capital formation, investor confidence, and the efficient performance of the United States economy.

(2) Credit rating agencies, including nationally recognized statistical rating organizations, play a critical "gatekeeper" role in the debt market that is functionally similar to that of securities analysts, who evaluate the quality of securities in the equity market, and auditors, who review the financial statements of firms. Such role justifies a similar level of public oversight and accountability.

(3) Because credit rating agencies perform evaluative and analytical services on behalf of clients, much as other financial "gatekeepers" do, the activities of credit rating agencies are fundamentally commercial in character and should be subject to the same standards of liability and oversight as apply to auditors, securities analysts, and investment bankers.

(4) In certain activities, particularly in advising arrangers of structured financial products on potential ratings of such products, credit rating agencies face conflicts of interest that need to be carefully monitored and that therefore should be addressed explicitly in legislation in order to give clearer authority to the Securities and Exchange Commission.

(5) In the recent financial crisis, the ratings on structured financial products have proven to be inaccurate. This inaccuracy contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world. Such inaccuracy necessitates increased accountability on the part of credit rating agencies.

SEC. 932. ENHANCED REGULATION, ACCOUNTABILITY, AND TRANSPARENCY OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS.

(a) IN GENERAL.—Section 15E of the Securities Exchange Act of 1934 (15 U.S.C. 78o–7) is amended—

(1) in subsection (b)—

(A) in paragraph (1)(A), by striking "furnished" and inserting "filed" and by striking "furnishing" and inserting "filing";

(B) in paragraph (1)(B), by striking "furnishing" and inserting "filing"; and

(C) in the first sentence of paragraph (2), by striking "furnish to" and inserting "file with";

(2) in subsection (c)—

(A) in paragraph (2)—

(i) in the second sentence, by inserting "any other provision of this section, or" after "Notwithstanding"; and

(ii) by inserting after the period at the end the following: "Nothing in this paragraph may be construed to afford a defense against any action or proceeding brought by the Commission to enforce the antifraud provisions of the securities laws."; and

(B) by adding at the end the following:

"(3) INTERNAL CONTROLS OVER PROCESSES FOR DETERMINING CREDIT RATINGS.—

"(A) IN GENERAL.—Each nationally recognized statistical rating organization shall establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings, taking into consideration such factors as the Commission may prescribe, by rule.

"(B) ATTESTATION REQUIREMENT.—The Commission shall prescribe rules requiring each nationally recognized statistical rating organization to submit to the Commission an annual internal controls report, which shall contain—

"(i) a description of the responsibility of the management of the nationally recognized statistical rating organization in establishing and maintaining an effective internal control structure under subparagraph (A);

"(ii) an assessment of the effectiveness of the internal control structure of the nationally recognized statistical rating organization; and

"(iii) the attestation of the chief executive officer, or equivalent individual, of the nationally recognized statistical rating organization.";

(3) in subsection (d)—

(A) by inserting after "or revoke the registration of any nationally recognized statistical rating organization" the following: ", or with respect to any person who is associated with, who is seeking to become associated with, or, at the time of the alleged misconduct, who was associated or was seeking to become associated with a nationally recognized statistical rating organization, the Commission, by order, shall censure, place limitations on the activities or functions of such person, suspend for a period not exceeding 1 year, or bar such person from being associated with a nationally recognized statistical rating organization,";

(B) by inserting "bar" after "placing of limitations, suspension,";

(C) in paragraph (2), by striking "furnished to" and inserting "filed with";

(D) in paragraph (2), by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively, and adjusting the clause margins accordingly;

(E) by redesignating paragraphs (1) through (5) as subparagraphs (A) through (E), respectively, and adjusting the subparagraph margins accordingly;

(F) in the matter preceding subparagraph (A), as so redesignated, by striking "The Commission" and inserting the following:

"(1) IN GENERAL.—The Commission";

(G) in subparagraph (D), as so redesignated—

(i) by striking "furnish" and inserting "file"; and

(ii) by striking "or" at the end.

(H) in subparagraph (E), as so redesignated, by striking the period at the end and inserting a semicolon; and

(I) by adding at the end the following:

"(F) has failed reasonably to supervise, with a view to preventing a violation of the securities laws, an individual who commits such a violation, if the individual is subject to the supervision of that person.

"(2) SUSPENSION OR REVOCATION FOR PARTICULAR CLASS OF SECURITIES.—

"(A) IN GENERAL.—The Commission may temporarily suspend or permanently revoke the registration of a nationally recognized statistical rating organization with respect to a particular class or subclass of securities, if the Commission finds, on the record after notice and opportunity for hearing, that the nationally recognized statistical rating organization does not have adequate financial and managerial resources to consistently produce credit ratings with integrity.

"(B) CONSIDERATIONS.—In making any determination under subparagraph (A), the Commission shall consider—

"(i) whether the nationally recognized statistical rating organization has failed over a sustained period of time, as determined by the Commission, to produce ratings that are accurate for that class or subclass of securities; and

"(ii) such other factors as the Commission may determine.";

(4) in subsection (h), by adding at the end the following:

"(3) SEPARATION OF RATINGS FROM SALES AND MARKETING.—

"(A) RULES REQUIRED.—The Commission shall issue rules to prevent the sales and marketing considerations of a nationally recognized statistical rating organization from influencing the production of ratings by the nationally recognized statistical rating organization.

"(B) CONTENTS OF RULES.—The rules issued under subparagraph (A) shall provide for—

"(i) exceptions for small nationally recognized statistical rating organizations with respect to which the Commission determines that the separation of the production of ratings and sales and marketing activities is not appropriate; and

"(ii) suspension or revocation of the registration of a nationally recognized statistical rating organization, if the Commission finds, on the record, after notice and opportunity for a hearing, that—

"(I) the nationally recognized statistical rating organization has committed a violation of a rule issued under this subsection; and

"(II) the violation of a rule issued under this subsection affected a rating.

"(4) LOOK-BACK REQUIREMENT.—

"(A) REVIEW BY THE NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION.—Each nationally recognized statistical rating organization shall establish, maintain, and enforce policies and procedures reasonably designed to ensure that, in any case in which an employee of a person subject to a credit rating of the nationally recognized statistical rating organization or the issuer, underwriter, or sponsor of a security or money market instrument subject to a credit rating of the nationally recognized statistical rating organization was employed by the nationally recognized statistical rating organization and participated in any capacity in determining credit ratings for the person or the securities or money market instruments during the 1-year period preceding the date an action was taken with respect to the credit rating, the nationally recognized statistical rating organization shall—

"(i) conduct a review to determine whether any conflicts of interest of the employee influenced the credit rating; and

"(ii) take action to revise the rating if appropriate, in accordance with such rules as the Commission shall prescribe.

"(B) REVIEW BY COMMISSION.—

"(i) IN GENERAL.—The Commission shall conduct periodic reviews of the policies described in subparagraph (A) and the implementation of the policies at each nationally recognized statistical rating organization to ensure they are reasonably designed and implemented to most effectively eliminate conflicts of interest.

"(ii) TIMING OF REVIEWS.—The Commission shall review the code of ethics and conflict of interest policy of each nationally recognized statistical rating organization—

"(I) not less frequently than annually; and

"(II) whenever such policies are materially modified or amended.

"(5) REPORT TO COMMISSION ON CERTAIN EMPLOYMENT TRANSITIONS.—

"(A) REPORT REQUIRED.—Each nationally recognized statistical rating organization shall report to the Commission any case such organization knows or can reasonably be expected to know where a person associated with such organization within the previous 5 years obtains employment with any obligor, issuer, underwriter, or sponsor of a security or money market instrument for which the organization issued a credit rating during the 12-month period prior to such employment, if such employee—

"(i) was a senior officer of such organization;

"(ii) participated in any capacity in determining credit ratings for such obligor, issuer, underwriter, or sponsor; or

"(iii) supervised an employee described in clause (ii).

"(B) PUBLIC DISCLOSURE.—Upon receiving such a report, the Commission shall make such information publicly available.";

(5) in subsection (j)—

(A) by striking "Each" and inserting the following: "(1) IN GENERAL.—Each"; and

(B) by adding at the end the following:

"(2) LIMITATIONS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), an individual designated under paragraph (1) may not, while serving in the designated capacity—

"(i) perform credit ratings;

"(ii) participate in the development of ratings methodologies or models;

"(iii) perform marketing or sales functions; or

"(iv) participate in establishing compensation levels, other than for employees working for that individual.

"(B) EXCEPTION.—The Commission may exempt a small nationally recognized statistical rating organization from the limitations under this paragraph, if the Commission finds that compliance with such limitations would impose an unreasonable burden on the nationally recognized statistical rating organization.

"(3) OTHER DUTIES.—Each individual designated under paragraph (1) shall establish procedures for the receipt, retention, and treatment of—

"(A) complaints regarding credit ratings, models, methodologies, and compliance with the securities laws and the policies and procedures developed under this section; and

"(B) confidential, anonymous complaints by employees or users of credit ratings.

"(4) COMPENSATION.—The compensation of each compliance officer appointed under paragraph (1) shall not be linked to the financial performance of the nationally recognized statistical rating organization and shall be arranged so as to ensure the independence of the officer's judgment.

"(5) ANNUAL REPORTS REQUIRED.—

"(A) ANNUAL REPORTS REQUIRED.—Each individual designated under paragraph (1) shall submit to the nationally recognized statistical rating organization an annual report on the compliance of the nationally recognized statistical rating organization with the securities laws and the policies and procedures of the nationally recognized statistical rating organization that includes—

"(i) a description of any material changes to the code of ethics and conflict of interest policies of the nationally recognized statistical rating organization; and

"(ii) a certification that the report is accurate and complete.

"(B) SUBMISSION OF REPORTS TO THE COMMISSION.—Each nationally recognized statistical rating organization shall file the reports required under subparagraph (A) together with the financial report that is required to be submitted to the Commission under this section.";

(6) in subsection (k), by striking "furnish to" and inserting "file with";

(7) in subsection (l)(2)(A)(i), by striking "furnished" and inserting "filed"; and

(8) by striking subsection (p) and inserting the following:

"(p) REGULATION OF NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS.—

"(1) ESTABLISHMENT OF OFFICE OF CREDIT RATINGS.—

"(A) OFFICE ESTABLISHED.—The Commission shall establish within the Commission an Office of Credit Ratings (referred to in this subsection as the 'Office') to administer the rules of the Commission—

"(i) with respect to the practices of nationally recognized statistical rating organizations in determining ratings, for the protection of users of credit ratings and in the public interest;

"(ii) to promote accuracy in credit ratings issued by nationally recognized statistical rating organizations; and

"(iii) to ensure that such ratings are not unduly influenced by conflicts of interest.

"(B) DIRECTOR OF THE OFFICE.—The head of the Office shall be the Director, who shall report to the Chairman.

"(2) STAFFING.—The Office established under this subsection shall be staffed sufficiently to carry out fully the requirements of this section. The staff shall include persons with knowledge of and expertise in corporate, municipal, and structured debt finance.

"(3) COMMISSION EXAMINATIONS.—

"(A) ANNUAL EXAMINATIONS REQUIRED.—The Office shall conduct an examination of each nationally recognized statistical rating organization at least annually.

"(B) CONDUCT OF EXAMINATIONS.—Each examination under subparagraph (A) shall include a review of—

"(i) whether the nationally recognized statistical rating organization conducts business in accordance with the policies, procedures, and rating methodologies of the nationally recognized statistical rating organization;

"(ii) the management of conflicts of interest by the nationally recognized statistical rating organization;

"(iii) implementation of ethics policies by the nationally recognized statistical rating organization;

"(iv) the internal supervisory controls of the nationally recognized statistical rating organization;

"(v) the governance of the nationally recognized statistical rating organization;

"(vi) the activities of the individual designated by the nationally recognized statistical rating organization under subsection (j)(1);

"(vii) the processing of complaints by the nationally recognized statistical rating organization; and

"(viii) the policies of the nationally recognized statistical rating organization governing the post-employment activities of former staff of the nationally recognized statistical rating organization.

"(C) INSPECTION REPORTS.—The Commission shall make available to the public, in an easily understandable format, an annual report summarizing—

"(i) the essential findings of all examinations conducted under subparagraph (A), as deemed appropriate by the Commission;

"(ii) the responses by the nationally recognized statistical rating organizations to any material regulatory deficiencies identified by the Commission under clause (i); and

"(iii) whether the nationally recognized statistical rating organizations have appropriately addressed the recommendations of the Commission contained in previous reports under this subparagraph.

"(4) RULEMAKING AUTHORITY.—The Commission shall—

"(A) establish, by rule, fines, and other penalties applicable to any nationally recognized statistical rating organization that violates the requirements of this section and the rules thereunder; and

"(B) issue such rules as may be necessary to carry out this section.

"(q) TRANSPARENCY OF RATINGS PERFORMANCE.—

"(1) RULEMAKING REQUIRED.—The Commission shall, by rule, require that each nationally recognized statistical rating organization publicly disclose information on the initial credit ratings determined by the nationally recognized statistical rating organization for each type of obligor, security, and money market instrument, and any subsequent changes to such credit ratings, for the purpose of allowing users of credit ratings to evaluate the accuracy of ratings and compare the performance of ratings by different nationally recognized statistical rating organizations.

"(2) CONTENT.—The rules of the Commission under this subsection shall require, at a minimum, disclosures that—

"(A) are comparable among nationally recognized statistical rating organizations, to allow users of credit ratings to compare the performance of credit ratings across nationally recognized statistical rating organizations;

"(B) are clear and informative for investors having a wide range of sophistication who use or might use credit ratings;

"(C) include performance information over a range of years and for a variety of types of credit ratings, including for credit ratings withdrawn by the nationally recognized statistical rating organization;

"(D) are published and made freely available by the nationally recognized statistical rating organization, on an easily accessible portion of its website, and in writing, when requested;

"(E) are appropriate to the business model of a nationally recognized statistical rating organization; and

"(F) each nationally recognized statistical rating organization include an attestation with any credit rating it issues affirming that no part of the rating was influenced by any other business activities, that the rating was based solely on the merits of the instruments being rated, and that such rating was an independent evaluation of the risks and merits of the instrument.

"(r) CREDIT RATINGS METHODOLOGIES.—The Commission shall prescribe rules, for the protection of investors and in the public interest, with respect to the procedures and methodologies, including qualitative and quantitative data and models, used by nationally recognized statistical rating organizations that require each nationally recognized statistical rating organization—

"(1) to ensure that credit ratings are determined using procedures and methodologies, including qualitative and quantitative data and models, that are—

"(A) approved by the board of the nationally recognized statistical rating organization, a body performing a function similar to that of a board; and

"(B) in accordance with the policies and procedures of the nationally recognized statistical rating organization for the development and modification of credit rating procedures and methodologies;

"(2) to ensure that when material changes to credit rating procedures and methodologies (including changes to qualitative and quantitative data and models) are made, that—

"(A) the changes are applied consistently to all credit ratings to which the changed procedures and methodologies apply;

"(B) to the extent that changes are made to credit rating surveillance procedures and methodologies, the changes are applied to then-current credit ratings by the nationally recognized statistical rating organization within a reasonable time period determined by the Commission, by rule; and

"(C) the nationally recognized statistical rating organization publicly discloses the reason for the change; and

"(3) to notify users of credit ratings—

"(A) of the version of a procedure or methodology, including the qualitative methodology or quantitative inputs, used with respect to a particular credit rating;

"(B) when a material change is made to a procedure or methodology, including to a qualitative model or quantitative inputs;

"(C) when a significant error is identified in a procedure or methodology, including a qualitative or quantitative model, that may result in credit rating actions; and

"(D) of the likelihood of a material change described in subparagraph (B) resulting in a change in current credit ratings.

"(s) TRANSPARENCY OF CREDIT RATING METHODOLOGIES AND INFORMATION REVIEWED.—

"(1) FORM FOR DISCLOSURES.—The Commission shall require, by rule, each nationally recognized statistical rating organization to prescribe a form to accompany the publication of each credit rating that discloses—

"(A) information relating to—

"(i) the assumptions underlying the credit rating procedures and methodologies;

"(ii) the data that was relied on to determine the credit rating; and "(iii) if applicable, how the nationally recognized statistical rating organization used servicer or remittance reports, and with what frequency, to conduct surveillance of the credit rating; and

"(B) information that can be used by investors and other users of credit ratings to better understand credit ratings in each class of credit rating issued by the nationally recognized statistical rating organization.

"(2) FORMAT.—The form developed under paragraph (1) shall—

"(A) be easy to use and helpful for users of credit ratings to understand the information contained in the report;

"(B) require the nationally recognized statistical rating organization to provide the content described in paragraph (3)(B) in a manner that is directly comparable across types of securities; and

"(C) be made readily available to users of credit ratings, in electronic or paper form, as the Commission may, by rule, determine.

"(3) CONTENT OF FORM.—

"(A) QUALITATIVE CONTENT.—Each nationally recognized statistical rating organization shall disclose on the form developed under paragraph (1)—

"(i) the credit ratings produced by the nationally recognized statistical rating organization;

"(ii) the main assumptions and principles used in constructing procedures and methodologies, including qualitative methodologies and quantitative inputs and assumptions about the correlation of defaults across underlying assets used in rating structured products;

"(iii) the potential limitations of the credit ratings, and the types of risks excluded from the credit ratings that the nationally recognized statistical rating organization does not comment on, including liquidity, market, and other risks;

"(iv) information on the uncertainty of the credit rating, including—

"(I) information on the reliability, accuracy, and quality of the data relied on in determining the credit rating; and

"(II) a statement relating to the extent to which data essential to the determination of the credit rating were reliable or limited, including—

"(aa) any limits on the scope of historical data; and

"(bb) any limits in accessibility to certain documents or other types of information that would have better informed the credit rating;

"(v) whether and to what extent third party due diligence services have been used by the nationally recognized statistical rating organization, a description of the information that such third party reviewed in conducting due diligence services, and a description of the findings or conclusions of such third party;

"(vi) a description of the data about any obligor, issuer, security, or money market instrument that were relied upon for the purpose of determining the credit rating;

"(vii) a statement containing an overall assessment of the quality of information available and considered in producing a rating for an obligor, security, or money market instrument, in relation to the quality of information available to the nationally recognized statistical rating organization in rating similar issuances;

"(viii) information relating to conflicts of interest of the nationally recognized statistical rating organization; and

"(ix) such additional information as the Commission may require.

"(B) QUANTITATIVE CONTENT.—Each nationally recognized statistical rating organization shall disclose on the form developed under this subsection—

"(i) an explanation or measure of the potential volatility of the credit rating, including—

"(I) any factors that might lead to a change in the credit ratings; and

"(II) the magnitude of the change that a user can expect under different market conditions;

"(ii) information on the content of the rating, including—

"(I) the historical performance of the rating; and

"(II) the expected probability of default and the expected loss in the event of default;

"(iii) information on the sensitivity of the rating to assumptions made by the nationally recognized statistical rating organization, including—

"(I) 5 assumptions made in the ratings process that, without accounting for any other factor, would have the greatest impact on a rating if the assumptions were proven false or inaccurate; and

"(II) an analysis, using specific examples, of how each of the 5 assumptions identified under subclause (I) impacts a rating;

"(iv) such additional information as may be required by the Commission.

"(4) DUE DILIGENCE SERVICES FOR ASSET-BACKED SECURITIES.—

"(A) FINDINGS.—The issuer or underwriter of any asset-backed security shall make publicly available the findings and conclusions of any third-party due diligence report obtained by the issuer or underwriter.

"(B) CERTIFICATION REQUIRED.—In any case in which third-party due diligence services are employed by a nationally recognized statistical rating organization, an issuer, or an underwriter, the person providing the due diligence services shall provide to any nationally recognized statistical rating organization that produces a rating to which such services relate, written certification, as provided in subparagraph (C).

"(C) FORMAT AND CONTENT.—The Commission shall establish the appropriate format and content for the written certifications required under subparagraph (B), to ensure that providers of due diligence services have conducted a thorough review of data, documentation, and other relevant information necessary for a nationally recognized statistical rating organization to provide an accurate rating.

"(D) DISCLOSURE OF CERTIFICATION.—The Commission shall adopt rules requiring a nationally recognized statistical rating organization, at the time at which the nationally recognized statistical rating organization produces a rating, to disclose the certification described in subparagraph (B) to the public in a manner that allows the public to determine the adequacy and level of due diligence services provided by a third party.

"(t) CORPORATE GOVERNANCE, ORGANIZATION, AND MANAGEMENT OF CONFLICTS OF INTEREST.—

"(1) BOARD OF DIRECTORS.—Each nationally recognized statistical rating organization shall have a board of directors.

"(2) INDEPENDENT DIRECTORS.—

"(A) IN GENERAL.—At least ½ of the board of directors, but not fewer than 2 of the members thereof, shall be independent of the nationally recognized statistical rating agency. A portion of the independent directors shall include users of ratings from a nationally recognized statistical rating organization.

"(B) INDEPENDENCE DETERMINATION.—In order to be considered independent for purposes of this subsection, a member of the board of directors of a nationally recognized statistical rating organization—

"(i) may not, other than in his or her capacity as a member of the board of directors or any committee thereof—

"(I) accept any consulting, advisory, or other compensatory fee from the nationally recognized statistical rating organization; or

"(II) be a person associated with the nationally recognized statistical rating organization or with any affiliated company thereof; and

"(ii) shall be disqualified from any deliberation involving a specific rating in which the independent board member has a financial interest in the outcome of the rating.

"(C) COMPENSATION AND TERM.—The compensation of the independent members of the board of directors of a nationally recognized statistical rating organization shall not be linked to the business performance of the nationally recognized statistical rating organization, and shall be arranged so as to ensure the independence of their judgment. The term of office of the independent directors shall be for a pre-agreed fixed period, not to exceed 5 years, and shall not be renewable.

"(3) DUTIES OF BOARD OF DIRECTORS.—In addition to the overall responsibilities of the board of directors, the board shall oversee—

"(A) the establishment, maintenance, and enforcement of policies and procedures for determining credit ratings;

"(B) the establishment, maintenance, and enforcement of policies and procedures to address, manage, and disclose any conflicts of interest;

"(C) the effectiveness of the internal control system with respect to policies and procedures for determining credit ratings; and

"(D) the compensation and promotion policies and practices of the nationally recognized statistical rating organization.

"(4) TREATMENT OF NRSRO SUBSIDIARIES.—If a nationally recognized statistical rating organization is a subsidiary of a parent entity, the board of the directors of the parent entity may satisfy the requirements of this subsection by assigning to a committee of such board of directors the duties under paragraph (3), if—

"(A) at least ½ of the members of the committee (including the chairperson of the committee) are independent, as defined in this section; and

"(B) at least 1 member of the committee is a user of ratings from a nationally recognized statistical rating organization.

"(5) EXCEPTION AUTHORITY.—If the Commission finds that compliance with the provisions of this subsection present an unreasonable burden on a small nationally recognized statistical rating organization, the Commission may permit the nationally recognized statistical rating organization to delegate such responsibilities to a committee that includes at least one individual who is a user of ratings of a nationally recognized statistical rating organization.".

(b) CONFORMING AMENDMENT.—Section 3(a)(62) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(62)) is amended by striking subparagraph (A) and redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

SEC. 933. STATE OF MIND IN PRIVATE ACTIONS.

(a) ACCOUNTABILITY.—Section 15E(m) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–7(m)) is amended to read as follows:

"(m) ACCOUNTABILITY.—

"(1) IN GENERAL.—The enforcement and penalty provisions of this title shall apply to statements made by a credit rating agency in the same manner and to the same extent as such provisions apply to statements made by a registered public accounting firm or a securities analyst under the securities laws, and such statements shall not be deemed forward-looking statements for the purposes of section 21E.

"(2) RULEMAKING.—The Commission shall issue such rules as may be necessary to carry out this subsection.".

(b) STATE OF MIND.—Section 21D(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–4(b)(2)) is amended—

(1) by striking "In any" and inserting the following:

"(A) IN GENERAL.—Except as provided in subparagraph (B), in any"; and

(2) by adding at the end the following:

"(B) EXCEPTION.—In the case of an action for money damages brought against a credit rating agency or a controlling person under this title, it shall be sufficient, for purposes of pleading any required state of mind in relation to such action, that the complaint state with particularity facts giving rise to a strong inference that the credit rating agency knowingly or recklessly failed—

"(i) to conduct a reasonable investigation of the rated security with respect to the factual elements relied upon by its own methodology for evaluating credit risk; or

"(ii) to obtain reasonable verification of such factual elements (which verification may be based on a sampling technique that does not amount to an audit) from other sources that the credit rating agency considered to be competent and that were independent of the issuer and underwriter.".

SEC. 934. REFERRING TIPS TO LAW ENFORCEMENT OR REGULATORY AUTHORITIES.

Section 15E of the Securities Exchange Act of 1934 (15 U.S.C. 78o–7), as amended by this subtitle, is amended by adding at the end the following:

"(u) DUTY TO REPORT TIPS ALLEGING MATERIAL VIOLATIONS OF LAW.—

"(1) DUTY TO REPORT.—Each nationally recognized statistical rating organization shall refer to the appropriate law enforcement or regulatory authorities any information that the nationally recognized statistical rating organization receives from a third party and finds credible that alleges that an issuer of securities rated by the nationally recognized statistical rating organization has committed or is committing a material violation of law that has not been adjudicated by a Federal or State court.

"(2) RULE OF CONSTRUCTION.—Nothing in paragraph (1) may be construed to require a nationally recognized statistical rating organization to verify the accuracy of the information described in paragraph (1).".

SEC. 935. CONSIDERATION OF INFORMATION FROM SOURCES OTHER THAN THE ISSUER IN RATING DECISIONS.

Section 15E of the Securities Exchange Act of 1934 (15 U.S.C. 78o–7), as amended by this subtitle, is amended by adding at the end the following:

"(v) INFORMATION FROM SOURCES OTHER THAN THE ISSUER.—In producing a credit rating, a nationally recognized statistical rating organization shall consider information about an issuer that the nationally recognized statistical rating organization has, or receives from a source other than the issuer or underwriter, that the nationally recognized statistical rating organization finds credible and potentially significant to a rating decision.".

SEC. 936. QUALIFICATION STANDARDS FOR CREDIT RATING ANALYSTS.

Not later than 1 year after the date of enactment of this Act, the Commission shall issue rules that are reasonably designed to ensure that any person employed by a nationally recognized statistical rating organization to perform credit ratings—

(1) meets standards of training, experience, and competence necessary to produce accurate ratings for the categories of issuers whose securities the person rates; and

(2) is tested for knowledge of the credit rating process.

SEC. 937. TIMING OF REGULATIONS.

Unless otherwise specifically provided in this subtitle, the Commission shall issue final regulations, as required by this subtitle and the amendments made by this subtitle, not later than 1 year after the date of enactment of this Act.

SEC. 938. UNIVERSAL RATINGS SYMBOLS.

(a) RULEMAKING.—The Commission shall require, by rule, each nationally recognized statistical rating organization to establish, maintain, and enforce written policies and procedures that—

(1) assess the probability that an issuer of a security or money market instrument will default, fail to make timely payments, or otherwise not make payments to investors in accordance with the terms of the security or money market instrument;

(2) clearly define and disclose the meaning of any symbol used by the nationally recognized statistical rating organization to denote a credit rating; and

(3) apply any symbol described in paragraph (2) in a manner that is consistent for all types of securities and money market instruments for which the symbol is used.

(b) RULE OF CONSTRUCTION.—Nothing in this section shall prohibit a nationally recognized statistical rating organization from using distinct sets of symbols to denote credit ratings for different types of securities or money market instruments.

SEC. 939. REMOVAL OF STATUTORY REFERENCES TO CREDIT RATINGS.

(a) FEDERAL DEPOSIT INSURANCE ACT.—The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended—

(1) in section 7(b)(1)(E)(i), by striking “credit rating entities, and other private economic” and insert “private economic, credit,”;

(2) in section 28(d)—

(A) in the subsection heading, by striking “NOT OF INVESTMENT GRADE”;

(B) in paragraph (1), by striking “not of investment grade” and inserting “that does not meet standards of credit-worthiness as established by the Corporation”;

(C) in paragraph (2), by striking “not of investment grade”;

(D) by striking paragraph (3);

(E) by redesignating paragraph (4) as paragraph (3); and

(F) in paragraph (3), as so redesignated—

(i) by striking subparagraph (A);

(ii) by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively; and

(iii) in subparagraph (B), as so redesignated, by striking “not of investment grade” and inserting “that does not meet standards of credit-worthiness as established by the Corporation”; and

(3) in section 28(e)—

(A) in the subsection heading, by striking "NOT OF INVESTMENT GRADE";

(B) in paragraph (1), by striking "not of investment grade" and inserting "that does not meet standards of credit-worthiness as established by the Corporation"; and

(C) in paragraphs (2) and (3), by striking "not of investment grade" each place that it appears and inserting "that does not meet standards of credit-worthiness established by the Corporation".

(b) FEDERAL HOUSING ENTERPRISES FINANCIAL SAFETY AND SOUNDNESS ACT OF 1992.—Section 1319 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4519) is amended by striking "that is a nationally recognized statistical rating organization, as such term is defined in section 3(a) of the Securities Exchange Act of 1934,".

(c) INVESTMENT COMPANY ACT OF 1940.—Section 6(a)(5)(A)(iv)(I) Investment Company Act of 1940 (15 U.S.C. 80a–6(a)(5)(A)(iv)(I)) is amended by striking "is rated investment grade by not less than 1 nationally recognized statistical rating organization" and inserting "meets such standards of credit-worthiness as the Commission shall adopt".

(d) REVISED STATUTES.—Section 5136A of title LXII of the Revised Statutes of the United States (12 U.S.C. 24a) is amended—

(1) in subsection (a)(2)(E), by striking "any applicable rating" and inserting "standards of credit-worthiness established by the Comptroller of the Currency";

(2) in the heading for subsection (a)(3) by striking "RATING OR COMPARABLE REQUIREMENT" and inserting "REQUIREMENT";

(3) subsection (a)(3), by amending subparagraph (A) to read as follows:

"(A) IN GENERAL.—A national bank meets the requirements of this paragraph if the bank is one of the 100 largest insured banks and has not fewer than 1 issue of outstanding debt that meets standards of credit-worthiness or other criteria as the Secretary of the Treasury and the Board of Governors of the Federal Reserve System may jointly establish.".

(4) in the heading for subsection (f), by striking "MAINTAIN PUBLIC RATING OR" and inserting "MEET STANDARDS OF CREDIT-WORTHINESS"; and

(5) in subsection (f)(1), by striking "any applicable rating" and inserting "standards of credit-worthiness established by the Comptroller of the Currency".

(e) SECURITIES EXCHANGE ACT OF 1934.—Section 3(a) Securities Exchange Act of 1934 (15 U.S.C. 78a(3)(a)) is amended—

(1) in paragraph (41), by striking "is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization" and inserting "meets standards of credit-worthiness as established by the Commission"; and

(2) in paragraph (53)(A), by striking "is rated in 1 of the 4 highest rating categories by at least 1 nationally recognized statistical rating organization" and inserting "meets standards of credit-worthiness as established by the Commission".

(f) WORLD BANK DISCUSSIONS.—Section 3(a)(6) of the amendment in the nature of a substitute to the text of H.R. 4645, as ordered reported from the Committee on Banking, Finance and

Urban Affairs on September 22, 1988, as enacted into law by section 555 of Public Law 100–461, (22 U.S.C. 286hh(a)(6)), is amended by striking "credit rating" and inserting "credit-worthiness".

(g) EFFECTIVE DATE.—The amendments made by this section shall take effect 2 years after the date of enactment of this Act.

(h) STUDY AND REPORT.—

(1) IN GENERAL.—Commission shall undertake a study on the feasability and desirability of—

(A) standardizing credit ratings terminology, so that all credit rating agencies issue credit ratings using identical terms;

(B) standardizing the market stress conditions under which ratings are evaluated;

(C) requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress; and

(D) standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity.

(2) REPORT.—Not later than 1 year after the date of enactment of this Act, the Commission shall submit to Congress a report containing the findings of the study under paragraph (1) and the recommendations, if any, of the Commission with respect to the study.

SEC. 939A. REVIEW OF RELIANCE ON RATINGS.

(a) AGENCY REVIEW.—Not later than 1 year after the date of the enactment of this subtitle, each Federal agency shall, to the extent applicable, review—

(1) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and

(2) any references to or requirements in such regulations regarding credit ratings.

(b) MODIFICATIONS REQUIRED.—Each such agency shall modify any such regulations identified by the review conducted under subsection (a) to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations. In making such determination, such agencies shall seek to establish, to the extent feasible, uniform standards of credit-worthiness for use by each such agency, taking into account the entities regulated by each such agency and the purposes for which such entities would rely on such standards of credit-worthiness.

(c) REPORT.—Upon conclusion of the review required under subsection (a), each Federal agency shall transmit a report to Congress containing a description of any modification of any regulation such agency made pursuant to subsection (b).

SEC. 939B. ELIMINATION OF EXEMPTION FROM FAIR DISCLOSURE RULE.

Not later than 90 days after the date of enactment of this subtitle, the Securities Exchange Commission shall revise Regulation FD (17 C.F.R. 243.100) to remove from such regulation the exemption for entities whose primary business is the issuance of credit ratings (17 C.F.R. 243.100(b)(2)(iii)).

SEC. 939C. SECURITIES AND EXCHANGE COMMISSION STUDY ON STRENGTHENING CREDIT RATING AGENCY INDEPENDENCE.

(a) STUDY.—The Commission shall conduct a study of—

(1) the independence of nationally recognized statistical rating organizations; and

(2) how the independence of nationally recognized statistical rating organizations affects the ratings issued by the nationally recognized statistical rating organizations.

(b) SUBJECTS FOR EVALUATION.—In conducting the study under subsection (a), the Commission shall evaluate—

(1) the management of conflicts of interest raised by a nationally recognized statistical rating organization providing other services, including risk management advisory services, ancillary assistance, or consulting services;

(2) the potential impact of rules prohibiting a nationally recognized statistical rating organization that provides a rating to an issuer from providing other services to the issuer; and

(3) any other issue relating to nationally recognized statistical rating organizations, as the Chairman of the Commission determines is appropriate.

(c) REPORT.—Not later than 3 years after the date of enactment of this Act, the Chairman of the Commission shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the results of the study conducted under subsection (a), including recommendations, if any, for improving the integrity of ratings issued by nationally recognized statistical rating organizations.

SEC. 939D. GOVERNMENT ACCOUNTABILITY OFFICE STUDY ON ALTERNATIVE BUSINESS MODELS.

(a) STUDY.—The Comptroller General of the United States shall conduct a study on alternative means for compensating nationally recognized statistical rating organizations in order to create incentives for nationally recognized statistical rating organizations to provide more accurate credit ratings, including any statutory changes that would be required to facilitate the use of an alternative means of compensation.

(b) REPORT.—Not later than 18 months after the date of enactment of this Act, the Comptroller General shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the results of the study conducted under subsection (a), including recommendations, if any, for providing incentives to credit rating agencies to improve the credit rating process.

SEC. 939E. GOVERNMENT ACCOUNTABILITY OFFICE STUDY ON THE CREATION OF AN INDEPENDENT PROFESSIONAL ANALYST ORGANIZATION.

(a) STUDY.—The Comptroller General of the United States shall conduct a study on the feasibility and merits of creating an independent professional organization for rating analysts employed by nationally recognized statistical rating organizations that would be responsible for—

(1) establishing independent standards for governing the profession of rating analysts;

(2) establishing a code of ethical conduct; and

(3) overseeing the profession of rating analysts.

(b) REPORT.—Not later than 1 year after the date of publication of the rules issued by the Commission pursuant to section 936, the Comptroller General shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the results of the study conducted under subsection (a).

SEC. 939F. STUDY AND RULEMAKING ON ASSIGNED CREDIT RATINGS.

(a) DEFINITION.—In this section, the term "structured finance product" means an asset-backed security, as defined in section 3(a)(77) of the Securities Exchange Act of 1934, as added by section 941, and any structured product based on an asset-backed security, as determined by the Commission, by rule.

(b) STUDY.—The Commission shall carry out a study of—

(1) the credit rating process for structured finance products and the conflicts of interest associated with the issuer-pay and the subscriber-pay models;

(2) the feasibility of establishing a system in which a public or private utility or a self-regulatory organization assigns nationally recognized statistical rating organizations to determine the credit ratings of structured finance products, including—

(A) an assessment of potential mechanisms for determining fees for the nationally recognized statistical rating organizations;

(B) appropriate methods for paying fees to the nationally recognized statistical rating organizations;

(C) the extent to which the creation of such a system would be viewed as the creation of moral hazard by the Federal Government; and

(D) any constitutional or other issues concerning the establishment of such a system;

(3) the range of metrics that could be used to determine the accuracy of credit ratings; and

(4) alternative means for compensating nationally recognized statistical rating organizations that would create incentives for accurate credit ratings.

(c) REPORT AND RECOMMENDATION.—Not later than 24 months after the date of enactment of this Act, the Commission shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report that contains—

(1) the findings of the study required under subsection (b); and

(2) any recommendations for regulatory or statutory changes that the Commission determines should be made to implement the findings of the study required under subsection (b).

(d) RULEMAKING.—

(1) RULEMAKING.—After submission of the report under subsection (c), the Commission shall, by rule, as the Commission determines is necessary or appropriate in the public interest or for the protection of investors, establish a system

for the assignment of nationally recognized statistical rating organizations to determine the initial credit ratings of structured finance products, in a manner that prevents the issuer, sponsor, or underwriter of the structured finance product from selecting the nationally recognized statistical rating organization that will determine the initial credit ratings and monitor such credit ratings. In issuing any rule under this paragraph, the Commission shall give thorough consideration to the provisions of section 15E(w) of the Securities Exchange Act of 1934, as that provision would have been added by section 939D of H.R. 4173 (111th Congress), as passed by the Senate on May 20, 2010, and shall implement the system described in such section 939D unless the Commission determines that an alternative system would better serve the public interest and the protection of investors.

(2) RULE OF CONSTRUCTION.—Nothing in this subsection may be construed to limit or suspend any other rulemaking authority of the Commission.

SEC. 939G. EFFECT OF RULE 436(G).

Rule 436(g), promulgated by the Securities and Exchange Commission under the Securities Act of 1933, shall have no force or effect.

SEC. 939H. SENSE OF CONGRESS.

It is the sense of Congress that the Securities and Exchange Commission should exercise the rulemaking authority of the Commission under section 15E(h)(2)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–7(h)(2)(B)) to prevent improper conflicts of interest arising from employees of nationally recognized statistical rating organizations providing services to issuers of securities that are unrelated to the issuance of credit ratings, including consulting, advisory, and other services.

Subtitle D—Improvements to the Asset-Backed Securitization Process

SEC. 941. REGULATION OF CREDIT RISK RETENTION.

(a) DEFINITION OF ASSET-BACKED SECURITY.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following:

"(77) ASSET-BACKED SECURITY.—The term 'asset-backed security'—

"(A) means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including—

"(i) a collateralized mortgage obligation;

"(ii) a collateralized debt obligation;

"(iii) a collateralized bond obligation;

"(iv) a collateralized debt obligation of asset-backed securities;

"(v) a collateralized debt obligation of collateralized debt obligations; and "(vi) a security that the Commission, by rule, determines to be an asset-backed security for purposes of this section; and

"(B) does not include a security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company.".

(b) CREDIT RISK RETENTION.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 15F, as added by this Act, the following:

"SEC. 15G. CREDIT RISK RETENTION.

"(a) DEFINITIONS.—In this section—

"(1) the term 'Federal banking agencies' means the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation;

"(2) the term 'insured depository institution' has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

"(3) the term 'securitizer' means—

"(A) an issuer of an asset-backed security; or

"(B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer; and

"(4) the term 'originator' means a person who—

"(A) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and

"(B) sells an asset directly or indirectly to a securitizer.

"(b) REGULATIONS REQUIRED.—

"(1) IN GENERAL.—Not later than 270 days after the date of enactment of this section, the Federal banking agencies and the Commission shall jointly prescribe regulations to require any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party.

"(2) RESIDENTIAL MORTGAGES.—Not later than 270 days after the date of the enactment of this section, the Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Federal Housing Finance Agency, shall jointly prescribe regulations to require any securitizer to retain an economic interest in a portion of the credit risk for any residential mortgage asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party.

"(c) STANDARDS FOR REGULATIONS.—

"(1) STANDARDS.—The regulations prescribed under subsection (b) shall—

"(A) prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain with respect to an asset;

"(B) require a securitizer to retain—

"(i) not less than 5 percent of the credit risk for any asset—

"(I) that is not a qualified residential mortgage that is transferred, sold, or conveyed through the issuance of an asset-backed security by the securitizer; or

"(II) that is a qualified residential mortgage that is transferred, sold, or conveyed through the issuance of an asset-backed security by the securitizer, if 1 or more of the assets that collateralize the asset-backed security are not qualified residential mortgages; or

"(ii) less than 5 percent of the credit risk for an asset that is not a qualified residential mortgage that is transferred, sold, or conveyed through the issuance of an asset-backed security by the securitizer, if the originator of the asset meets the underwriting standards prescribed under paragraph (2)(B);

"(C) specify—

"(i) the permissible forms of risk retention for purposes of this section;

"(ii) the minimum duration of the risk retention required under this section; and

"(iii) that a securitizer is not required to retain any part of the credit risk for an asset that is transferred, sold or conveyed through the issuance of an asset-backed security by the securitizer, if all of the assets that collateralize the asset-backed security are qualified residential mortgages;

"(D) apply, regardless of whether the securitizer is an insured depository institution;

"(E) with respect to a commercial mortgage, specify the permissible types, forms, and amounts of risk retention that would meet the requirements of subparagraph (B), which in the determination of the Federal banking agencies and the Commission may include—

"(i) retention of a specified amount or percentage of the total credit risk of the asset;

"(ii) retention of the first-loss position by a third-party purchaser that specifically negotiates for the purchase of such first loss position, holds adequate financial resources to back losses, provides due diligence on all individual assets in the pool before the issuance of the asset-backed securities, and meets the same standards for risk retention as the Federal banking agencies and the Commission require of the securitizer;

"(iii) a determination by the Federal banking agencies and the Commission that the underwriting standards and controls for the asset are adequate; and

"(iv) provision of adequate representations and warranties and related enforcement mechanisms; and

"(F) establish appropriate standards for retention of an economic interest with respect to collateralized debt obligations, securities collateralized by collateralized debt obligations, and similar instruments collateralized by other asset-backed securities; and

"(G) provide for—

"(i) a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors;

"(ii) a total or partial exemption for the securitization of an asset issued or guaranteed by the United States, or an agency of the United States, as the Federal banking agencies and the Commission jointly determine appropriate in the public interest and for the protection of investors, except that, for purposes of this clause, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation are not agencies of the United States;

"(iii) a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of a State or territory that is exempt from the registration requirements of the Securities Act of 1933 by reason of section 3(a)(2) of that Act (15 U.S.C. 77c(a)(2)), or a security defined as a qualified scholarship funding bond in section 150(d)(2) of the Internal Revenue Code of 1986, as may be appropriate in the public interest and for the protection of investors; and

"(iv) the allocation of risk retention obligations between a securitizer and an originator in the case of a securitizer that purchases assets from an originator, as the Federal banking agencies and the Commission jointly determine appropriate.

"(2) ASSET CLASSES.—

"(A) ASSET CLASSES.—The regulations prescribed under subsection (b) shall establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets that the Federal banking agencies and the Commission deem appropriate.

"(B) CONTENTS.—For each asset class established under subparagraph (A), the regulations prescribed under subsection (b) shall include underwriting standards established by the Federal banking agencies that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan.

"(d) ORIGINATORS.—In determining how to allocate risk retention obligations between a securitizer and an originator under subsection (c)(1)(E)(iv), the Federal banking agencies and the Commission shall—

"(1) reduce the percentage of risk retention obligations required of the securitizer by the percentage of risk retention obligations required of the originator; and

"(2) consider—

"(A) whether the assets sold to the securitizer have terms, conditions, and characteristics that reflect low credit risk;

"(B) whether the form or volume of transactions in securitization markets creates incentives for imprudent origination of the type of loan or asset to be sold to the securitizer; and

"(C) the potential impact of the risk retention obligations on the access of consumers and businesses to credit on reasonable terms, which may not include the transfer of credit risk to a third party.

"(e) EXEMPTIONS, EXCEPTIONS, AND ADJUSTMENTS.—

"(1) IN GENERAL.—The Federal banking agencies and the Commission may jointly adopt or issue exemptions, exceptions, or adjustments to the rules issued under this section, including exemptions, exceptions, or adjustments for classes of institutions or assets relating to the risk retention requirement and the prohibition on hedging under subsection (c)(1).

"(2) APPLICABLE STANDARDS.—Any exemption, exception, or adjustment adopted or issued by the Federal banking agencies and the Commission under this paragraph shall—

"(A) help ensure high quality underwriting standards for the securitizers and originators of assets that are securitized or available for securitization; and

"(B) encourage appropriate risk management practices by the securitizers and originators of assets, improve the access of consumers and businesses to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors.

"(3) CERTAIN INSTITUTIONS AND PROGRAMS EXEMPT.—

"(A) FARM CREDIT SYSTEM INSTITUTIONS.—Notwithstanding any other provision of this section, the requirements of this section shall not apply to any loan or other financial asset made, insured, guaranteed, or purchased by any institution that is subject to the supervision of the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation.

"(B) OTHER FEDERAL PROGRAMS.—This section shall not apply to any residential, multifamily, or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset, which is insured or guaranteed by the United States or an agency of the United States. For purposes of this subsection, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Federal home loan banks shall not be considered an agency of the United States.

"(4) EXEMPTION FOR QUALIFIED RESIDENTIAL MORTGAGES.—

"(A) IN GENERAL.—The Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency shall jointly issue regulations to exempt qualified residential mortgages from the risk retention requirements of this subsection.

"(B) QUALIFIED RESIDENTIAL MORTGAGE.—The Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency shall jointly define the term 'qualified residential mortgage' for purposes of this subsection, taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default, such as—

"(i) documentation and verification of the financial resources relied upon to qualify the mortgagor;

"(ii) standards with respect to—

"(I) the residual income of the mortgagor after all monthly obligations;

"(II) the ratio of the housing payments of the mortgagor to the monthly income of the mortgagor;

"(III) the ratio of total monthly installment payments of the mortgagor to the income of the mortgagor;

"(iii) mitigating the potential for payment shock on adjustable rate mortgages through product features and underwriting standards;

"(iv) mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default; and

"(v) prohibiting or restricting the use of balloon payments, negative amortization, prepayment penalties, interest-only payments, and other features that have been demonstrated to exhibit a higher risk of borrower default.

"(C) LIMITATION ON DEFINITION.—The Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency in defining the term 'qualified residential mortgage', as required by subparagraph (B), shall define that term to be no broader than the definition 'qualified mortgage' as the term is defined under section 129C(c)(2) of the Truth in Lending Act, as amended by the Consumer Financial Protection Act of 2010, and regulations adopted thereunder.

"(5) CONDITION FOR QUALIFIED RESIDENTIAL MORTGAGE EXEMPTION.—The regulations issued under paragraph (4) shall provide that an asset-backed security that is collateralized by tranches of other asset-backed securities shall not be exempt from the risk retention requirements of this subsection.

"(6) CERTIFICATION.—The Commission shall require an issuer to certify, for each issuance of an asset-backed security collateralized exclusively by qualified residential mortgages, that the issuer has evaluated the effectiveness of the internal supervisory controls of the issuer with respect to the process for ensuring that all assets that collateralize the asset-backed security are qualified residential mortgages.

"(f) ENFORCEMENT.—The regulations issued under this section shall be enforced by—

"(1) the appropriate Federal banking agency, with respect to any securitizer that is an insured depository institution; and

"(2) the Commission, with respect to any securitizer that is not an insured depository institution.

"(g) AUTHORITY OF COMMISSION.—The authority of the Commission under this section shall be in addition to the authority of the Commission to otherwise enforce the securities laws.

"(h) AUTHORITY TO COORDINATE ON RULEMAKING.—The Chairperson of the Financial Stability Oversight Council shall coordinate all joint rulemaking required under this section.

“(i) EFFECTIVE DATE OF REGULATIONS.—The regulations issued under this section shall become effective—

“(1) with respect to securitizers and originators of asset-backed securities backed by residential mortgages, 1 year after the date on which final rules under this section are published in the Federal Register; and

“(2) with respect to securitizers and originators of all other classes of asset-backed securities, 2 years after the date on which final rules under this section are published in the Federal Register.”.

(c) STUDY ON RISK RETENTION.—

(1) STUDY.—The Board of Governors of the Federal Reserve System, in coordination and consultation with the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Chairperson of the Federal Deposit Insurance Corporation, and the Securities and Exchange Commission shall conduct a study of the combined impact on each individual class of asset-backed security established under section 15G(c)(2) of the Securities Exchange Act of 1934, as added by subsection (b), of—

(A) the new credit risk retention requirements contained in the amendment made by subsection (b), including the effect credit risk retention requirements have on increasing the market for Federally subsidized loans; and

(B) the Financial Accounting Statements 166 and 167 issued by the Financial Accounting Standards Board.

(2) REPORT.—Not later than 90 days after the date of enactment of this Act, the Board of Governors of the Federal Reserve System shall submit to Congress a report on the study conducted under paragraph (1). Such report shall include statutory and regulatory recommendations for eliminating any negative impacts on the continued viability of the asset-backed securitization markets and on the availability of credit for new lending identified by the study conducted under paragraph (1).

SEC. 942. DISCLOSURES AND REPORTING FOR ASSET-BACKED SECURITIES.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)) is amended—

(1) by striking “(d) Each” and inserting the following:

“(d) SUPPLEMENTARY AND PERIODIC INFORMATION.—

“(1) IN GENERAL.—Each”;

(2) in the third sentence, by inserting after “securities of each class” the following: “, other than any class of asset-backed securities,”; and

(3) by adding at the end the following:

“(2) ASSET-BACKED SECURITIES.—

“(A) SUSPENSION OF DUTY TO FILE.—The Commission may, by rule or regulation, provide for the suspension or termination of the duty to file under this subsection for any class of asset-backed security, on such terms and conditions and for such period or periods as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

“(B) CLASSIFICATION OF ISSUERS.—The Commission may, for purposes of this subsection, classify issuers and prescribe requirements appropriate for each class of issuers of asset-backed securities.''.

(b) SECURITIES ACT OF 1933.—Section 7 of the Securities Act of 1933 (15 U.S.C. 77g) is amended by adding at the end the following:

''(c) DISCLOSURE REQUIREMENTS.—

''(1) IN GENERAL.—The Commission shall adopt regulations under this subsection requiring each issuer of an asset-backed security to disclose, for each tranche or class of security, information regarding the assets backing that security.

''(2) CONTENT OF REGULATIONS.—In adopting regulations under this subsection, the Commission shall—

''(A) set standards for the format of the data provided by issuers of an asset-backed security, which shall, to the extent feasible, facilitate comparison of such data across securities in similar types of asset classes; and

''(B) require issuers of asset-backed securities, at a minimum, to disclose asset-level or loan-level data, if such data are necessary for investors to independently perform due diligence, including—

''(i) data having unique identifiers relating to loan brokers or originators;

''(ii) the nature and extent of the compensation of the broker or originator of the assets backing the security; and

''(iii) the amount of risk retention by the originator and the securitizer of such assets.''.

SEC. 943. REPRESENTATIONS AND WARRANTIES IN ASSET-BACKED OFFERINGS.

Not later than 180 days after the date of enactment of this Act, the Securities and Exchange Commission shall prescribe regulations on the use of representations and warranties in the market for asset-backed securities (as that term is defined in section 3(a)(77) of the Securities Exchange Act of 1934, as added by this subtitle) that—

(1) require each national recognized statistical rating organization to include in any report accompanying a credit rating a description of—

(A) the representations, warranties, and enforcement mechanisms available to investors; and

(B) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities; and

(2) require any securitizer (as that term is defined in section 15G(a) of the Securities Exchange Act of 1934, as added by this subtitle) to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer, so that investors may identify asset originators with clear underwriting deficiencies.

SEC. 944. EXEMPTED TRANSACTIONS UNDER THE SECURITIES ACT OF 1933.

(a) EXEMPTION ELIMINATED.—Section 4 of the Securities Act of 1933 (15 U.S.C. 77d) is amended—

(1) by striking paragraph (5); and

(2) by striking ''(6) transactions'' and inserting the following:

"(5) transactions".

(b) CONFORMING AMENDMENT.—Section 3(a)(4)(B)(vii)(I) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)(B)(vii)(I)) is amended by striking "4(6)" and inserting "4(5)".

SEC. 945. DUE DILIGENCE ANALYSIS AND DISCLOSURE IN ASSET-BACKED SECURITIES ISSUES.

Section 7 of the Securities Act of 1933 (15 U.S.C. 77g), as amended by this subtitle, is amended by adding at the end the following:

"(d) REGISTRATION STATEMENT FOR ASSET-BACKED SECURITIES.—Not later than 180 days after the date of enactment of this subsection, the Commission shall issue rules relating to the registration statement required to be filed by any issuer of an asset-backed security (as that term is defined in section 3(a)(77) of the Securities Exchange Act of 1934) that require any issuer of an asset-backed security—

"(1) to perform a review of the assets underlying the asset-backed security; and

"(2) to disclose the nature of the review under paragraph (1).".

SEC. 946. STUDY ON THE MACROECONOMIC EFFECTS OF RISK RETENTION REQUIREMENTS.

(a) STUDY REQUIRED.—The Chairman of the Financial Services Oversight Council shall carry out a study on the macroeconomic effects of the risk retention requirements under this subtitle, and the amendments made by this subtitle, with emphasis placed on potential beneficial effects with respect to stabilizing the real estate market. Such study shall include—

(1) an analysis of the effects of risk retention on real estate asset price bubbles, including a retrospective estimate of what fraction of real estate losses may have been averted had such requirements been in force in recent years;

(2) an analysis of the feasibility of minimizing real estate price bubbles by proactively adjusting the percentage of risk retention that must be borne by creditors and securitizers of real estate debt, as a function of regional or national market conditions;

(3) a comparable analysis for proactively adjusting mortgage origination requirements;

(4) an assessment of whether such proactive adjustments should be made by an independent regulator, or in a formulaic and transparent manner;

(5) an assessment of whether such adjustments should take place independently or in concert with monetary policy; and

(6) recommendations for implementation and enabling legislation.

(b) REPORT.—Not later than the end of the 180-day period beginning on the date of the enactment of this title, the Chairman of the Financial Services Oversight Council shall issue a report to the Congress containing any findings and determinations made in carrying out the study required under subsection (a).

Subtitle E—Accountability and Executive Compensation

SEC. 951. SHAREHOLDER VOTE ON EXECUTIVE COMPENSATION DISCLOSURES.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 14 (15 U.S.C. 78n) the following:

"SEC. 14A. SHAREHOLDER APPROVAL OF EXECUTIVE COMPENSATION.

"(a) SEPARATE RESOLUTION REQUIRED.—

"(1) IN GENERAL.—Not less frequently than once every 3 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to approve the compensation of executives, as disclosed pursuant to section 229.402 of title 17, Code of Federal Regulations, or any successor thereto.

"(2) FREQUENCY OF VOTE.—Not less frequently than once every 6 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to determine whether votes on the resolutions required under paragraph (1) will occur every 1, 2, or 3 years.

"(3) EFFECTIVE DATE.—The proxy or consent or authorization for the first annual or other meeting of the shareholders occurring after the end of the 6-month period beginning on the date of enactment of this section shall include—

"(A) the resolution described in paragraph (1); and

"(B) a separate resolution subject to shareholder vote to determine whether votes on the resolutions required under paragraph (1) will occur every 1, 2, or 3 years.

"(b) SHAREHOLDER APPROVAL OF GOLDEN PARACHUTE COMPENSATION.—

"(1) DISCLOSURE.—In any proxy or consent solicitation material (the solicitation of which is subject to the rules of the Commission pursuant to subsection (a)) for a meeting of the shareholders occurring after the end of the 6-month period beginning on the date of enactment of this section, at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the assets of an issuer, the person making such solicitation shall disclose in the proxy or consent solicitation material, in a clear and simple form in accordance with regulations to be promulgated by the Commission, any agreements or understandings that such person has with any named executive officers of such issuer (or of the acquiring issuer, if such issuer is not the acquiring issuer) concerning any type of compensation (whether present, deferred, or contingent) that is based on or otherwise relates to the acquisition, merger, consolidation, sale, or other disposition of all or substantially all of the assets of the issuer and the aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to or on behalf of such executive officer.

"(2) SHAREHOLDER APPROVAL.—Any proxy or consent or authorization relating to the proxy or consent solicitation material containing the disclosure required by paragraph (1) shall include a separate resolution subject to shareholder vote to approve such agreements or understandings and compensation as disclosed, unless such agreements or understandings have been subject to a shareholder vote under subsection (a).

"(c) RULE OF CONSTRUCTION.—The shareholder vote referred to in subsections (a) and (b) shall not be binding on the issuer or the board of directors of an issuer, and may not be construed—

"(1) as overruling a decision by such issuer or board of directors;

"(2) to create or imply any change to the fiduciary duties of such issuer or board of directors;

"(3) to create or imply any additional fiduciary duties for such issuer or board of directors; or

"(4) to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.

"(d) DISCLOSURE OF VOTES.—Every institutional investment manager subject to section 13(f) shall report at least annually how it voted on any shareholder vote pursuant to subsections (a) and (b), unless such vote is otherwise required to be reported publicly by rule or regulation of the Commission.

"(e) EXEMPTION.—The Commission may, by rule or order, exempt an issuer or class of issuers from the requirement under subsection (a) or (b). In determining whether to make an exemption under this subsection, the Commission shall take into account, among other considerations, whether the requirements under subsections (a) and (b) disproportionately burdens small issuers.".

SEC. 952. COMPENSATION COMMITTEE INDEPENDENCE.

(a) IN GENERAL.—The Securities Exchange Act of 1934 (15 U.S.C. 78 et seq.) is amended by inserting after section 10B, as added by section 753, the following:

"SEC. 10C. COMPENSATION COMMITTEES.

"(a) INDEPENDENCE OF COMPENSATION COMMITTEES.—

"(1) LISTING STANDARDS.—The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer, other than an issuer that is a controlled company, limited partnership, company in bankruptcy proceedings, open-ended management investment company that is registered under the Investment Company Act of 1940, or a foreign private issuer that provides annual disclosures to shareholders of the reasons that the foreign private issuer does not have an independent compensation committee, that does not comply with the requirements of this subsection.

"(2) INDEPENDENCE OF COMPENSATION COMMITTEES.—The rules of the Commission under paragraph (1) shall require that each member of the compensation committee of the board of directors of an issuer be—

"(A) a member of the board of directors of the issuer; and

"(B) independent.

"(3) INDEPENDENCE.—The rules of the Commission under paragraph (1) shall require that, in determining the definition of the term 'independence' for purposes of paragraph (2), the national securities exchanges and the national securities associations shall consider relevant factors, including—

"(A) the source of compensation of a member of the board of directors of an issuer, including any consulting, advisory, or other compensatory fee paid by the issuer to such member of the board of directors; and

"(B) whether a member of the board of directors of an issuer is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

"(4) EXEMPTION AUTHORITY.—The rules of the Commission under paragraph (1) shall permit a national securities exchange or a national securities association to exempt a particular relationship from the requirements of paragraph (2), with respect to the members of a compensation committee, as the national securities exchange or national securities association determines is appropriate, taking into consideration the size of an issuer and any other relevant factors.

"(b) INDEPENDENCE OF COMPENSATION CONSULTANTS AND OTHER COMPENSATION COMMITTEE ADVISERS.—

"(1) IN GENERAL.—The compensation committee of an issuer may only select a compensation consultant, legal counsel, or other adviser to the compensation committee after taking into consideration the factors identified by the Commission under paragraph (2).

"(2) RULES.—The Commission shall identify factors that affect the independence of a compensation consultant, legal counsel, or other adviser to a compensation committee of an issuer. Such factors shall be competitively neutral among categories of consultants, legal counsel, or other advisers and preserve the ability of compensation committees to retain the services of members of any such category, and shall include—

"(A) the provision of other services to the issuer by the person that employs the compensation consultant, legal counsel, or other adviser;

"(B) the amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel, or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel, or other adviser;

"(C) the policies and procedures of the person that employs the compensation consultant, legal counsel, or other adviser that are designed to prevent conflicts of interest;

"(D) any business or personal relationship of the compensation consultant, legal counsel, or other adviser with a member of the compensation committee; and

"(E) any stock of the issuer owned by the compensation consultant, legal counsel, or other adviser.

"(c) COMPENSATION COMMITTEE AUTHORITY RELATING TO COMPENSATION CONSULTANTS.—

"(1) AUTHORITY TO RETAIN COMPENSATION CONSULTANT.—

“(A) IN GENERAL.—The compensation committee of an issuer, in its capacity as a committee of the board of directors, may, in its sole discretion, retain or obtain the advice of a compensation consultant.

“(B) DIRECT RESPONSIBILITY OF COMPENSATION COMMITTEE.—The compensation committee of an issuer shall be directly responsible for the appointment, compensation, and oversight of the work of a compensation consultant.

“(C) RULE OF CONSTRUCTION.—This paragraph may not be construed—

“(i) to require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant; or

“(ii) to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

“(2) DISCLOSURE.—In any proxy or consent solicitation material for an annual meeting of the shareholders (or a special meeting in lieu of the annual meeting) occurring on or after the date that is 1 year after the date of enactment of this section, each issuer shall disclose in the proxy or consent material, in accordance with regulations of the Commission, whether—

“(A) the compensation committee of the issuer retained or obtained the advice of a compensation consultant; and

“(B) the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed.

“(d) AUTHORITY TO ENGAGE INDEPENDENT LEGAL COUNSEL AND OTHER ADVISERS.—

“(1) IN GENERAL.—The compensation committee of an issuer, in its capacity as a committee of the board of directors, may, in its sole discretion, retain and obtain the advice of independent legal counsel and other advisers.

“(2) DIRECT RESPONSIBILITY OF COMPENSATION COMMITTEE.—The compensation committee of an issuer shall be directly responsible for the appointment, compensation, and oversight of the work of independent legal counsel and other advisers.

“(3) RULE OF CONSTRUCTION.—This subsection may not be construed—

“(A) to require a compensation committee to implement or act consistently with the advice or recommendations of independent legal counsel or other advisers under this subsection; or

“(B) to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

“(e) COMPENSATION OF COMPENSATION CONSULTANTS, INDEPENDENT LEGAL COUNSEL, AND OTHER ADVISERS.—Each issuer shall provide for appropriate funding, as determined by the compensation committee in its capacity as a committee of the board of directors, for payment of reasonable compensation—

“(1) to a compensation consultant; and

“(2) to independent legal counsel or any other adviser to the compensation committee.

"(f) COMMISSION RULES.—

"(1) IN GENERAL.—Not later than 360 days after the date of enactment of this section, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of this section.

"(2) OPPORTUNITY TO CURE DEFECTS.—The rules of the Commission under paragraph (1) shall provide for appropriate procedures for an issuer to have a reasonable opportunity to cure any defects that would be the basis for the prohibition under paragraph (1), before the imposition of such prohibition.

"(3) EXEMPTION AUTHORITY.—

"(A) IN GENERAL.—The rules of the Commission under paragraph (1) shall permit a national securities exchange or a national securities association to exempt a category of issuers from the requirements under this section, as the national securities exchange or the national securities association determines is appropriate.

"(B) CONSIDERATIONS.—In determining appropriate exemptions under subparagraph (A), the national securities exchange or the national securities association shall take into account the potential impact of the requirements of this section on smaller reporting issuers.

"(g) CONTROLLED COMPANY EXEMPTION.—

"(1) IN GENERAL.—This section shall not apply to any controlled company.

"(2) DEFINITION.—For purposes of this section, the term 'controlled company' means an issuer—

"(A) that is listed on a national securities exchange or by a national securities association; and

"(B) that holds an election for the board of directors of the issuer in which more than 50 percent of the voting power is held by an individual, a group, or another issuer.".

(b) STUDY AND REPORT.—

(1) STUDY.—The Securities and Exchange Commission shall conduct a study and review of the use of compensation consultants and the effects of such use.

(2) REPORT.—Not later than 2 years after the date of the enactment of this Act, the Commission shall submit a report to Congress on the results of the study and review required by this subsection.

SEC. 953. EXECUTIVE COMPENSATION DISCLOSURES.

(a) DISCLOSURE OF PAY VERSUS PERFORMANCE.—Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n), as amended by this title, is amended by adding at the end the following:

"(i) DISCLOSURE OF PAY VERSUS PERFORMANCE.—The Commission shall, by rule, require each issuer to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders of the issuer a clear description of any compensation required to be disclosed by the issuer under section 229.402 of title 17, Code of Federal Regulations (or any successor thereto), including information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions. The disclosure under this subsection may include a graphic representation of the information required to be disclosed.''.

(b) ADDITIONAL DISCLOSURE REQUIREMENTS.—

(1) IN GENERAL.—The Commission shall amend section 229.402 of title 17, Code of Federal Regulations, to require each issuer to disclose in any filing of the issuer described in section 229.10(a) of title 17, Code of Federal Regulations (or any successor thereto)—

(A) the median of the annual total compensation of all employees of the issuer, except the chief executive officer (or any equivalent position) of the issuer;

(B) the annual total compensation of the chief executive officer (or any equivalent position) of the issuer; and

(C) the ratio of the amount described in subparagraph (A) to the amount described in subparagraph (B).

(2) TOTAL COMPENSATION.—For purposes of this subsection, the total compensation of an employee of an issuer shall be determined in accordance with section 229.402(c)(2)(x) of title 17, Code of Federal Regulations, as in effect on the day before the date of enactment of this Act.

SEC. 954. RECOVERY OF ERRONEOUSLY AWARDED COMPENSATION.

The Securities Exchange Act of 1934 is amended by inserting after section 10C, as added by section 952, the following:

''SEC. 10D. RECOVERY OF ERRONEOUSLY AWARDED COMPENSATION POLICY.

''(a) LISTING STANDARDS.—The Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that does not comply with the requirements of this section.

''(b) RECOVERY OF FUNDS.—The rules of the Commission under subsection (a) shall require each issuer to develop and implement a policy providing—

''(1) for disclosure of the policy of the issuer on incentive-based compensation that is based on financial information required to be reported under the securities laws; and

''(2) that, in the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, the issuer will recover from any current or former executive officer of the issuer who received incentive-based compensation (including stock options awarded as compensation) during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement.''.

SEC. 955. DISCLOSURE REGARDING EMPLOYEE AND DIRECTOR HEDGING.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n), as amended by this title, is amended by adding at the end the following:

''(j) DISCLOSURE OF HEDGING BY EMPLOYEES AND DIRECTORS.—The Commission shall, by rule, require each issuer to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders of the issuer whether any employee or member of the board of directors of the issuer, or any designee of such employee or member, is permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities—

"(1) granted to the employee or member of the board of directors by the issuer as part of the compensation of the employee or member of the board of directors; or

"(2) held, directly or indirectly, by the employee or member of the board of directors.".

SEC. 956. ENHANCED COMPENSATION STRUCTURE REPORTING.

(a) ENHANCED DISCLOSURE AND REPORTING OF COMPENSATION ARRANGEMENTS.—

(1) IN GENERAL.—Not later than 9 months after the date of enactment of this title, the appropriate Federal regulators jointly shall prescribe regulations or guidelines to require each covered financial institution to disclose to the appropriate Federal regulator the structures of all incentive-based compensation arrangements offered by such covered financial institutions sufficient to determine whether the compensation structure—

(A) provides an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or

(B) could lead to material financial loss to the covered financial institution.

(2) RULES OF CONSTRUCTION.—Nothing in this section shall be construed as requiring the reporting of the actual compensation of particular individuals. Nothing in this section shall be construed to require a covered financial institution that does not have an incentive-based payment arrangement to make the disclosures required under this subsection.

(b) PROHIBITION ON CERTAIN COMPENSATION ARRANGEMENTS.—Not later than 9 months after the date of enactment of this title, the appropriate Federal regulators shall jointly prescribe regulations or guidelines that prohibit any types of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions—

(1) by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or

(2) that could lead to material financial loss to the covered financial institution.

(c) STANDARDS.—The appropriate Federal regulators shall—

(1) ensure that any standards for compensation established under subsections (a) or (b) are comparable to the standards established under section of the Federal Deposit Insurance Act (12 U.S.C. 2 1831p–1) for insured depository institutions; and

(2) in establishing such standards under such subsections, take into consideration the compensation standards described in section 39(c) of the Federal Deposit Insurance Act (12 U.S.C. 1831p– 9 1(c)).

(d) ENFORCEMENT.—The provisions of this section and the regulations issued under this section shall be enforced under section

505 of the Gramm-Leach-Bliley Act and, for purposes of such section, a violation of this section or such regulations shall be treated as a violation of subtitle A of title V of such Act.

(e) DEFINITIONS.—As used in this section—

(1) the term "appropriate Federal regulator" means the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the Securities and Exchange Commission, the Federal Housing Finance Agency; and

(2) the term "covered financial institution" means—

(A) a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(B) a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o);

(C) a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act;

(D) an investment advisor, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11));

(E) the Federal National Mortgage Association;

(F) the Federal Home Loan Mortgage Corporation; and

(G) any other financial institution that the appropriate Federal regulators, jointly, by rule, determine should be treated as a covered financial institution for purposes of this section.

(f) EXEMPTION FOR CERTAIN FINANCIAL INSTITUTIONS.—The requirements of this section shall not apply to covered financial institutions with assets of less than $1,000,000,000.

SEC. 957. VOTING BY BROKERS.

Section 6(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78f(b)) is amended—

(1) in paragraph (9)—

(A) in subparagraph (A), by redesignating clauses (i) through (v) as subclauses (I) through (V), respectively, and adjusting the margins accordingly;

(B) by redesignating subparagraphs (A) through (D) as clauses (i) through (iv), respectively, and adjusting the margins accordingly;

(C) by inserting "(A)" after "(9)"; and

(D) in the matter immediately following clause (iv), as so redesignated, by striking "As used" and inserting the following:

"(B) As used".

(2) by adding at the end the following:

"(10)(A) The rules of the exchange prohibit any member that is not the beneficial owner of a security registered under section 12 from granting a proxy to vote the security in connection with a shareholder vote described in subparagraph (B), unless the beneficial owner of the security has instructed the member to vote the proxy in accordance with the voting instructions of the beneficial owner.

"(B) A shareholder vote described in this subparagraph is a shareholder vote with respect to the election of a member of the board of directors of an issuer, executive compensation, or any other significant matter, as determined by the Commission, by rule, and does not include a vote with respect to the uncontested election of a member of the board of directors of any investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80b–1 et seq.).

"(C) Nothing in this paragraph shall be construed to prohibit a national securities exchange from prohibiting a member that is not the beneficial owner of a security registered under section 12 from granting a proxy to vote the security in connection with a shareholder vote not described in subparagraph (A).".

Subtitle F—Improvements to the Management of the Securities and Exchange Commission

SEC. 961. REPORT AND CERTIFICATION OF INTERNAL SUPERVISORY CONTROLS.

(a) ANNUAL REPORTS AND CERTIFICATION.—Not later than 90 days after the end of each fiscal year, the Commission shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the conduct by the Commission of examinations of registered entities, enforcement investigations, and review of corporate financial securities filings.

(b) CONTENTS OF REPORTS.—Each report under subsection (a) shall contain—

(1) an assessment, as of the end of the most recent fiscal year, of the effectiveness of—

(A) the internal supervisory controls of the Commission; and

(B) the procedures of the Commission applicable to the staff of the Commission who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings;

(2) a certification that the Commission has adequate internal supervisory controls to carry out the duties of the Commission described in paragraph (1)(B); and

(3) a summary by the Comptroller General of the United States of the review carried out under subsection (d).

(c) CERTIFICATION.—

(1) SIGNATURE.—The certification under subsection (b)(2) shall be signed by the Director of the Division of Enforcement, the Director of the Division of Corporation Finance, and the Director of the Office of Compliance Inspections and Examinations (or the head of any successor division or office).

(2) CONTENT OF CERTIFICATION.—Each individual described in paragraph (1) shall certify that the individual—

(A) is directly responsible for establishing and maintaining the internal supervisory controls of the Division or Office of which the individual is the head;

(B) is knowledgeable about the internal supervisory controls of the Division or Office of which the individual is the head;

(C) has evaluated the effectiveness of the internal supervisory controls during the 90-day period ending on the final day of the fiscal year to which the report relates; and

(D) has disclosed to the Commission any significant deficiencies in the design or operation of internal supervisory controls that could adversely affect the ability of the Division or Office to consistently conduct inspections, or investigations, or reviews of filings with professional competence and integrity.

(d) NEW DIRECTOR OR ACTING DIRECTOR.—Notwithstanding subsection (a), if the Director of the Division of Enforcement, the Director of the Division of Corporate Finance, or the Director of the Office of Compliance Inspections and Examinations has served as Director of the Division or Office for less than 90 days on the date on which a report is required to be submitted under subsection (a), the Commission may submit the report on the date on which the Director has served as Director for 90 days. If there is no Director of the Division of Enforcement, the Division of Corporate Finance, or the Office of Compliance Inspections and Examinations, on the date on which a report is required to be submitted under subsection (a), the Acting Director of the Division or Office may make the certification required under subsection (c).

(e) REVIEW BY THE COMPTROLLER GENERAL.—

(1) REPORT.—The Comptroller General of the United States shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report that contains a review of the adequacy and effectiveness of the internal supervisory control structure and procedures described in subsection (b)(1), not less frequently than once every 3 years, at a time to coincide with the publication of the reports of the Commission under this section.

(2) AUTHORITY TO HIRE EXPERTS.—The Comptroller General of the United States may hire independent consultants with specialized expertise in any area relevant to the duties of the Comptroller General described in this section, in order to assist the Comptroller General in carrying out such duties.

SEC. 962. TRIENNIAL REPORT ON PERSONNEL MANAGEMENT.

(a) TRIENNIAL REPORT REQUIRED.—Once every 3 years, the Comptroller General of the United States shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the quality of personnel management by the Commission.

(b) CONTENTS OF REPORT.—Each report under subsection (a) shall include—

(1) an evaluation of—

(A) the effectiveness of supervisors in using the skills, talents, and motivation of the employees of the Commission to achieve the goals of the Commission;

(B) the criteria for promoting employees of the Commission to supervisory positions;

(C) the fairness of the application of the promotion criteria to the decisions of the Commission;

(D) the competence of the professional staff of the Commission;

(E) the efficiency of communication between the units of the Commission regarding the work of the Commission (including communication between divisions and between subunits of a division) and the efforts by the Commission to promote such communication;

(F) the turnover within subunits of the Commission, including the consideration of supervisors whose subordinates have an unusually high rate of turnover;

(G) whether there are excessive numbers of low-level, mid-level, or senior-level managers;

(H) any initiatives of the Commission that increase the competence of the staff of the Commission;

(I) the actions taken by the Commission regarding employees of the Commission who have failed to perform their duties and circumstances under which the Commission has issued to employees a notice of termination; and

(J) such other factors relating to the management of the Commission as the Comptroller General determines are appropriate;

(2) an evaluation of any improvements made with respect to the areas described in paragraph (1) since the date of submission of the previous report; and

(3) recommendations for how the Commission can use the human resources of the Commission more effectively and efficiently to carry out the mission of the Commission.

(c) CONSULTATION.—In preparing the report under subsection (a), the Comptroller General shall consult with current employees of the Commission, retired employees and other former employees of the Commission, the Inspector General of the Commission, persons that have business before the Commission, any union representing the employees of the Commission, private management consultants, academics, and any other source that the Comptroller General deems appropriate.

(d) REPORT BY COMMISSION.—Not later than 90 days after the date on which the Comptroller General submits each report under subsection (a), the Commission shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report describing the actions taken by the Commission in response to the recommendations contained in the report under subsection (a).

(e) REIMBURSEMENTS FOR COST OF REPORTS.—

(1) REIMBURSEMENTS REQUIRED.—The Commission shall reimburse the Government Accountability Office for the full cost of making the reports under this section, as billed therefor by the Comptroller General.

(2) CREDITING AND USE OF REIMBURSEMENTS.—Such reimbursements shall—

(A) be credited to the appropriation account "Salaries and Expenses, Government Accountability Office" current when the payment is received; and

(B) remain available until expended.

(f) AUTHORITY TO HIRE EXPERTS.—The Comptroller General of the United States may hire independent consultants with specialized expertise in any area relevant to the duties of the Comptroller

General described in this section, in order to assist the Comptroller General in carrying out such duties.

SEC. 963. ANNUAL FINANCIAL CONTROLS AUDIT.

(a) REPORTS OF COMMISSION.—

(1) ANNUAL REPORTS REQUIRED.—Not later than 6 months after the end of each fiscal year, the Commission shall publish and submit to Congress a report that—

(A) describes the responsibility of the management of the Commission for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

(B) contains an assessment of the effectiveness of the internal control structure and procedures for financial reporting of the Commission during that fiscal year.

(2) ATTESTATION.—The reports required under paragraph (1) shall be attested to by the Chairman and chief financial officer of the Commission.

(b) REPORT BY COMPTROLLER GENERAL.—

(1) REPORT REQUIRED.—Not later than 6 months after the end of the first fiscal year after the date of enactment of this Act, the Comptroller General of the United States shall submit a report to Congress that assesses—

(A) the effectiveness of the internal control structure and procedures of the Commission for financial reporting; and

(B) the assessment of the Commission under subsection (a)(1)(B).

(2) ATTESTATION.—The Comptroller General shall attest to, and report on, the assessment made by the Commission under subsection (a).

(c) REIMBURSEMENTS FOR COST OF REPORTS.—

(1) REIMBURSEMENTS REQUIRED.—The Commission shall reimburse the Government Accountability Office for the full cost of making the reports under subsection (b), as billed therefor by the Comptroller General.

(2) CREDITING AND USE OF REIMBURSEMENTS.—Such reimbursements shall—

(A) be credited to the appropriation account "Salaries and Expenses, Government Accountability Office" current when the payment is received; and

(B) remain available until expended.

SEC. 964. REPORT ON OVERSIGHT OF NATIONAL SECURITIES ASSOCIATIONS.

(a) REPORT REQUIRED.—Not later than 2 years after the date of enactment of this Act, and every 3 years thereafter, the Comptroller General of the United States shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report that includes an evaluation of the oversight by the Commission of national securities associations registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3) with respect to—

(1) the governance of such national securities associations, including the identification and management of conflicts of interest by such national securities associations, together with an analysis of the impact of any conflicts of interest on the

regulatory enforcement or rulemaking by such national securities associations;

(2) the examinations carried out by the national securities associations, including the expertise of the examiners;

(3) the executive compensation practices of such national securities associations;

(4) the arbitration services provided by the national securities associations;

(5) the review performed by national securities associations of advertising by the members of the national securities associations;

(6) the cooperation with and assistance to State securities administrators by the national securities associations to promote investor protection;

(7) how the funding of national securities associations is used to support the mission of the national securities associations, including—

(A) the methods of funding;

(B) the sufficiency of funds;

(C) how funds are invested by the national securities association pending use; and

(D) the impact of the methods, sufficiency, and investment of funds on regulatory enforcement by the national securities associations;

(8) the policies regarding the employment of former employees of national securities associations by regulated entities;

(9) the ongoing effectiveness of the rules of the national securities associations in achieving the goals of the rules;

(10) the transparency of governance and activities of the national securities associations; and

(11) any other issue that has an impact, as determined by the Comptroller General, on the effectiveness of such national securities associations in performing their mission and in dealing fairly with investors and members;

(b) REIMBURSEMENTS FOR COST OF REPORTS.—

(1) REIMBURSEMENTS REQUIRED.—The Commission shall reimburse the Government Accountability Office for the full cost of making the reports under subsection (a), as billed therefor by the Comptroller General.

(2) CREDITING AND USE OF REIMBURSEMENTS.—Such reimbursements shall—

(A) be credited to the appropriation account "Salaries and Expenses, Government Accountability Office" current when the payment is received; and

(B) remain available until expended.

SEC. 965. COMPLIANCE EXAMINERS.

Section 4 of the Securities Exchange Act of 1934 (15 U.S.C. 78d) is amended by adding at the end the following:

"(h) EXAMINERS.—

"(1) DIVISION OF TRADING AND MARKETS.—The Division of Trading and Markets of the Commission, or any successor organizational unit, shall have a staff of examiners who shall—

"(A) perform compliance inspections and examinations of entities under the jurisdiction of that Division; and

"(B) report to the Director of that Division.

"(2) DIVISION OF INVESTMENT MANAGEMENT.—The Division of Investment Management of the Commission, or any successor organizational unit, shall have a staff of examiners who shall—

"(A) perform compliance inspections and examinations of entities under the jurisdiction of that Division; and

"(B) report to the Director of that Division.".

SEC. 966. SUGGESTION PROGRAM FOR EMPLOYEES OF THE COMMISSION.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 4C (15 U.S.C. 78d–3) the following:

"SEC. 4D. ADDITIONAL DUTIES OF INSPECTOR GENERAL.

"(a) SUGGESTION SUBMISSIONS BY COMMISSION EMPLOYEES.—

"(1) HOTLINE ESTABLISHED.—The Inspector General of the Commission shall establish and maintain a telephone hotline or other electronic means for the receipt of—

"(A) suggestions by employees of the Commission for improvements in the work efficiency, effectiveness, and productivity, and the use of the resources, of the Commission; and

"(B) allegations by employees of the Commission of waste, abuse, misconduct, or mismanagement within the Commission.

"(2) CONFIDENTIALITY.—The Inspector General shall maintain as confidential—

"(A) the identity of any individual who provides information by the means established under paragraph (1), unless the individual requests otherwise, in writing; and

"(B) at the request of any such individual, any specific information provided by the individual.

"(b) CONSIDERATION OF REPORTS.—The Inspector General shall consider any suggestions or allegations received by the means established under subsection (a)(1), and shall recommend appropriate action in relation to such suggestions or allegations.

"(c) RECOGNITION.—The Inspector General may recognize any employee who makes a suggestion under subsection (a)(1) (or by other means) that would or does—

"(1) increase the work efficiency, effectiveness, or productivity of the Commission; or

"(2) reduce waste, abuse, misconduct, or mismanagement within the Commission.

"(d) REPORT.—The Inspector General of the Commission shall submit to Congress an annual report containing a description of—

"(1) the nature, number, and potential benefits of any suggestions received under subsection (a);

"(2) the nature, number, and seriousness of any allegations received under subsection (a);

"(3) any recommendations made or actions taken by the Inspector General in response to substantiated allegations received under subsection (a); and

"(4) any action the Commission has taken in response to suggestions or allegations received under subsection (a).

"(e) FUNDING.—The activities of the Inspector General under this subsection shall be funded by the Securities and Exchange

Commission Investor Protection Fund established under section 21F.''.

SEC. 967. COMMISSION ORGANIZATIONAL STUDY AND REFORM.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—Not later than the end of the 90-day period beginning on the date of the enactment of this subtitle, the Securities and Exchange Commission (hereinafter in this section referred to as the "SEC") shall hire an independent consultant of high caliber and with expertise in organizational restructuring and the operations of capital markets to examine the internal operations, structure, funding, and the need for comprehensive reform of the SEC, as well as the SEC's relationship with and the reliance on self-regulatory organizations and other entities relevant to the regulation of securities and the protection of securities investors that are under the SEC's oversight.

(2) SPECIFIC AREAS FOR STUDY.—The study required under paragraph (1) shall, at a minimum, include the study of—

(A) the possible elimination of unnecessary or redundant units at the SEC;

(B) improving communications between SEC offices and divisions;

(C) the need to put in place a clear chain-of-command structure, particularly for enforcement examinations and compliance inspections;

(D) the effect of high-frequency trading and other technological advances on the market and what the SEC requires to monitor the effect of such trading and advances on the market;

(E) the SEC's hiring authorities, workplace policies, and personal practices, including—

(i) whether there is a need to further streamline hiring authorities for those who are not lawyers, accountants, compliance examiners, or economists;

(ii) whether there is a need for further pay reforms;

(iii) the diversity of skill sets of SEC employees and whether the present skill set diversity efficiently and effectively fosters the SEC's mission of investor protection; and

(iv) the application of civil service laws by the SEC;

(F) whether the SEC's oversight and reliance on self-regulatory organizations promotes efficient and effective governance for the securities markets; and

(G) whether adjusting the SEC's reliance on self-regulatory organizations is necessary to promote more efficient and effective governance for the securities markets.

(b) CONSULTANT REPORT.—Not later than the end of the 150-day period after being retained, the independent consultant hired pursuant to subsection (a)(1) shall issue a report to the SEC and the Congress containing—

(1) a detailed description of any findings and conclusions made while carrying out the study required under subsection (a)(1); and

(2) recommendations for legislative, regulatory, or administrative action that the consultant determines appropriate to

enable the SEC and other entities on which the consultant reports to perform their statutorily or otherwise mandated missions.

(c) SEC REPORT.—Not later than the end of the 6-month period beginning on the date the consultant issues the report under subsection (b), and every 6-months thereafter during the 2-year period following the date on which the consultant issues such report, the SEC shall issue a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate describing the SEC's implementation of the regulatory and administrative recommendations contained in the consultant's report.

SEC. 968. STUDY ON SEC REVOLVING DOOR.

(a) GOVERNMENT ACCOUNTABILITY OFFICE STUDY.—The Comptroller General of the United States shall conduct a study that will—

(1) review the number of employees who leave the Securities and Exchange Commission to work for financial institutions regulated by such Commission;

(2) determine how many employees who leave the Securities and Exchange Commission worked on cases that involved financial institutions regulated by such Commission;

(3) review the length of time employees work for the Securities and Exchange Commission before leaving to be employed by financial institutions regulated by such Commission;

(4) review existing internal controls and make recommendations on strengthening such controls to ensure that employees of the Securities and Exchange Commission who are later employed by financial institutions did not assist such institutions in violating any rules or regulations of the Commission during the course of their employment with such Commission;

(5) determine if greater post-employment restrictions are necessary to prevent employees of the Securities and Exchange Commission from being employed by financial institutions after employment with such Commission;

(6) determine if the volume of employees of the Securities and Exchange Commission who are later employed by financial institutions has led to inefficiencies in enforcement;

(7) determine if employees of the Securities and Exchange Commission who are later employed by financial institutions assisted such institutions in circumventing Federal rules and regulations while employed by such Commission;

(8) review any information that may address the volume of employees of the Securities and Exchange Commission who are later employed by financial institutions, and make recommendations to Congress; and

(9) review other additional issues as may be raised during the course of the study conducted under this subsection.

(b) REPORT.—Not later than 1 year after the date of the enactment of this subtitle, the Comptroller General of the United States shall submit to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate a report on the results of the study required by subsection (a).

Subtitle G—Strengthening Corporate Governance

SEC. 971. PROXY ACCESS.

(a) PROXY ACCESS.—Section 14(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a)) is amended—

(1) by inserting "(1)" after "(a)"; and

(2) by adding at the end the following:

"(2) The rules and regulations prescribed by the Commission under paragraph (1) may include—

"(A) a requirement that a solicitation of proxy, consent, or authorization by (or on behalf of) an issuer include a nominee submitted by a shareholder to serve on the board of directors of the issuer; and

"(B) a requirement that an issuer follow a certain procedure in relation to a solicitation described in subparagraph (A).".

(b) REGULATIONS.—The Commission may issue rules permitting the use by a shareholder of proxy solicitation materials supplied by an issuer of securities for the purpose of nominating individuals to membership on the board of directors of the issuer, under such terms and conditions as the Commission determines are in the interests of shareholders and for the protection of investors.

(c) EXEMPTIONS.—The Commission may, by rule or order, exempt an issuer or class of issuers from the requirement made by this section or an amendment made by this section. In determining whether to make an exemption under this subsection, the Commission shall take into account, among other considerations, whether the requirement in the amendment made by subsection (a) disproportionately burdens small issuers.

SEC. 972. DISCLOSURES REGARDING CHAIRMAN AND CEO STRUCTURES.

The Securities Exchange Act of 1934 (15 U.S. C. 78a et seq.) is amended by inserting after section 14A, as added by this title, the following:

"SEC. 14B. CORPORATE GOVERNANCE.

"Not later than 180 days after the date of enactment of this subsection, the Commission shall issue rules that require an issuer to disclose in the annual proxy sent to investors the reasons why the issuer has chosen—

"(1) the same person to serve as chairman of the board of directors and chief executive officer (or in equivalent positions); or

"(2) different individuals to serve as chairman of the board of directors and chief executive officer (or in equivalent positions of the issuer).".

Subtitle H—Municipal Securities

SEC. 975. REGULATION OF MUNICIPAL SECURITIES AND CHANGES TO THE BOARD OF THE MSRB.

(a) REGISTRATION OF MUNICIPAL SECURITIES DEALERS AND MUNICIPAL ADVISORS.—Section 15B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4(a)) is amended—

(1) in paragraph (1)—

(A) by inserting "(A)" after "(1)"; and

(B) by adding at the end the following:

"(B) It shall be unlawful for a municipal advisor to provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, or to undertake a solicitation of a municipal entity or obligated person, unless the municipal advisor is registered in accordance with this subsection.";

(2) in paragraph (2), by inserting "or municipal advisor" after "municipal securities dealer" each place that term appears;

(3) in paragraph (3), by inserting "or municipal advisor" after "municipal securities dealer" each place that term appears;

(4) in paragraph (4), by striking "dealer, or municipal securities dealer or class of brokers, dealers, or municipal securities dealers" and inserting "dealer, municipal securities dealer, or municipal advisor, or class of brokers, dealers, municipal securities dealers, or municipal advisors"; and

(5) by adding at the end the following:

"(5) No municipal advisor shall make use of the mails or any means or instrumentality of interstate commerce to provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products, the issuance of municipal securities, or to undertake a solicitation of a municipal entity or obligated person, in connection with which such municipal advisor engages in any fraudulent, deceptive, or manipulative act or practice.".

(b) MUNICIPAL SECURITIES RULEMAKING BOARD.—Section 15B(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4(b)) is amended—

(1) in paragraph (1)—

(A) in the first sentence, by striking "Not later than" and all that follows through "appointed by the Commission" and inserting "The Municipal Securities Rulemaking Board shall be composed of 15 members, or such other number of members as specified by rules of the Board pursuant to paragraph (2)(B),";

(B) by striking the second sentence and inserting the following: "The members of the Board shall serve as members for a term of 3 years or for such other terms as specified by rules of the Board pursuant to paragraph (2)(B), and shall consist of (A) 8 individuals who are independent of any municipal securities broker, municipal securities dealer, or municipal advisor, at least 1 of whom shall be representative of institutional or retail investors in municipal securities, at least 1 of whom shall be representative of municipal entities, and at least 1 of whom shall be a member of the public with knowledge of or experience in the municipal industry (which members are hereinafter referred to as 'public representatives'); and (B) 7 individuals who are associated with a broker, dealer, municipal securities dealer, or municipal advisor, including at least 1 individual who is associated with and representative of brokers, dealers, or municipal securities dealers that are not banks or subsidiaries or departments or divisions of banks (which members are hereinafter referred to as 'broker-dealer representatives'), at least 1 individual who is associated with and representative of municipal securities dealers which are banks or subsidiaries or departments or divisions of banks (which members are hereinafter referred to as 'bank representatives'), and at least 1 individual who is associated with a municipal advisor (which members are hereinafter referred to as 'advisor representatives' and, together with the broker-dealer representatives and the bank representatives, are referred to as 'regulated representatives'). Each member of the board shall be knowledgeable of matters related to the municipal securities markets."; and

(C) in the third sentence, by striking "initial";

(2) in paragraph (2)—

(A) in the matter preceding subparagraph (A)—

(i) by inserting before the period at the end of the first sentence the following: "and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors"; and

(ii) by striking the second sentence;

(B) in subparagraph (A)—

(i) in the matter preceding clause (i)—

(I) by inserting ", and no broker, dealer, municipal securities dealer, or municipal advisor shall provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities," after "sale of, any municipal security"; and

(II) by inserting "and municipal entities or obligated persons" after "protection of investors";

(ii) in clause (i), by striking "municipal securities brokers and municipal securities dealers" each place that term appears and inserting "municipal securities brokers, municipal securities dealers, and municipal advisors";

(iii) in clause (ii), by adding "and" at the end;

(iv) in clause (iii), by striking "; and" and inserting a period; and

(v) by striking clause (iv);

(C) by amending subparagraph (B) to read as follows:

"(B) establish fair procedures for the nomination and election of members of the Board and assure fair representation in such nominations and elections of public representatives, broker dealer representatives, bank representatives, and advisor representatives. Such rules—

"(i) shall provide that the number of public representatives of the Board shall at all times exceed the total number of regulated representatives and that the membership shall at all times be as evenly divided in number as possible between public representatives and regulated representatives;

"(ii) shall specify the length or lengths of terms members shall serve;

"(iii) may increase the number of members which shall constitute the whole Board, provided that such number is an odd number; and

"(iv) shall establish requirements regarding the independence of public representatives.".

(D) in subparagraph (C)—

(i) by inserting "and municipal financial products" after "municipal securities" the first two times that term appears;

(ii) by inserting ", municipal entities, obligated persons," before "and the public interest";

(iii) by striking "between" and inserting "among";

(iv) by striking "issuers, municipal securities brokers, or municipal securities dealers, to fix" and inserting "municipal entities, obligated persons, municipal securities brokers, municipal securities dealers, or municipal advisors, to fix"; and

(v) by striking "brokers or municipal securities dealers, to regulate" and inserting "brokers, municipal securities dealers, or municipal advisors, to regulate";

(E) in subparagraph (D)—

(i) by inserting "and advice concerning municipal financial products" after "transactions in municipal securities";

(ii) by striking "That no" and inserting "that no";

(iii) by inserting "municipal advisor," before "or person associated"; and

(iv) by striking "a municipal securities broker or municipal securities dealer may be compelled" and inserting "a municipal securities broker, municipal securities dealer, or municipal advisor may be compelled";

(F) in subparagraph (E)—

(i) by striking "municipal securities brokers and municipal securities dealers" and inserting "municipal securities brokers, municipal securities dealers, and municipal advisors"; and

(ii) by striking "municipal securities broker or municipal securities dealer" and inserting "municipal securities broker, municipal securities dealer, or municipal advisor";

(G) in subparagraph (G), by striking "municipal securities brokers and municipal securities dealers" and inserting "municipal securities brokers, municipal securities dealers, and municipal advisors";

(H) in subparagraph (J)—

(i) by striking "municipal securities broker and each municipal securities dealer" and inserting "municipal securities broker, municipal securities dealer, and municipal advisor"; and

(ii) by striking the period at the end of the second sentence and inserting ", which may include charges for failure to submit to the Board, or to any information system operated by the Board, within the prescribed timeframes, any items of information or documents required to be submitted under any rule issued by the Board.";

(I) in subparagraph (K)—

(i) by inserting "broker, dealer, or" before "municipal securities dealer" each place that term appears; and

(ii) by striking "municipal securities investment portfolio" and inserting "related account of a broker, dealer, or municipal securities dealer"; and

(J) by adding at the end the following:

"(L) with respect to municipal advisors—

"(i) prescribe means reasonably designed to prevent acts, practices, and courses of business as are not consistent with a municipal advisor's fiduciary duty to its clients;

"(ii) provide continuing education requirements for municipal advisors;

"(iii) provide professional standards; and

"(iv) not impose a regulatory burden on small municipal advisors that is not necessary or appropriate in the public interest and for the protection of investors, municipal entities, and obligated persons, provided that there is robust protection of investors against fraud.";

(3) by redesignating paragraph (3) as paragraph (7); and

(4) by inserting after paragraph (2) the following:

"(3) The Board, in conjunction with or on behalf of any Federal financial regulator or self-regulatory organization, may—

"(A) establish information systems; and

"(B) assess such reasonable fees and charges for the submission of information to, or the receipt of information from, such systems from any persons which systems may be developed for the purposes of serving as a repository of information from municipal market participants or otherwise in furtherance of the purposes of the Board, a Federal financial regulator, or a self-regulatory organization, except that the Board—

"(i) may not charge a fee to municipal entities or obligated persons to submit documents or other information to the Board or charge a fee to any person to obtain, directly from the Internet site of the Board, documents or information submitted by municipal entities, obligated persons, brokers, dealers, municipal securities dealers, or municipal advisors, including documents submitted under the rules of the Board or the Commission; and

"(ii) shall not be prohibited from charging commercially reasonable fees for automated subscription-based feeds or similar services, or for charging for other data or document-based services customized upon request of any person, made available to commercial enterprises, municipal securities market professionals, or the general public, whether delivered through the Internet or any other means, that contain all or part of the documents or information, subject to approval of the fees by the Commission under section 19(b).

"(4) The Board may provide guidance and assistance in the enforcement of, and examination for, compliance with the rules of the Board to the Commission, a registered securities association under section 15A, or any other appropriate regulatory agency, as applicable.

"(5) The Board, the Commission, and a registered securities association under section 15A, or the designees of the Board, the Commission, or such association, shall meet not less frequently than 2 times a year—

"(A) to describe the work of the Board, the Commission, and the registered securities association involving the regulation of municipal securities; and

"(B) to share information about—

"(i) the interpretation of the Board, the Commission, and the registered securities association of Board rules; and

"(ii) examination and enforcement of compliance with Board rules.".

(c) DISCIPLINE OF BROKERS, DEALERS, MUNICIPAL SECURITIES DEALERS AND MUNICIPAL ADVISORS; FIDUCIARY DUTY OF MUNICIPAL ADVISORS.—Section 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4(c)) is amended—

(1) in paragraph (1), by inserting ", and no broker, dealer, municipal securities dealer, or municipal advisor shall make use of the mails or any means or instrumentality of interstate commerce to provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products, the issuance of municipal securities, or to undertake a solicitation of a municipal entity or obligated person," after "any municipal security";

(2) by adding at the end of paragraph (1) the following: "A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor's fiduciary duty or that is in contravention of any rule of the Board.".

(3) in paragraph (2), by inserting "or municipal advisor" after "municipal securities dealer" each place that term appears;

(4) in paragraph (3)—

(A) by inserting "or municipal entities or obligated person" after "protection of investors" each place that term appears; and

(B) by inserting "or municipal advisor" after "municipal securities dealer" each place that term appears;

(5) in paragraph (4), by inserting "or municipal advisor" after "municipal securities dealer or obligated person" each place that term appears;

(6) in paragraph (6)(B), by inserting "or municipal entities or obligated person" after "protection of investors";

(7) in paragraph (7)—

(A) in subparagraph (A)—

(i) in clause (i), by striking "; and" and inserting a semicolon;

(ii) in clause (ii), by striking the period and inserting "; and"; and

(iii) by adding at the end the following:

"(iii) the Commission, or its designee, in the case of municipal advisors.".

(B) in subparagraph (B), by inserting "or municipal entities or obligated person" after "protection of investors"; and

(8) by adding at the end the following:

"(9)(A) Fines collected by the Commission for violations of the rules of the Board shall be equally divided between the Commission and the Board.

"(B) Fines collected by a registered securities association under section 15A(7) with respect to violations of the rules of the Board shall be accounted for by such registered securities association separately from other fines collected under section 15A(7) and shall be allocated between such registered securities association and the Board, and such allocation shall require the registered securities association to pay to the Board ⅓ of all fines collected by the registered securities association reasonably allocable to violations of the rules of the Board, or such other portion of such fines as may be directed by the Commission upon agreement between the registered securities association and the Board.".

(d) ISSUANCE OF MUNICIPAL SECURITIES.—Section 15B(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4(d)) is amended—

(1) by striking "through a municipal securities broker or municipal securities dealer or otherwise" and inserting "through a municipal securities broker, municipal securities dealer, municipal advisor, or otherwise"; and

(2) by inserting "or municipal advisors" before "to furnish".

(e) DEFINITIONS.—Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4) is amended by adding at the end the following:

"(e) DEFINITIONS.—For purposes of this section—

"(1) the term 'Board' means the Municipal Securities Rulemaking Board established under subsection (b)(1);

"(2) the term 'guaranteed investment contract' includes any investment that has specified withdrawal or reinvestment provisions and a specifically negotiated or bid interest rate, and also includes any agreement to supply investments on 2 or more future dates, such as a forward supply contract;

"(3) the term 'investment strategies' includes plans or programs for the investment of the proceeds of municipal securities that are not municipal derivatives, guaranteed investment contracts, and the recommendation of and brokerage of municipal escrow investments;

"(4) the term 'municipal advisor'—

"(A) means a person (who is not a municipal entity or an employee of a municipal entity) that—

"(i) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or

"(ii) undertakes a solicitation of a municipal entity;

“(B) includes financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and swap advisors, if such persons are described in any of clauses (i) through (iii) of subparagraph (A); and

“(C) does not include a broker, dealer, or municipal securities dealer serving as an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933) (15 U.S.C. 77b(a)(11)), any investment adviser registered under the Investment Advisers Act of 1940, or persons associated with such investment advisers who are providing investment advice, any commodity trading advisor registered under the Commodity Exchange Act or persons associated with a commodity trading advisor who are providing advice related to swaps, attorneys offering legal advice or providing services that are of a traditional legal nature, or engineers providing engineering advice;

“(5) the term ‘municipal financial product’ means municipal derivatives, guaranteed investment contracts, and investment strategies;

“(6) the term ‘rules of the Board’ means the rules proposed and adopted by the Board under subsection (b)(2);

“(7) the term ‘person associated with a municipal advisor’ or ‘associated person of an advisor’ means—

“(A) any partner, officer, director, or branch manager of such municipal advisor (or any person occupying a similar status or performing similar functions);

“(B) any other employee of such municipal advisor who is engaged in the management, direction, supervision, or performance of any activities relating to the provision of advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities; and

“(C) any person directly or indirectly controlling, controlled by, or under common control with such municipal advisor;

“(8) the term ‘municipal entity’ means any State, political subdivision of a State, or municipal corporate instrumentality of a State, including—

“(A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality;

“(B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and

“(C) any other issuer of municipal securities;

“(9) the term ‘solicitation of a municipal entity or obligated person’ means a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser (as defined in section 202 of the Investment Advisers Act of 1940) that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person of a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity; and

"(10) the term 'obligated person' means any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities to be sold in an offering of municipal securities.".

(f) REGISTERED SECURITIES ASSOCIATION.—Section 15A(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3(b)) is amended by adding at the end the following:

"(15) The rules of the association provide that the association shall—

"(A) request guidance from the Municipal Securities Rulemaking Board in interpretation of the rules of the Municipal Securities Rulemaking Board; and

"(B) provide information to the Municipal Securities Rulemaking Board about the enforcement actions and examinations of the association under section 15B(b)(2)(E), so that the Municipal Securities Rulemaking Board may—

"(i) assist in such enforcement actions and examinations; and

"(ii) evaluate the ongoing effectiveness of the rules of the Board.".

(g) REGISTRATION AND REGULATION OF BROKERS AND DEALERS.—Section 15 of the Securities Exchange Act of 1934 is amended—

(1) in subsection (b)(4), by inserting "municipal advisor," after "municipal securities dealer" each place that term appears; and

(2) in subsection (c), by inserting "broker, dealer, or" before "municipal securities dealer" each place that term appears.

(h) ACCOUNTS AND RECORDS, REPORTS, EXAMINATIONS OF EXCHANGES, MEMBERS, AND OTHERS.—Section 17(a)(1) of the Securities Exchange Act of 1934 is amended by inserting "municipal advisor," after "municipal securities dealer".

(i) EFFECTIVE DATE.—This section, and the amendments made by this section, shall take effect on October 1, 2010.

SEC. 976. GOVERNMENT ACCOUNTABILITY OFFICE STUDY OF INCREASED DISCLOSURE TO INVESTORS.

(a) STUDY.—The Comptroller General of the United States shall conduct a study and review of the disclosure required to be made by issuers of municipal securities.

(b) SUBJECTS FOR EVALUATION.—In conducting the study under subsection (a), the Comptroller General of the United States shall—

(1) broadly describe—

(A) the size of the municipal securities markets and the issuers and investors; and

(B) the disclosures provided by issuers to investors;

(2) compare the amount, frequency, and quality of disclosures that issuers of municipal securities are required by law to provide for the benefit of municipal securities holders, including the amount of and frequency of disclosures actually

provided by issuers of municipal securities, with the amount of and frequency of disclosures that issuers of corporate securities provide for the benefit of corporate securities holders, taking into account the differences between issuers of municipal securities and issuers of corporate securities;

(3) evaluate the costs and benefits to various types of issuers of municipal securities of requiring issuers of municipal bonds to provide additional financial disclosures for the benefit of investors;

(4) evaluate the potential benefit to investors from additional financial disclosures by issuers of municipal bonds; and

(5) make recommendations relating to disclosure requirements for municipal issuers, including the advisability of the repeal or retention of section 15B(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4(d)) (commonly known as the "Tower Amendment").

(c) REPORT.—Not later than 24 months after the date of enactment of this Act, the Comptroller General of the United States shall submit a report to Congress on the results of the study conducted under subsection (a), including recommendations for how to improve disclosure by issuers of municipal securities.

SEC. 977. GOVERNMENT ACCOUNTABILITY OFFICE STUDY ON THE MUNICIPAL SECURITIES MARKETS.

(a) STUDY.—The Comptroller General of the United States shall conduct a study of the municipal securities markets.

(b) REPORT.—Not later than 18 months after the date of enactment of this Act, the Comptroller General of the United States shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, with copies to the Special Committee on Aging of the Senate and the Commission, on the results of the study conducted under subsection (a), including—

(1) an analysis of the mechanisms for trading, quality of trade executions, market transparency, trade reporting, price discovery, settlement clearing, and credit enhancements;

(2) the needs of the markets and investors and the impact of recent innovations;

(3) recommendations for how to improve the transparency, efficiency, fairness, and liquidity of trading in the municipal securities markets, including with reference to items listed in paragraph (1); and

(4) potential uses of derivatives in the municipal securities markets.

(c) RESPONSES.—Not later than 180 days after receipt of the report required under subsection (b), the Commission shall submit a response to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, with a copy to the Special Committee on Aging of the Senate, stating the actions the Commission has taken in response to the recommendations contained in such report.

SEC. 978. FUNDING FOR GOVERNMENTAL ACCOUNTING STANDARDS BOARD.

(a) AMENDMENT TO THE SECURITIES ACT OF 1933.—Section 19 of the Securities Act of 1933 (15 U.S.C. 77s), as amended by section 912, is further amended by adding at the end the following:

"(g) FUNDING FOR THE GASB.—

"(1) IN GENERAL.—The Commission may, subject to the limitations imposed by section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o–4), require a national securities association registered under the Securities Exchange Act of 1934 to establish—

"(A) a reasonable annual accounting support fee to adequately fund the annual budget of the Governmental Accounting Standards Board (referred to in this subsection as the 'GASB'); and

"(B) rules and procedures, in consultation with the principal organizations representing State governors, legislators, local elected officials, and State and local finance officers, to provide for the equitable allocation, assessment, and collection of the accounting support fee established under subparagraph (A) from the members of the association, and the remittance of all such accounting support fees to the Financial Accounting Foundation.

"(2) ANNUAL BUDGET.—For purposes of this subsection, the annual budget of the GASB is the annual budget reviewed and approved according to the internal procedures of the Financial Accounting Foundation.

"(3) USE OF FUNDS.—Any fees or funds collected under this subsection shall be used to support the efforts of the GASB to establish standards of financial accounting and reporting recognized as generally accepted accounting principles applicable to State and local governments of the United States.

"(4) LIMITATION ON FEE.—The annual accounting support fees collected under this subsection for a fiscal year shall not exceed the recoverable annual budgeted expenses of the GASB (which may include operating expenses, capital, and accrued items).

"(5) RULES OF CONSTRUCTION.—

"(A) FEES NOT PUBLIC MONIES.—Accounting support fees collected under this subsection and other receipts of the GASB shall not be considered public monies of the United States.

"(B) LIMITATION ON AUTHORITY OF THE COMMISSION.—Nothing in this subsection shall be construed to—

"(i) provide the Commission or any national securities association direct or indirect oversight of the budget or technical agenda of the GASB; or

"(ii) affect the setting of generally accepted accounting principles by the GASB.

"(C) NONINTERFERENCE WITH STATES.—Nothing in this subsection shall be construed to impair or limit the authority of a State or local government to establish accounting and financial reporting standards.".

(b) STUDY OF FUNDING FOR GOVERNMENTAL ACCOUNTING STANDARDS BOARD.—

(1) STUDY.—The Comptroller General of the United States shall conduct a study that evaluates—

(A) the role and importance of the Governmental Accounting Standards Board in the municipal securities markets; and

(B) the manner and the level at which the Governmental Accounting Standards Board has been funded.

(2) CONSULTATION.—In conducting the study required under paragraph (1), the Comptroller General shall consult with the principal organizations representing State governors, legislators, local elected officials, and State and local finance officers.

(3) REPORT.—Not later than 180 days after the date of enactment of this Act, the Comptroller General shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the study required under paragraph (1).

SEC. 979. COMMISSION OFFICE OF MUNICIPAL SECURITIES.

(a) IN GENERAL.—There shall be in the Commission an Office of Municipal Securities, which shall—

(1) administer the rules of the Commission with respect to the practices of municipal securities brokers and dealers, municipal securities advisors, municipal securities investors, and municipal securities issuers; and

(2) coordinate with the Municipal Securities Rulemaking Board for rulemaking and enforcement actions as required by law.

(b) DIRECTOR OF THE OFFICE.—The head of the Office of Municipal Securities shall be the Director, who shall report to the Chairman.

(c) STAFFING.—

(1) IN GENERAL.—The Office of Municipal Securities shall be staffed sufficiently to carry out the requirements of this section.

(2) REQUIREMENT.—The staff of the Office of Municipal Securities shall include individuals with knowledge of and expertise in municipal finance.

Subtitle I—Public Company Accounting Oversight Board, Portfolio Margining, and Other Matters

SEC. 981. AUTHORITY TO SHARE CERTAIN INFORMATION WITH FOREIGN AUTHORITIES.

(a) DEFINITION.—Section 2(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201(a)) is amended by adding at the end the following:

"(17) FOREIGN AUDITOR OVERSIGHT AUTHORITY.—The term 'foreign auditor oversight authority' means any governmental body or other entity empowered by a foreign government to conduct inspections of public accounting firms or otherwise to administer or enforce laws related to the regulation of public accounting firms.".

(b) AVAILABILITY TO SHARE INFORMATION.—Section 105(b)(5) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7215(b)(5)) is amended by adding at the end the following:

"(C) AVAILABILITY TO FOREIGN OVERSIGHT AUTHORITIES.—Without the loss of its status as confidential and privileged in the hands of the Board, all information referred to in subparagraph (A) that relates to a public accounting firm that a foreign government has empowered a foreign auditor oversight authority to inspect or otherwise enforce laws with respect to, may, at the discretion of the Board, be made available to the foreign auditor oversight authority, if—

"(i) the Board finds that it is necessary to accomplish the purposes of this Act or to protect investors;

"(ii) the foreign auditor oversight authority provides—

"(I) such assurances of confidentiality as the Board may request;

"(II) a description of the applicable information systems and controls of the foreign auditor oversight authority; and

"(III) a description of the laws and regulations of the foreign government of the foreign auditor oversight authority that are relevant to information access; and

"(iii) the Board determines that it is appropriate to share such information.".

(c) CONFORMING AMENDMENT.—Section 105(b)(5)(A) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7215(b)(5)(A)) is amended by striking "subparagraph (B)" and inserting "subparagraphs (B) and (C)".

SEC. 982. OVERSIGHT OF BROKERS AND DEALERS.

(a) DEFINITIONS.—

(1) DEFINITIONS AMENDED.—Title I of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.) is amended by adding at the end the following new section:

"SEC. 110. DEFINITIONS.

"For the purposes of this title, the following definitions shall apply:

"(1) AUDIT.—The term 'audit' means an examination of the financial statements, reports, documents, procedures, controls, or notices of any issuer, broker, or dealer by an independent public accounting firm in accordance with the rules of the Board or the Commission, for the purpose of expressing an opinion on the financial statements or providing an audit report.

"(2) AUDIT REPORT.—The term 'audit report' means a document, report, notice, or other record—

"(A) prepared following an audit performed for purposes of compliance by an issuer, broker, or dealer with the requirements of the securities laws; and

"(B) in which a public accounting firm either—

"(i) sets forth the opinion of that firm regarding a financial statement, report, notice, or other document, procedures, or controls; or

"(ii) asserts that no such opinion can be expressed.

"(3) BROKER.—The term 'broker' means a broker (as such term is defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4))) that is required to file a balance sheet, income statement, or other financial statement under section 17(e)(1)(A) of such Act (15 U.S.C. 78q(e)(1)(A)), where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

"(4) DEALER.—The term 'dealer' means a dealer (as such term is defined in section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(5))) that is required to file a balance sheet, income statement, or other financial statement under section 17(e)(1)(A) of such Act (15 U.S.C. 78q(e)(1)(A)), where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

"(5) PROFESSIONAL STANDARDS.—The term 'professional standards' means—

"(A) accounting principles that are—

"(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by this Act, or prescribed by the Commission under section 19(a) of that Act (15 U.S.C. 17a(s)) or section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78a(m)); and

"(ii) relevant to audit reports for particular issuers, brokers, or dealers, or dealt with in the quality control system of a particular registered public accounting firm; and

"(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing title II) that the Board or the Commission determines—

"(i) relate to the preparation or issuance of audit reports for issuers, brokers, or dealers; and

"(ii) are established or adopted by the Board under section 103(a), or are promulgated as rules of the Commission.

"(6) SELF-REGULATORY ORGANIZATION.—The term 'self-regulatory organization' has the same meaning as in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).".

(2) CONFORMING AMENDMENT.—Section 2(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201(a)) is amended in the matter preceding paragraph (1), by striking "In this" and inserting "Except as otherwise specifically provided in this Act, in this".

(b) ESTABLISHMENT AND ADMINISTRATION OF THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD.—Section 101 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7211) is amended—

(1) by striking "issuers" each place that term appears and inserting "issuers, brokers, and dealers"; and

(2) in subsection (a)—

(A) by striking "public companies" and inserting "companies"; and

(B) by striking "for companies the securities of which are sold to, and held by and for, public investors".

(c) REGISTRATION WITH THE BOARD.—Section 102 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7212) is amended—

(1) in subsection (a)—

(A) by striking "Beginning 180" and all that follows through "101(d), it" and inserting "It"; and

(B) by striking "issuer" and inserting "issuer, broker, or dealer";

(2) in subsection (b)—

(A) in paragraph (2)(A), by striking "issuers" and inserting "issuers, brokers, and dealers"; and

(B) by striking "issuer" each place that term appears and inserting "issuer, broker, or dealer".

(d) AUDITING AND INDEPENDENCE.—Section 103(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7213(a)) is amended—

(1) in paragraph (1), by striking "and such ethics standards" and inserting "such ethics standards, and such independence standards";

(2) in paragraph (2)(A)(iii), by striking "describe in each audit report" and inserting "in each audit report for an issuer, describe"; and

(3) in paragraph (2)(B)(i), by striking "issuers" and inserting "issuers, brokers, and dealers".

(e) INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS.—

(1) AMENDMENTS.—Section 104(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7214(a)) is amended—

(A) by striking "The Board shall" and inserting the following:

"(1) INSPECTIONS GENERALLY.—The Board shall"; and

(B) by adding at the end the following:

"(2) INSPECTIONS OF AUDIT REPORTS FOR BROKERS AND DEALERS.—

"(A) The Board may, by rule, conduct and require a program of inspection in accordance with paragraph (1), on a basis to be determined by the Board, of registered public accounting firms that provide one or more audit reports for a broker or dealer. The Board, in establishing such a program, may allow for differentiation among classes of brokers and dealers, as appropriate.

"(B) If the Board determines to establish a program of inspection pursuant to subparagraph (A), the Board shall consider in establishing any inspection schedules whether differing schedules would be appropriate with respect to registered public accounting firms that issue audit reports only for one or more brokers or dealers that do not receive, handle, or hold customer securities or cash or are not a member of the Securities Investor Protection Corporation.

"(C) Any rules of the Board pursuant to this paragraph shall be subject to prior approval by the Commission pursuant to section 107(b) before the rules become effective, including an opportunity for public notice and comment.

"(D) Notwithstanding anything to the contrary in section 102 of this Act, a public accounting firm shall not be required to register with the Board if the public accounting firm is exempt from the inspection program which may be established by the Board under subparagraph (A).".

(2) CONFORMING AMENDMENT.—Section 17(e)(1)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(e)(1)(A)) is amended by striking "registered public accounting firm" and inserting "independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002,".

(f) INVESTIGATIONS AND DISCIPLINARY PROCEEDINGS.—Section 105(c)(7)(B) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7215(c)(7)(B)) is amended—

(1) in the subparagraph heading, by inserting ", BROKER, OR DEALER" after "ISSUER";

(2) by striking "any issuer" each place that term appears and inserting "any issuer, broker, or dealer"; and

(3) by striking "an issuer under this subsection" and inserting "a registered public accounting firm under this subsection".

(g) FOREIGN PUBLIC ACCOUNTING FIRMS.—Section 106(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7216(a)) is amended—

(1) in paragraph (1), by striking "issuer" and inserting "issuer, broker, or dealer"; and

(2) in paragraph (2), by striking "issuers" and inserting "issuers, brokers, or dealers".

(h) FUNDING.—Section 109 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7219) is amended—

(1) in subsection (c)(2), by striking "subsection (i)" and inserting "subsection (j)";

(2) in subsection (d)—

(A) in paragraph (2), by striking "allowing for differentiation among classes of issuers, as appropriate" and inserting "and among brokers and dealers, in accordance with subsection (h), and allowing for differentiation among classes of issuers, brokers and dealers, as appropriate"; and

(B) by adding at the end the following:

"(3) BROKERS AND DEALERS.—The Board shall begin the allocation, assessment, and collection of fees under paragraph (2) with respect to brokers and dealers with the payment of support fees to fund the first full fiscal year beginning after the date of enactment of the Investor Protection and Securities Reform Act of 2010.";

(3) by redesignating subsections (h), (i), and (j) as subsections (i), (j), and (k), respectively; and

(4) by inserting after subsection (g) the following:

"(h) ALLOCATION OF ACCOUNTING SUPPORT FEES AMONG BROKERS AND DEALERS.—

"(1) OBLIGATION TO PAY.—Each broker or dealer shall pay to the Board the annual accounting support fee allocated to such broker or dealer under this section.

"(2) ALLOCATION.—Any amount due from a broker or dealer (or from a particular class of brokers and dealers) under this section shall be allocated among brokers and dealers and payable by the broker or dealer (or the brokers and dealers in the particular class, as applicable).

"(3) PROPORTIONALITY.—The amount due from a broker or dealer shall be in proportion to the net capital of the broker or dealer (before or after any adjustments), compared to the total net capital of all brokers and dealers (before or after any adjustments), in accordance with rules issued by the Board.".

(i) REFERRAL OF INVESTIGATIONS TO A SELF-REGULATORY ORGANIZATION.—Section 105(b)(4)(B) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7215(b)(4)(B)) is amended—

(1) by redesignating clauses (ii) and (iii) as clauses (iii) and (iv), respectively; and

(2) by inserting after clause (i) the following:

"(ii) to a self-regulatory organization, in the case of an investigation that concerns an audit report for a broker or dealer that is under the jurisdiction of such self-regulatory organization;".

(j) USE OF DOCUMENTS RELATED TO AN INSPECTION OR INVESTIGATION.—Section 105(b)(5)(B)(ii) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7215(b)(5)(B)(ii)) is amended—

(1) in subclause (III), by striking "and" at the end;

(2) in subclause (IV), by striking the comma and inserting "; and"; and

(3) by inserting after subclause (IV) the following:

"(V) a self-regulatory organization, with respect to an audit report for a broker or dealer that is under the jurisdiction of such self-regulatory organization,".

SEC. 983. PORTFOLIO MARGINING.

(a) ADVANCES.—Section 9(a)(1) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78fff3(a)(1)) is amended by inserting "or options on commodity futures contracts" after "claim for securities".

(b) DEFINITIONS.—Section 16 of the Securities Investor Protection Act of 1970 (15 U.S.C. 78lll) is amended—

(1) by striking paragraph (2) and inserting the following:

"(2) CUSTOMER.—

"(A) IN GENERAL.—The term 'customer' of a debtor means any person (including any person with whom the debtor deals as principal or agent) who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral, security, or for purposes of effecting transfer.

"(B) INCLUDED PERSONS.—The term 'customer' includes—

"(i) any person who has deposited cash with the debtor for the purpose of purchasing securities;

"(ii) any person who has a claim against the debtor for cash, securities, futures contracts, or options on futures contracts received, acquired, or held in a portfolio margining account carried as a securities account pursuant to a portfolio margining program approved by the Commission; and

"(iii) any person who has a claim against the debtor arising out of sales or conversions of such securities.

"(C) EXCLUDED PERSONS.—The term 'customer' does not include any person, to the extent that—

"(i) the claim of such person arises out of transactions with a foreign subsidiary of a member of SIPC; or

"(ii) such person has a claim for cash or securities which by contract, agreement, or understanding, or by operation of law, is part of the capital of the debtor, or is subordinated to the claims of any or all creditors of the debtor, notwithstanding that some ground exists for declaring such contract, agreement, or understanding void or voidable in a suit between the claimant and the debtor.";

(2) in paragraph (4)—

(A) in subparagraph (C), by striking "and" at the end;

(B) by redesignating subparagraph (D) as subparagraph (E); and

(C) by inserting after subparagraph (C) the following:

"(D) in the case of a portfolio margining account of a customer that is carried as a securities account pursuant to a portfolio margining program approved by the Commission, a futures contract or an option on a futures contract received, acquired, or held by or for the account of a debtor from or for such portfolio margining account, and the proceeds thereof; and";

(3) in paragraph (9), in the matter following subparagraph (L), by inserting after "Such term" the following: "includes revenues earned by a broker or dealer in connection with a transaction in the portfolio margining account of a customer carried as securities accounts pursuant to a portfolio margining program approved by the Commission. Such term"; and

(4) in paragraph (11)—

(A) in subparagraph (A)—

(i) by striking "filing date, all" and all that follows through the end of the subparagraph and inserting the following: "filing date—

"(i) all securities positions of such customer (other than customer name securities reclaimed by such customer); and

"(ii) all positions in futures contracts and options on futures contracts held in a portfolio margining account carried as a securities account pursuant to a portfolio margining program approved by the Commission, including all property collateralizing such positions, to the extent that such property is not otherwise included herein; minus"; and

(B) in the matter following subparagraph (C), by striking "In determining" and inserting the following: "A claim for a commodity futures contract received, acquired, or held in a portfolio margining account pursuant to a portfolio margining program approved by the Commission or a claim for a security futures contract, shall be deemed to be a claim with respect to such contract as of the filing date, and such claim shall be treated as a claim for cash. In determining".

SEC. 984. LOAN OR BORROWING OF SECURITIES.

(a) RULEMAKING AUTHORITY.—Section 10 of the Securities Exchange Act of 1934 (15 U.S.C. 78j) is amended by adding at the end the following:

"(c)(1) To effect, accept, or facilitate a transaction involving the loan or borrowing of securities in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

"(2) Nothing in paragraph (1) may be construed to limit the authority of the appropriate Federal banking agency (as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), the National Credit Union Administration, or any other Federal department or agency having a responsibility under Federal law to prescribe rules or regulations restricting transactions involving the loan or borrowing of securities in order to protect the safety and soundness of a financial institution or to protect the financial system from systemic risk.''.

(b) RULEMAKING REQUIRED.—Not later than 2 years after the date of enactment of this Act, the Commission shall promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan or borrowing of securities.

SEC. 985. TECHNICAL CORRECTIONS TO FEDERAL SECURITIES LAWS.

(a) SECURITIES ACT OF 1933.—The Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended—

(1) in section 3(a)(4) (15 U.S.C. 77c(a)(4)), by striking "individual;" and inserting "individual,";

(2) in section 18 (15 U.S.C. 77r)—

(A) in subsection (b)(1)(C), by striking "is a security" and inserting "a security"; and

(B) in subsection (c)(2)(B)(i), by striking "State, or" and inserting "State or";

(3) in section 19(d)(6)(A) (15 U.S.C. 77s(d)(6)(A)), by striking "in paragraph (1) of (3)" and inserting "in paragraph (1) or (3)"; and

(4) in section 27A(c)(1)(B)(ii) (15 U.S.C. 77z–2(c)(1)(B)(ii)), by striking "business entity;" and inserting "business entity,".

(b) SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 2 (15 U.S.C. 78b), by striking "affected" and inserting "effected";

(2) in section 3 (15 U.S.C. 78c)—

(A) in subsection (a)(55)(A), by striking "section 3(a)(12) of the Securities Exchange Act of 1934" and inserting "section 3(a)(12) of this title"; and

(B) in subsection (g), by striking "company, account person, or entity" and inserting "company, account, person, or entity";

(3) in section 10A(i)(1)(B) (15 U.S.C. 78j–1(i)(1)(B))—

(A) in the subparagraph heading, by striking "MINIMUS" and inserting "MINIMIS"; and

(B) in clause (i), by striking "nonaudit" and inserting "non-audit";

(4) in section 13(b)(1) (15 U.S.C. 78m(b)(1)), by striking "earning statement" and inserting "earnings statement";

(5) in section 15 (15 U.S.C. 78o)—

(A) in subsection (b)(1)—

(i) in subparagraph (B), by striking "The order granting" and all that follows through "from such membership."; and

(ii) in the undesignated matter immediately following subparagraph (B), by inserting after the first sentence the following: "The order granting registration shall not be effective until such broker or dealer has become a member of a registered securities association, or until such broker or dealer has become a member of a national securities exchange, if such broker or dealer effects transactions solely on that exchange, unless the Commission has exempted such broker or dealer, by rule or order, from such membership.";

(6) in section 15C(a)(2) (15 U.S.C. 78o–5(a)(2))—

(A) by redesignating clauses (i) and (ii) as subparagraphs (A) and (B), respectively, and adjusting the subparagraph margins accordingly;

(B) in subparagraph (B), as so redesignated, by striking "The order granting" and all that follows through "from such membership."; and

(C) in the matter following subparagraph (B), as so redesignated, by inserting after the first sentence the following: "The order granting registration shall not be effective until such government securities broker or government securities dealer has become a member of a national securities exchange registered under section 6 of this title, or a securities association registered under section 15A of this title, unless the Commission has exempted such government securities broker or government securities dealer, by rule or order, from such membership.";

(7) in section 17(b)(1)(B) (15 U.S.C. 78q(b)(1)(B)), by striking "15A(k) gives" and inserting "15A(k), give"; and

(8) in section 21C(c)(2) (15 U.S.C. 78u–3(c)(2)), by striking "paragraph (1) subsection" and inserting "Paragraph (1)".

(c) TRUST INDENTURE ACT OF 1939.—The Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.) is amended—

(1) in section 304(b) (15 U.S.C. 77ddd(b)), by striking "section 2 of such Act" and inserting "section 2(a) of such Act"; and

(2) in section 317(a)(1) (15 U.S.C. 77qqq(a)(1)), by striking ", in the" and inserting "in the".

(d) INVESTMENT COMPANY ACT OF 1940.—The Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.) is amended—

(1) in section 2(a)(19) (15 U.S.C. 80a–2(a)(19)), in the matter following subparagraph (B)(vii)—

(A) by striking "clause (vi)" each place that term appears and inserting "clause (vii)"; and

(B) in each of subparagraphs (A)(vi) and (B)(vi), by adding "and" at the end of subclause (III);

(2) in section 9(b)(4)(B) (15 U.S.C. 80a–9(b)(4)(B)), by adding "or" after the semicolon at the end;

(3) in section 12(d)(1)(J) (15 U.S.C. 80a–12(d)(1)(J)), by striking "any provision of this subsection" and inserting "any provision of this paragraph";

(4) in section 17(f) (15 U.S.C. 80a–17(f))—

(A) in paragraph (4), by striking "No such member" and inserting "No member of a national securities exchange"; and

(B) in paragraph (6), by striking "company may serve" and inserting "company, may serve"; and

(5) in section 61(a)(3)(B)(iii) (15 U.S.C. 80a–60(a)(3)(B)(iii))—

(A) by striking "paragraph (1) of section 205" and inserting "section 205(a)(1)"; and

(B) by striking "clause (A) or (B) of that section" and inserting "paragraph (1) or (2) of section 205(b)".

(e) INVESTMENT ADVISERS ACT OF 1940.—The Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.) is amended—

(1) in section 203 (15 U.S.C. 80b–3)—

(A) in subsection (c)(1)(A), by striking "principal business office and" and inserting "principal office, principal place of business, and"; and

(B) in subsection (k)(4)(B), in the matter following clause (ii), by striking "principal place of business" and inserting "principal office or place of business";

(2) in section 206(3) (15 U.S.C. 80b–6(3)), by adding "or" after the semicolon at the end;

(3) in section 213(a) (15 U.S.C. 80b–13(a)), by striking "principal place of business" and inserting "principal office or place of business"; and

(4) in section 222 (15 U.S.C. 80b–18a), by striking "principal place of business" each place that term appears and inserting "principal office and place of business".

SEC. 986. CONFORMING AMENDMENTS RELATING TO REPEAL OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935.

(a) SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78 et seq.) is amended—

(1) in section 3(a)(47) (15 U.S.C. 78c(a)(47)), by striking "the Public Utility Holding Company Act of 1935 (15 U.S.C. 79a et seq.),";

(2) in section 12(k) (15 U.S.C. 78l(k)), by amending paragraph (7) to read as follows:

"(7) DEFINITION.—For purposes of this subsection, the term 'emergency' means—

"(A) a major market disturbance characterized by or constituting—

"(i) sudden and excessive fluctuations of securities prices generally, or a substantial threat thereof, that threaten fair and orderly markets; or

"(ii) a substantial disruption of the safe or efficient operation of the national system for clearance and settlement of transactions in securities, or a substantial threat thereof; or

"(B) a major disturbance that substantially disrupts, or threatens to substantially disrupt—

"(i) the functioning of securities markets, investment companies, or any other significant portion or segment of the securities markets; or

"(ii) the transmission or processing of securities transactions."; and

(3) in section 21(h)(2) (15 U.S.C. 78u(h)(2)), by striking "section 18(c) of the Public Utility Holding Company Act of 1935,".

(b) TRUST INDENTURE ACT OF 1939.—The Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.) is amended—

(1) in section 303 (15 U.S.C. 77ccc), by striking paragraph (17) and inserting the following:

"(17) The terms 'Securities Act of 1933' and 'Securities Exchange Act of 1934' shall be deemed to refer, respectively, to such Acts, as amended, whether amended prior to or after the enactment of this title.";

(2) in section 308 (15 U.S.C. 77hhh), by striking "Securities Act of 1933, the Securities Exchange Act of 1934, or the Public Utility Holding Company Act of 1935" each place that term appears and inserting "Securities Act of 1933 or the Securities Exchange Act of 1934";

(3) in section 310 (15 U.S.C. 77jjj), by striking subsection (c);

(4) in section 311 (15 U.S.C. 77kkk), by striking subsection (c);

(5) in section 323(b) (15 U.S.C. 77www(b)), by striking "Securities Act of 1933, or the Securities Exchange Act of 1934, or the Public Utility Holding Company Act of 1935" and inserting "Securities Act of 1933 or the Securities Exchange Act of 1934"; and

(6) in section 326 (15 U.S.C. 77zzz), by striking "Securities Act of 1933, or the Securities Exchange Act of 1934, or the Public Utility Holding Company Act of 1935," and inserting "Securities Act of 1933 or the Securities Exchange Act of 1934".

(c) INVESTMENT COMPANY ACT OF 1940.—The Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.) is amended—

(1) in section 2(a)(44) (15 U.S.C. 80a–2(a)(44)), by striking " 'Public Utility Holding Company Act of 1935',";

(2) in section 3(c) (15 U.S.C. 80a–3(c)), by striking paragraph (8) and inserting the following:

"(8) [Repealed]";

(3) in section 38(b) (15 U.S.C. 80a–37(b)), by striking "the Public Utility Holding Company Act of 1935,"; and

(4) in section 50 (15 U.S.C. 80a–49), by striking "the Public Utility Holding Company Act of 1935,".

(d) INVESTMENT ADVISERS ACT OF 1940.—Section 202(a)(21) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(21)) is amended by striking " 'Public Utility Holding Company Act of 1935',".

SEC. 987. AMENDMENT TO DEFINITION OF MATERIAL LOSS AND NON-MATERIAL LOSSES TO THE DEPOSIT INSURANCE FUND FOR PURPOSES OF INSPECTOR GENERAL REVIEWS.

(a) IN GENERAL.—Section 38(k) of the Federal Deposit Insurance Act (U.S.C. 1831o(k)) is amended—

(1) in paragraph (2), by striking subparagraph (B) and inserting the following:

"(B) MATERIAL LOSS DEFINED.—The term 'material loss' means any estimated loss in excess of—

"(i) $200,000,000, if the loss occurs during the period beginning on January 1, 2010, and ending on December 31, 2011;

"(ii) $150,000,000, if the loss occurs during the period beginning on January 1, 2012, and ending on December 31, 2013; and

"(iii) $50,000,000, if the loss occurs on or after January 1, 2014, provided that if the inspector general of a Federal banking agency certifies to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives that the number of projected failures of depository institutions that would require material loss reviews for the following 12 months will be greater than 30 and would hinder the effectiveness of its oversight functions, then the definition of 'material loss' shall be $75,000,000 for a duration of 1 year from the date of the certification.";

(2) in paragraph (4)(A) by striking "the report" and inserting "any report on losses required under this subsection,";

(3) by striking paragraph (6);

(4) by redesignating paragraph (5) as paragraph (6); and

(5) by inserting after paragraph (4) the following:

"(5) LOSSES THAT ARE NOT MATERIAL.—

"(A) SEMIANNUAL REPORT.—For the 6-month period ending on March 31, 2010, and each 6-month period thereafter, the Inspector General of each Federal banking agency shall—

"(i) identify losses that the Inspector General estimates have been incurred by the Deposit Insurance Fund during that 6-month period, with respect to the insured depository institutions supervised by the Federal banking agency;

"(ii) for each loss incurred by the Deposit Insurance Fund that is not a material loss, determine—

"(I) the grounds identified by the Federal banking agency or State bank supervisor for appointing the Corporation as receiver under section 11(c)(5); and

"(II) whether any unusual circumstances exist that might warrant an in-depth review of the loss; and

"(iii) prepare and submit a written report to the appropriate Federal banking agency and to Congress on the results of any determination by the Inspector General, including—

"(I) an identification of any loss that warrants an in-depth review, together with the reasons why such review is warranted, or, if the Inspector General determines that no review is warranted, an explanation of such determination; and

"(II) for each loss identified under subclause (I) that warrants an in-depth review, the date by which such review, and a report on such review prepared in a manner consistent with reports under paragraph (1)(A), will be completed and submitted to the Federal banking agency and Congress.

"(B) DEADLINE FOR SEMIANNUAL REPORT.—The Inspector General of each Federal banking agency shall—

"(i) submit each report required under paragraph (A) expeditiously, and not later than 90 days after the end of the 6-month period covered by the report; and

"(ii) provide a copy of the report required under paragraph (A) to any Member of Congress, upon request.".

(b) TECHNICAL AND CONFORMING AMENDMENT.—The heading for subsection (k) of section 38 of the Federal Deposit Insurance Act (U.S.C. 1831o(k)) is amended to read as follows:

"(k) REVIEWS REQUIRED WHEN DEPOSIT INSURANCE FUND INCURS LOSSES.—".

SEC. 988. AMENDMENT TO DEFINITION OF MATERIAL LOSS AND NON-MATERIAL LOSSES TO THE NATIONAL CREDIT UNION SHARE INSURANCE FUND FOR PURPOSES OF INSPECTOR GENERAL REVIEWS.

(a) IN GENERAL.—Section 216(j) of the Federal Credit Union Act (12 U.S.C. 1790d(j)) is amended to read as follows:

"(j) REVIEWS REQUIRED WHEN SHARE INSURANCE FUND EXPERIENCES LOSSES.—

"(1) IN GENERAL.—If the Fund incurs a material loss with respect to an insured credit union, the Inspector General of the Board shall—

"(A) submit to the Board a written report reviewing the supervision of the credit union by the Administration (including the implementation of this section by the Administration), which shall include—

"(i) a description of the reasons why the problems of the credit union resulted in a material loss to the Fund; and

"(ii) recommendations for preventing any such loss in the future; and

"(B) submit a copy of the report under subparagraph (A) to—

"(i) the Comptroller General of the United States;

"(ii) the Corporation;

"(iii) in the case of a report relating to a State credit union, the appropriate State supervisor; and

"(iv) to any Member of Congress, upon request.

"(2) MATERIAL LOSS DEFINED.—For purposes of determining whether the Fund has incurred a material loss with respect to an insured credit union, a loss is material if it exceeds the sum of—

"(A) $25,000,000; and

"(B) an amount equal to 10 percent of the total assets of the credit union on the date on which the Board initiated assistance under section 208 or was appointed liquidating agent.

"(3) PUBLIC DISCLOSURE REQUIRED.—

"(A) IN GENERAL.—The Board shall disclose a report under this subsection, upon request under section 552 of title 5, United States Code, without excising—

"(i) any portion under section 552(b)(5) of title 5, United States Code; or

"(ii) any information about the insured credit union (other than trade secrets) under section 552(b)(8) of title 5, United States Code.

"(B) RULE OF CONSTRUCTION.—Subparagraph (A) may not be construed as requiring the agency to disclose the name of any customer of the insured credit union (other than an institution-affiliated party), or information from which the identity of such customer could reasonably be ascertained.

"(4) LOSSES THAT ARE NOT MATERIAL.—

"(A) SEMIANNUAL REPORT.—For the 6-month period ending on March 31, 2010, and each 6-month period thereafter, the Inspector General of the Board shall—

"(i) identify any losses that the Inspector General estimates were incurred by the Fund during such 6-month period, with respect to insured credit unions;

"(ii) for each loss to the Fund that is not a material loss, determine—

"(I) the grounds identified by the Board or the State official having jurisdiction over a State credit union for appointing the Board as the liquidating agent for any Federal or State credit union; and

"(II) whether any unusual circumstances exist that might warrant an in-depth review of the loss; and

"(iii) prepare and submit a written report to the Board and to Congress on the results of the determinations of the Inspector General that includes—

"(I) an identification of any loss that warrants an in-depth review, and the reasons such review is warranted, or if the Inspector General determines that no review is warranted, an explanation of such determination; and

"(II) for each loss identified in subclause (I) that warrants an in-depth review, the date by which such review, and a report on the review prepared in a manner consistent with reports under paragraph (1)(A), will be completed.

"(B) DEADLINE FOR SEMIANNUAL REPORT.—The Inspector General of the Board shall—

"(i) submit each report required under subparagraph (A) expeditiously, and not later than 90 days after the end of the 6-month period covered by the report; and

"(ii) provide a copy of the report required under subparagraph (A) to any Member of Congress, upon request.

"(5) GAO REVIEW.—The Comptroller General of the United States shall, under such conditions as the Comptroller General determines to be appropriate—

"(A) review each report made under paragraph (1), including the extent to which the Inspector General of the Board complied with the requirements under section 8L of the Inspector General Act of 1978 (5 U.S.C. App.) with respect to each such report; and

"(B) recommend improvements to the supervision of insured credit unions (including improvements relating to the implementation of this section).".

SEC. 989. GOVERNMENT ACCOUNTABILITY OFFICE STUDY ON PROPRIETARY TRADING.

(a) DEFINITIONS.—In this section—

(1) the term "covered entity" means—

(A) an insured depository institution, an affiliate of an insured depository institution, a bank holding company, a financial holding company, or a subsidiary of a bank holding company or a financial holding company, as those terms are defined in the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.); and

(B) any other entity, as the Comptroller General of the United States may determine; and

(2) the term "proprietary trading" means the act of a covered entity investing as a principal in securities, commodities, derivatives, hedge funds, private equity firms, or such other financial products or entities as the Comptroller General may determine.

(b) STUDY.—

(1) IN GENERAL.—The Comptroller General of the United States shall conduct a study regarding the risks and conflicts associated with proprietary trading by and within covered entities, including an evaluation of—

(A) whether proprietary trading presents a material systemic risk to the stability of the United States financial system, and if so, the costs and benefits of options for mitigating such systemic risk;

(B) whether proprietary trading presents material risks to the safety and soundness of the covered entities that engage in such activities, and if so, the costs and benefits of options for mitigating such risks;

(C) whether proprietary trading presents material conflicts of interest between covered entities that engage in proprietary trading and the clients of the institutions who use the firm to execute trades or who rely on the firm to manage assets, and if so, the costs and benefits of options for mitigating such conflicts of interest;

(D) whether adequate disclosure regarding the risks and conflicts of proprietary trading is provided to the depositors, trading and asset management clients, and investors of covered entities that engage in proprietary trading, and if not, the costs and benefits of options for the improvement of such disclosure; and

(E) whether the banking, securities, and commodities regulators of institutions that engage in proprietary trading have in place adequate systems and controls to monitor and contain any risks and conflicts of interest related to proprietary trading, and if not, the costs and benefits of options for the improvement of such systems and controls.

(2) CONSIDERATIONS.—In carrying out the study required under paragraph (1), the Comptroller General shall consider—

(A) current practice relating to proprietary trading;

(B) the advisability of a complete ban on proprietary trading;

(C) limitations on the scope of activities that covered entities may engage in with respect to proprietary trading;

(D) the advisability of additional capital requirements for covered entities that engage in proprietary trading;

(E) enhanced restrictions on transactions between affiliates related to proprietary trading;

(F) enhanced accounting disclosures relating to proprietary trading;

(G) enhanced public disclosure relating to proprietary trading; and

(H) any other options the Comptroller General deems appropriate.

(c) REPORT TO CONGRESS.—Not later than 15 months after the date of enactment of this Act, the Comptroller General shall submit a report to Congress on the results of the study conducted under subsection (b).

(d) ACCESS BY COMPTROLLER GENERAL.—For purposes of conducting the study required under subsection (b), the Comptroller General shall have access, upon request, to any information, data, schedules, books, accounts, financial records, reports, files, electronic communications, or other papers, things, or property belonging to or in use by a covered entity that engages in proprietary trading, and to the officers, directors, employees, independent public accountants, financial advisors, staff, and agents and representatives of a covered entity (as related to the activities of the agent or representative on behalf of the covered entity), at such reasonable times as the Comptroller General may request. The Comptroller General may make and retain copies of books, records, accounts, and other records, as the Comptroller General deems appropriate.

(e) CONFIDENTIALITY OF REPORTS.—

(1) IN GENERAL.—Except as provided in paragraph (2), the Comptroller General may not disclose information regarding—

(A) any proprietary trading activity of a covered entity, unless such information is disclosed at a level of generality that does not reveal the investment or trading position or strategy of the covered entity for any specific security, commodity, derivative, or other investment or financial product; or

(B) any individual interviewed by the Comptroller General for purposes of the study under subsection (b), unless such information is disclosed at a level of generality that does not reveal—

(i) the name of or identifying details relating to such individual; or

(ii) in the case of an individual who is an employee of a third party that provides professional services to a covered entity believed to be engaged in proprietary trading, the name of or any identifying details relating to such third party.

(2) EXCEPTIONS.—The Comptroller General may disclose the information described in paragraph (1)—

(A) to a department, agency, or official of the Federal Government, for official use, upon request;

(B) to a committee of Congress, upon request; and

(C) to a court, upon an order of such court.

SEC. 989A. SENIOR INVESTOR PROTECTIONS.

(a) DEFINITIONS.—As used in this section—

(1) the term "eligible entity" means—

(A) a securities commission (or any agency or office performing like functions) of a State that the Office determines has adopted rules on the appropriate use of designations in the offer or sale of securities or the provision of investment advice that meet or exceed the minimum requirements of the NASAA Model Rule on the Use of

Senior-Specific Certifications and Professional Designations (or any successor thereto);

(B) the insurance commission (or any agency or office performing like functions) of any State that the Office determines has—

(i) adopted rules on the appropriate use of designations in the sale of insurance products that, to the extent practicable, conform to the minimum requirements of the National Association of Insurance Commissioners Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities (or any successor thereto); and

(ii) adopted rules with respect to fiduciary or suitability requirements in the sale of annuities that meet or exceed the minimum requirements established by the Suitability in Annuity Transactions Model Regulation of the National Association of Insurance Commissioners (or any successor thereto); or

(C) a consumer protection agency of any State, if—

(i) the securities commission (or any agency or office performing like functions) of the State is eligible under subparagraph (A); or

(ii) the insurance commission (or any agency or office performing like functions) of the State is eligible under subparagraph (B);

(2) the term "financial product" means a security, an insurance product (including an insurance product that pays a return, whether fixed or variable), a bank product, and a loan product;

(3) the term "misleading designation"—

(A) means a certification, professional designation, or other purported credential that indicates or implies that a salesperson or adviser has special certification or training in advising or servicing seniors; and

(B) does not include a certification, professional designation, license, or other credential that—

(i) was issued by or obtained from an academic institution having regional accreditation;

(ii) meets the standards for certifications and professional designations outlined by the NASAA Model Rule on the Use of Senior-Specific Certifications and Professional Designations (or any successor thereto) or by the Model Regulations on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities, adopted by the National Association of Insurance Commissioners (or any successor thereto); or

(iii) was issued by or obtained from a State;

(4) the term "misleading or fraudulent marketing" means the use of a misleading designation by a person that sells to or advises a senior in connection with the sale of a financial product;

(5) the term "NASAA" means the North American Securities Administrators Association;

(6) the term "Office" means the Office of Financial Literacy of the Bureau;

(7) the term "senior" means any individual who has attained the age of 62 years or older; and

(8) the term "State" has the same meaning as in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

(b) GRANTS TO STATES FOR ENHANCED PROTECTION OF SENIORS FROM BEING MISLED BY FALSE DESIGNATIONS.—The Office shall establish a program under which the Office may make grants to States or eligible entities—

(1) to hire staff to identify, investigate, and prosecute (through civil, administrative, or criminal enforcement actions) cases involving misleading or fraudulent marketing;

(2) to fund technology, equipment, and training for regulators, prosecutors, and law enforcement officers, in order to identify salespersons and advisers who target seniors through the use of misleading designations;

(3) to fund technology, equipment, and training for prosecutors to increase the successful prosecution of salespersons and advisers who target seniors with the use of misleading designations;

(4) to provide educational materials and training to regulators on the appropriateness of the use of designations by salespersons and advisers in connection with the sale and marketing of financial products;

(5) to provide educational materials and training to seniors to increase awareness and understanding of misleading or fraudulent marketing;

(6) to develop comprehensive plans to combat misleading or fraudulent marketing of financial products to seniors; and

(7) to enhance provisions of State law to provide protection for seniors against misleading or fraudulent marketing.

(c) APPLICATIONS.—A State or eligible entity desiring a grant under this section shall submit an application to the Office, in such form and in such a manner as the Office may determine, that includes—

(1) a proposal for activities to protect seniors from misleading or fraudulent marketing that are proposed to be funded using a grant under this section, including—

(A) an identification of the scope of the problem of misleading or fraudulent marketing in the State;

(B) a description of how the proposed activities would—

(i) protect seniors from misleading or fraudulent marketing in the sale of financial products, including by proactively identifying victims of misleading and fraudulent marketing who are seniors;

(ii) assist in the investigation and prosecution of those using misleading or fraudulent marketing; and

(iii) discourage and reduce cases of misleading or fraudulent marketing; and

(C) a description of how the proposed activities would be coordinated with other State efforts; and

(2) any other information, as the Office determines is appropriate.

(d) PERFORMANCE OBJECTIVES AND REPORTING REQUIREMENTS.—The Office may establish such performance objectives and reporting requirements for States and eligible entities receiving a grant under this section as the Office determines are necessary to carry out and assess the effectiveness of the program under this section.

(e) MAXIMUM AMOUNT.—The amount of a grant under this section may not exceed—

(1) $500,000 for each of 3 consecutive fiscal years, if the recipient is a State, or an eligible entity of a State, that has adopted rules—

(A) on the appropriate use of designations in the offer or sale of securities or investment advice that meet or exceed the minimum requirements of the NASAA Model Rule on the Use of Senior-Specific Certifications and Professional Designations (or any successor thereto);

(B) on the appropriate use of designations in the sale of insurance products that, to the extent practicable, conform to the minimum requirements of the National Association of Insurance Commissioners Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities (or any successor thereto); and

(C) with respect to fiduciary or suitability requirements in the sale of annuities that meet or exceed the minimum requirements established by the Suitability in Annuity Transactions Model Regulation of the National Association of Insurance Commissioners (or any successor thereto); and

(2) $100,000 for each of 3 consecutive fiscal years, if the recipient is a State, or an eligible entity of a State, that has adopted—

(A) rules on the appropriate use of designations in the offer or sale of securities or investment advice that meet or exceed the minimum requirements of the NASAA Model Rule on the Use of Senior-Specific Certifications and Professional Designations (or any successor thereto); or

(B) rules—

(i) on the appropriate use of designations in the sale of insurance products that, to the extent practicable, conform to the minimum requirements of the National Association of Insurance Commissioners Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities (or any successor thereto); and

(ii) with respect to fiduciary or suitability requirements in the sale of annuities that meet or exceed the minimum requirements established by the Suitability in Annuity Transactions Model Regulation of the National Association of Insurance Commissioners (or any successor thereto).

(f) SUBGRANTS.—A State or eligible entity that receives a grant under this section may make a subgrant, as the State or eligible entity determines is necessary to carry out the activities funded using a grant under this section.

(g) REAPPLICATION.—A State or eligible entity that receives a grant under this section may reapply for a grant under this section, notwithstanding the limitations on grant amounts under subsection (e).

(h) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated to carry out this section, $8,000,000 for each of fiscal years 2011 through 2015.

SEC. 989B. DESIGNATED FEDERAL ENTITY INSPECTORS GENERAL INDEPENDENCE.

Section 8G of the Inspector General Act of 1978 (5 U.S.C. App.) is amended—

(1) in subsection (a)(4)—

(A) in the matter preceding subparagraph (A), by inserting "the board or commission of the designated Federal entity, or in the event the designated Federal entity does not have a board or commission," after "means";

(B) in subparagraph (A), by striking "and" after the semicolon; and

(C) by adding after subparagraph (B) the following:

"(C) with respect to the Federal Labor Relations Authority, such term means the members of the Authority (described under section 7104 of title 5, United States Code);

"(D) with respect to the National Archives and Records Administration, such term means the Archivist of the United States;

"(E) with respect to the National Credit Union Administration, such term means the National Credit Union Administration Board (described under section 102 of the Federal Credit Union Act (12 U.S.C. 1752a);

"(F) with respect to the National Endowment of the Arts, such term means the National Council on the Arts;

"(G) with respect to the National Endowment for the Humanities, such term means the National Council on the Humanities; and

"(H) with respect to the Peace Corps, such term means the Director of the Peace Corps;"; and

(2) in subsection (h), by inserting "if the designated Federal entity is not a board or commission, include" after "designated Federal entities and".

SEC. 989C. STRENGTHENING INSPECTOR GENERAL ACCOUNTABILITY.

Section 5(a) of the Inspector General Act of 1978 (5 U.S.C. App.) is amended—

(1) in paragraph (12), by striking "and" after the semicolon;

(2) in paragraph (13), by striking the period and inserting a semicolon; and

(3) by adding at the end the following:

"(14)(A) an appendix containing the results of any peer review conducted by another Office of Inspector General during the reporting period; or

"(B) if no peer review was conducted within that reporting period, a statement identifying the date of the last peer review conducted by another Office of Inspector General;

"(15) a list of any outstanding recommendations from any peer review conducted by another Office of Inspector General that have not been fully implemented, including a statement describing the status of the implementation and why implementation is not complete; and

"(16) a list of any peer reviews conducted by the Inspector General of another Office of the Inspector General during the reporting period, including a list of any outstanding recommendations made from any previous peer review (including any peer review conducted before the reporting period) that remain outstanding or have not been fully implemented.''.

SEC. 989D. REMOVAL OF INSPECTORS GENERAL OF DESIGNATED FEDERAL ENTITIES.

Section 8G(e) of the Inspector General Act of 1978 (5 U.S.C. App.) is amended—

(1) by redesignating the sentences following ''(e)'' as paragraph (2); and

(2) by striking ''(e)'' and inserting the following:

''(e)(1) In the case of a designated Federal entity for which a board or commission is the head of the designated Federal entity, a removal under this subsection may only be made upon the written concurrence of a ⅔ majority of the board or commission.''.

SEC. 989E. ADDITIONAL OVERSIGHT OF FINANCIAL REGULATORY SYSTEM.

(a) COUNCIL OF INSPECTORS GENERAL ON FINANCIAL OVERSIGHT.—

(1) ESTABLISHMENT AND MEMBERSHIP.—There is established a Council of Inspectors General on Financial Oversight (in this section referred to as the ''Council of Inspectors General'') chaired by the Inspector General of the Department of the Treasury and composed of the inspectors general of the following:

(A) The Board of Governors of the Federal Reserve System.

(B) The Commodity Futures Trading Commission.

(C) The Department of Housing and Urban Development.

(D) The Department of the Treasury.

(E) The Federal Deposit Insurance Corporation.

(F) The Federal Housing Finance Agency.

(G) The National Credit Union Administration.

(H) The Securities and Exchange Commission.

(I) The Troubled Asset Relief Program (until the termination of the authority of the Special Inspector General for such program under section 121(k) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5231(k))).

(2) DUTIES.—

(A) MEETINGS.—The Council of Inspectors General shall meet not less than once each quarter, or more frequently if the chair considers it appropriate, to facilitate the sharing of information among inspectors general and to discuss the ongoing work of each inspector general who is a member of the Council of Inspectors General, with a focus on concerns that may apply to the broader financial sector and ways to improve financial oversight.

(B) ANNUAL REPORT.—Each year the Council of Inspectors General shall submit to the Council and to Congress a report including—

(i) for each inspector general who is a member of the Council of Inspectors General, a section within the exclusive editorial control of such inspector general that highlights the concerns and recommendations of such inspector general in such inspector general's ongoing and completed work, with a focus on issues that may apply to the broader financial sector; and

(ii) a summary of the general observations of the Council of Inspectors General based on the views expressed by each inspector general as required by clause (i), with a focus on measures that should be taken to improve financial oversight.

(3) WORKING GROUPS TO EVALUATE COUNCIL.—

(A) CONVENING A WORKING GROUP.—The Council of Inspectors General may, by majority vote, convene a Council of Inspectors General Working Group to evaluate the effectiveness and internal operations of the Council.

(B) PERSONNEL AND RESOURCES.—The inspectors general who are members of the Council of Inspectors General may detail staff and resources to a Council of Inspectors General Working Group established under this paragraph to enable it to carry out its duties.

(C) REPORTS.—A Council of Inspectors General Working Group established under this paragraph shall submit regular reports to the Council and to Congress on its evaluations pursuant to this paragraph.

(b) RESPONSE TO REPORT BY COUNCIL.—The Council shall respond to the concerns raised in the report of the Council of Inspectors General under subsection (a)(2)(B) for such year.

SEC. 989F. GAO STUDY OF PERSON TO PERSON LENDING.

(a) STUDY.—

(1) IN GENERAL.—The Comptroller General of the United States shall conduct a study of person to person lending to determine the optimal Federal regulatory structure.

(2) CONSULTATION.—In conducting the study required under paragraph (1), the Comptroller General shall consult with Federal banking agencies, the Commission, consumer groups, outside experts, and the person to person lending industry.

(3) CONTENT OF STUDY.—The study required under paragraph (1) shall include an examination of—

(A) the regulatory structure as it exists on the date of enactment of this Act, as determined by the Commission, with particular attention to—

(i) the application of the Securities Act of 1933 to person to person lending platforms;

(ii) the posting of consumer loan information on the EDGAR database of the Commission; and

(iii) the treatment of privately held person to person lending platforms as public companies;

(B) the State and other Federal regulators responsible for the oversight and regulation of person to person lending markets;

(C) any Federal, State, or local government or private studies of person to person lending completed or in progress on the date of enactment of this Act;

(D) consumer privacy and data protections, minimum credit standards, anti-money laundering and risk management in the regulatory structure as it exists on the date of enactment of this Act, and whether additional or alternative safeguards are needed; and

(E) the uses of person to person lending.

(b) REPORT.—

(1) IN GENERAL.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report on the study required under subsection (a) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

(2) CONTENT OF REPORT.—The report required under paragraph (1) shall include alternative regulatory options, including—

(A) the involvement of other Federal agencies; and

(B) alternative approaches by the Commission and recommendations on whether the alternative approaches are effective.

SEC. 989G. EXEMPTION FOR NONACCELERATED FILERS.

(a) EXEMPTION.—Section 404 of the Sarbanes-Oxley Act of 2002 is amended by adding at the end the following:

"(c) EXEMPTION FOR SMALLER ISSUERS.—Subsection (b) shall not apply with respect to any audit report prepared for an issuer that is neither a 'large accelerated filer' nor an 'accelerated filer' as those terms are defined in Rule 12b–2 of the Commission (17 C.F.R. 240.12b–2).".

(b) STUDY.—The Securities and Exchange Commission shall conduct a study to determine how the Commission could reduce the burden of complying with section 404(b) of the Sarbanes-Oxley Act of 2002 for companies whose market capitalization is between $75,000,000 and $250,000,000 for the relevant reporting period while maintaining investor protections for such companies. The study shall also consider whether any such methods of reducing the compliance burden or a complete exemption for such companies from compliance with such section would encourage companies to list on exchanges in the United States in their initial public offerings. Not later than 9 months after the date of the enactment of this subtitle, the Commission shall transmit a report of such study to Congress.

SEC. 989H. CORRECTIVE RESPONSES BY HEADS OF CERTAIN ESTABLISHMENTS TO DEFICIENCIES IDENTIFIED BY INSPECTORS GENERAL.

The Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Commodity Futures Trading Commission, the Chairman of the National Credit Union Administration, the Director of the Pension Benefit Guaranty Corporation, and the Chairman of the Securities and Exchange Commission shall each—

(1) take action to address deficiencies identified by a report or investigation of the Inspector General of the establishment concerned; or

(2) certify to both Houses of Congress that no action is necessary or appropriate in connection with a deficiency described in paragraph (1).

SEC. 989I. GAO STUDY REGARDING EXEMPTION FOR SMALLER ISSUERS.

(a) STUDY REGARDING EXEMPTION FOR SMALLER ISSUERS.—The Comptroller General of the United States shall carry out a study on the impact of the amendments made by this Act to section 404(b) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7262(b)), which shall include an analysis of—

(1) whether issuers that are exempt from such section 404(b) have fewer or more restatements of published accounting statements than issuers that are required to comply with such section 404(b);

(2) the cost of capital for issuers that are exempt from such section 404(b) compared to the cost of capital for issuers that are required to comply with such section 404(b);

(3) whether there is any difference in the confidence of investors in the integrity of financial statements of issuers that comply with such section 404(b) and issuers that are exempt from compliance with such section 404(b);

(4) whether issuers that do not receive the attestation for internal controls required under such section 404(b) should be required to disclose the lack of such attestation to investors; and

(5) the costs and benefits to issuers that are exempt from such section 404(b) that voluntarily have obtained the attestation of an independent auditor.

(b) REPORT.—Not later than 3 years after the date of enactment of this Act, the Comptroller General shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the results of the study required under subsection (a).

SEC. 989J. FURTHER PROMOTING THE ADOPTION OF THE NAIC MODEL REGULATIONS THAT ENHANCE PROTECTION OF SENIORS AND OTHER CONSUMERS.

(a) IN GENERAL.—The Commission shall treat as exempt securities described under section 3(a)(8) of the Securities Act of 1933 (15 U.S.C. 77c(a)(8)) any insurance or endowment policy or annuity contract or optional annuity contract—

(1) the value of which does not vary according to the performance of a separate account;

(2) that—

(A) satisfies standard nonforfeiture laws or similar requirements of the applicable State at the time of issue; or

(B) in the absence of applicable standard nonforfeiture laws or requirements, satisfies the Model Standard Nonforfeiture Law for Life Insurance or Model Standard Nonforfeiture Law for Individual Deferred Annuities, or any successor model law, as published by the National Association of Insurance Commissioners; and

(3) that is issued—

(A) on and after June 16, 2013, in a State, or issued by an insurance company that is domiciled in a State, that—

(i) adopts rules that govern suitability requirements in the sale of an insurance or endowment policy or annuity contract or optional annuity contract, which shall substantially meet or exceed the minimum requirements established by the Suitability in Annuity Transactions Model Regulation adopted by the

National Association of Insurance Commissioners in March 2010; and

(ii) adopts rules that substantially meet or exceed the minimum requirements of any successor modifications to the model regulations described in subparagraph (A) within 5 years of the adoption by the Association of any further successors thereto; or

(B) by an insurance company that adopts and implements practices on a nationwide basis for the sale of any insurance or endowment policy or annuity contract or optional annuity contract that meet or exceed the minimum requirements established by the National Association of Insurance Commissioners Suitability in Annuity Transactions Model Regulation (Model 275), and any successor thereto, and is therefore subject to examination by the State of domicile of the insurance company, or by any other State where the insurance company conducts sales of such products, for the purpose of monitoring compliance under this section.

(b) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to affect whether any insurance or endowment policy or annuity contract or optional annuity contract that is not described in this section is or is not an exempt security under section 3(a)(8) of the Securities Act of 1933 (15 U.S.C. 77c(a)(8)).

Subtitle J—Securities and Exchange Commission Match Funding

SEC. 991. SECURITIES AND EXCHANGE COMMISSION MATCH FUNDING.

(a) MATCH FUNDING AUTHORITY.—

(1) AMENDMENTS.—Section 31 of the Securities Exchange Act of 1934 (15 U.S.C. 78ee) is amended—

(A) by striking subsection (a) and inserting the following:

"(a) RECOVERY OF COSTS OF ANNUAL APPROPRIATION.—The Commission shall, in accordance with this section, collect transaction fees and assessments that are designed to recover the costs to the Government of the annual appropriation to the Commission by Congress.";

(B) in subsection (e)(2), by striking "September 30" and inserting "September 25";

(C) in subsection (g), by striking "April 30 of the fiscal year preceding the fiscal year to which such rate applies" and inserting "30 days after the date on which an Act making a regular appropriation to the Commission for such fiscal year is enacted";

(D) by striking subsection (j) and inserting the following:

"(j) ADJUSTMENTS TO FEE RATES.—

"(1) ANNUAL ADJUSTMENT.—Subject to subsections (i)(1)(B) and (k), for each fiscal year, the Commission shall by order adjust each of the rates applicable under subsections (b) and (c) for such fiscal year to a uniform adjusted rate that, when applied to the baseline estimate of the aggregate dollar amount of sales for such fiscal year, is reasonably likely to produce aggregate fee collections under this section (including assessments collected under subsection (d) of this section) that are equal to the regular appropriation to the Commission by Congress for such fiscal year.

"(2) MID-YEAR ADJUSTMENT.—Subject to subsections (i)(1)(B) and (k), for each fiscal year, the Commission shall determine, by March 1 of such fiscal year, whether, based on the actual aggregate dollar volume of sales during the first 5 months of such fiscal year, the baseline estimate of the aggregate dollar volume of sales used under paragraph (1) for such fiscal year is reasonably likely to be 10 percent (or more) greater or less than the actual aggregate dollar volume of sales for such fiscal year. If the Commission so determines, the Commission shall by order, no later than March 1, adjust each of the rates applicable under subsections (b) and (c) for such fiscal year to a uniform adjusted rate that, when applied to the revised estimate of the aggregate dollar amount of sales for the remainder of such fiscal year, is reasonably likely to produce aggregate fee collections under this section (including fees collected during such five-month period and assessments collected under subsection (d) of this section) that are equal to the regular appropriation to the Commission by Congress for such fiscal year. In making such revised estimate, the Commission shall, after consultation with the Congressional Budget Office and the Office of Management and Budget, use the same methodology required by subsection (l).

"(3) REVIEW.—In exercising its authority under this subsection, the Commission shall not be required to comply with the provisions of section 553 of title 5, United States Code. An adjusted rate prescribed under paragraph (1) or (2) and published under subsection (g) shall not be subject to judicial review.

"(4) EFFECTIVE DATE.—

"(A) ANNUAL ADJUSTMENT.—Subject to subsections (i)(1)(B) and (k), an adjusted rate prescribed under paragraph (1) shall take effect on the later of—

"(i) the first day of the fiscal year to which such rate applies; or

"(ii) 60 days after the date on which an Act making a regular appropriation to the Commission for such fiscal year is enacted.

"(B) MID-YEAR ADJUSTMENT.—An adjusted rate prescribed under paragraph (2) shall take effect on April 1 of the fiscal year to which such rate applies.";

(E) in subsection (k), by striking "30 days" and inserting "60 days"; and

(F) in subsection (l), by striking "DEFINITIONS.—" and all that follows through "SALES.—The baseline" and inserting "BASELINE ESTIMATE OF THE AGGREGATE DOLLAR AMOUNT OF SALES.—The baseline".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on the later of—

(A) October 1, 2011; or

(B) the date of enactment of an Act making a regular appropriation to the Commission for fiscal year 2012.

(b) AMENDMENTS TO REGISTRATION FEE PROVISIONS.—

(1) SECTION 6(b) OF THE SECURITIES ACT OF 1933.—Section 6(b) of the Securities Act of 1933 (15 U.S.C. 77f(b)) is amended—

(A) by striking "offsetting" each place that term appears and inserting "fee";

(B) by striking paragraphs (1), (3), (4), (6), (8), and (9);

(C) by redesignating paragraph (2) as paragraph (1);

(D) by redesignating paragraph (5) as paragraph (2);

(E) by redesignating paragraph (7) as paragraph (3);

(F) by redesignating paragraph (10) as paragraph (5);

(G) by redesignating paragraph (11) as paragraph (6);

(H) in paragraph (1), as so redesignated, by striking "paragraph (5) or (6)." and inserting "paragraph (2).";

(I) in paragraph (2), as so redesignated—

(i) by striking "of the fiscal years 2003 through 2011" and inserting "fiscal year"; and

(ii) by striking "paragraph (2)" and inserting "paragraph (1)";

(J) by inserting after paragraph (3), as so redesignated, the following:

"(4) REVIEW AND EFFECTIVE DATE.—In exercising its authority under this subsection, the Commission shall not be required to comply with the provisions of section 553 of title 5, United States Code. An adjusted rate prescribed under paragraph (2) and published under paragraph (5) shall not be subject to judicial review. An adjusted rate prescribed under paragraph (2) shall take effect on the first day of the fiscal year to which such rate applies.";

(K) in paragraph (5), as redesignated, by striking "April 30" and inserting "August 31";

(L) in paragraph (6), as so redesignated—

(i) by striking "of the fiscal years 2002 through 2011" and inserting "fiscal year"; and

(ii) by inserting at the end of the table in subparagraph (A) the following:

"2012	$425,000,000
2013	$455,000,000
2014	$485,000,000
2015	$515,000,000
2016	$550,000,000
2017	$585,000,000
2018	$620,000,000
2019	$660,000,000
2020	$705,000,000
2021 and each fiscal year thereafter	An amount that is equal to the target fee collection amount for the prior fiscal year, adjusted by the rate of inflation.".

(2) SECTION 13(e) OF THE SECURITIES EXCHANGE ACT OF 1934.—Section 13(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(e)) is amended—

(A) in paragraph (3), by striking "paragraphs (5) and (6)" and inserting "paragraph (4)";

(B) by striking paragraphs (4), (5), and (6);

(C) by inserting after paragraph (3) the following:

"(4) ANNUAL ADJUSTMENT.—For each fiscal year, the Commission shall by order adjust the rate required by paragraph (3) for such fiscal year to a rate that is equal to the rate (expressed in dollars per million) that is applicable under section 6(b) of the Securities Act of 1933 for such fiscal year.

"(5) FEE COLLECTIONS.—Fees collected pursuant to this subsection for fiscal year 2012 and each fiscal year thereafter shall be deposited and credited as general revenue of the Treasury and shall not be available for obligation.

"(6) EFFECTIVE DATE; PUBLICATION.—In exercising its authority under this subsection, the Commission shall not be required to comply with the provisions of section 553 of title 5, United States Code. An adjusted rate prescribed under paragraph (4) shall be published and take effect in accordance with section 6(b) of the Securities Act of 1933 (15 U.S.C. 77f(b)).''; and

(D) by striking paragraphs (8), (9), and (10).

(3) SECTION 14(g) OF THE SECURITIES EXCHANGE ACT OF 1934.—Section 14(g) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(g)) is amended—

(A) in paragraph (1), by striking "paragraphs (5) and (6)" each time that term appears and inserting "paragraph (4)";

(B) in paragraph (3), by striking "paragraphs (5) and (6)" and inserting "paragraph (4)";

(C) by striking paragraphs (4), (5), and (6);

(D) by inserting after paragraph (3) the following:

"(4) ANNUAL ADJUSTMENT.—For each fiscal year, the Commission shall by order adjust the rate required by paragraphs (1) and (3) for such fiscal year to a rate that is equal to the rate (expressed in dollars per million) that is applicable under section 6(b) of the Securities Act of 1933 (15 U.S.C. 77f(b)) for such fiscal year.

"(5) FEE COLLECTION.—Fees collected pursuant to this subsection for fiscal year 2012 and each fiscal year thereafter shall be deposited and credited as general revenue of the Treasury and shall not be available for obligation.

"(6) REVIEW; EFFECTIVE DATE; PUBLICATION.—In exercising its authority under this subsection, the Commission shall not be required to comply with the provisions of section 553 of title 5, United States Code. An adjusted rate prescribed under paragraph (4) shall be published and take effect in accordance with section 6(b) of the Securities Act of 1933 (15 U.S.C. 77f(b)).'';

(E) by striking paragraphs (8), (9), and (10); and

(F) by redesignating paragraph (11) as paragraph (8).

(4) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on October 1, 2011, except that for fiscal year 2012, the Commission shall publish the rate established under section 6(b) of the Securities Act of 1933 (15 U.S.C. 77f(b)), as amended by this Act, on August 31, 2011.

(c) AUTHORIZATION OF APPROPRIATIONS.—Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

"SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

"In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission—

"(1) for fiscal year 2011, $1,300,000,000;

"(2) for fiscal year 2012, $1,500,000,000;

"(3) for fiscal year 2013, $1,750,000,000;

"(4) for fiscal year 2014, $2,000,000,000; and

"(5) for fiscal year 2015, $2,250,000,000.".

(d) TRANSMITTAL OF BUDGET REQUESTS.—

(1) AMENDMENT.—Section 31 of the Securities Exchange Act of 1934 (15 U.S.C. 78ee) is amended by adding at the end the following:

"(m) TRANSMITTAL OF COMMISSION BUDGET REQUESTS.—

"(1) BUDGET REQUIRED.—For fiscal year 2012, and each fiscal year thereafter, the Commission shall prepare and submit a budget to the President. Whenever the Commission submits a budget estimate or request to the President or the Office of Management and Budget, the Commission shall concurrently transmit copies of the estimate or request to the Committee on Appropriations of the Senate, the Committee on Appropriations of the House of Representatives, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives.

"(2) SUBMISSION TO CONGRESS.—The President shall submit each budget submitted under paragraph (1) to Congress, in unaltered form, together with the annual budget for the Administration submitted by the President.

"(3) CONTENTS.—The Commission shall include in each budget submitted under paragraph (1)—

"(A) an itemization of the amount of funds necessary to carry out the functions of the Commission.

"(B) an amount to be designated as contingency funding to be used by the Commission to address unanticipated needs; and

"(C) a designation of any activities of the Commission for which multi-year budget authority would be suitable.".

(2) BUDGET OF THE PRESIDENT.—For fiscal year 2012, and each fiscal year thereafter, the annual budget for the Administration submitted by the President to Congress shall reflect the amendments made by this section.

(e) SECURITIES AND EXCHANGE COMMISSION RESERVE FUND.—

(1) AMENDMENT.—Section 4 of the Securities Exchange Act of 1934 (15 U.S.C. 78d), as amended by this Act, is amended by adding at the end the following:

"(i) SECURITIES AND EXCHANGE COMMISSION RESERVE FUND.—

"(1) RESERVE FUND ESTABLISHED.—There is established in the Treasury of the United States a separate fund, to be known as the 'Securities and Exchange Commission Reserve Fund' (referred to in this subsection as the 'Reserve Fund').

"(2) RESERVE FUND AMOUNTS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), any registration fees collected by the Commission under section 6(b) of the Securities Act of 1933 (15 U.S.C. 77f(b)) or section 24(f) of the Investment Company Act of 1940

(15 U.S.C. 80a-24(f)) shall be deposited into the Reserve Fund.

"(B) LIMITATIONS.—For any 1 fiscal year—

"(i) the amount deposited in the Fund may not exceed $50,000,000; and

"(ii) the balance in the Fund may not exceed $100,000,000.

"(C) EXCESS FEES.—Any amounts in excess of the limitations described in subparagraph (B) that the Commission collects from registration fees under section 6(b) of the Securities Act of 1933 (15 U.S.C. 77f(b)) or section 24(f) of the Investment Company Act of 1940 (15 U.S.C. 80a-24(f)) shall be deposited in the General Fund of the Treasury of the United States and shall not be available for obligation by the Commission.

"(3) USE OF AMOUNTS IN RESERVE FUND.—The Commission may obligate amounts in the Reserve Fund, not to exceed a total of $100,000,000 in any 1 fiscal year, as the Commission determines is necessary to carry out the functions of the Commission. Any amounts in the reserve fund shall remain available until expended. Not later than 10 days after the date on which the Commission obligates amounts under this paragraph, the Commission shall notify Congress of the date, amount, and purpose of the obligation.

"(4) RULE OF CONSTRUCTION.—Amounts collected and deposited in the Reserve Fund shall not be construed to be Government funds or appropriated monies and shall not be subject to apportionment for the purpose of chapter 15 of title 31, United States Code, or under any other authority.".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall take effect on October 1, 2011.

TITLE X—BUREAU OF CONSUMER FINANCIAL PROTECTION

SEC. 1001. SHORT TITLE.

This title may be cited as the "Consumer Financial Protection Act of 2010".

SEC. 1002. DEFINITIONS.

Except as otherwise provided in this title, for purposes of this title, the following definitions shall apply:

(1) AFFILIATE.—The term "affiliate" means any person that controls, is controlled by, or is under common control with another person.

(2) BUREAU.—The term "Bureau" means the Bureau of Consumer Financial Protection.

(3) BUSINESS OF INSURANCE.—The term "business of insurance" means the writing of insurance or the reinsuring of risks by an insurer, including all acts necessary to such writing or reinsuring and the activities relating to the writing of insurance or the reinsuring of risks conducted by persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons.

(4) CONSUMER.—The term "consumer" means an individual or an agent, trustee, or representative acting on behalf of an individual.

(5) CONSUMER FINANCIAL PRODUCT OR SERVICE.—The term "consumer financial product or service" means any financial product or service that is described in one or more categories under—

(A) paragraph (15) and is offered or provided for use by consumers primarily for personal, family, or household purposes; or

(B) clause (i), (iii), (ix), or (x) of paragraph (15)(A), and is delivered, offered, or provided in connection with a consumer financial product or service referred to in subparagraph (A).

(6) COVERED PERSON.—The term "covered person" means—

(A) any person that engages in offering or providing a consumer financial product or service; and

(B) any affiliate of a person described in subparagraph (A) if such affiliate acts as a service provider to such person.

(7) CREDIT.—The term "credit" means the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purchase.

(8) DEPOSIT-TAKING ACTIVITY.—The term "deposit-taking activity" means—

(A) the acceptance of deposits, maintenance of deposit accounts, or the provision of services related to the acceptance of deposits or the maintenance of deposit accounts;

(B) the acceptance of funds, the provision of other services related to the acceptance of funds, or the maintenance of member share accounts by a credit union; or

(C) the receipt of funds or the equivalent thereof, as the Bureau may determine by rule or order, received or held by a covered person (or an agent for a covered person) for the purpose of facilitating a payment or transferring funds or value of funds between a consumer and a third party.

(9) DESIGNATED TRANSFER DATE.—The term "designated transfer date" means the date established under section 1062.

(10) DIRECTOR.—The term "Director" means the Director of the Bureau.

(11) ELECTRONIC CONDUIT SERVICES.—The term "electronic conduit services"—

(A) means the provision, by a person, of electronic data transmission, routing, intermediate or transient storage, or connections to a telecommunications system or network; and

(B) does not include a person that provides electronic conduit services if, when providing such services, the person—

(i) selects or modifies the content of the electronic data;

(ii) transmits, routes, stores, or provides connections for electronic data, including financial data, in a manner that such financial data is differentiated from other types of data of the same form that such person transmits, routes, or stores, or with respect to which, provides connections; or

(iii) is a payee, payor, correspondent, or similar party to a payment transaction with a consumer.

(12) ENUMERATED CONSUMER LAWS.—Except as otherwise specifically provided in section 1029, subtitle G or subtitle H, the term "enumerated consumer laws" means—

(A) the Alternative Mortgage Transaction Parity Act of 1982 (12 U.S.C. 3801 et seq.);

(B) the Consumer Leasing Act of 1976 (15 U.S.C. 1667 et seq.);

(C) the Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.), except with respect to section 920 of that Act;

(D) the Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.);

(E) the Fair Credit Billing Act (15 U.S.C. 1666 et seq.);

(F) the Fair Credit Reporting Act (15 U.S.C. 1681 et seq.), except with respect to sections 615(e) and 628 of that Act (15 U.S.C. 1681m(e), 1681w);

(G) the Home Owners Protection Act of 1998 (12 U.S.C. 4901 et seq.);

(H) the Fair Debt Collection Practices Act (15 U.S.C. 1692 et seq.);

(I) subsections (b) through (f) of section 43 of the Federal Deposit Insurance Act (12 U.S.C. 1831t(c)–(f));

(J) sections 502 through 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6802–6809) except for section 505 as it applies to section 501(b);

(K) the Home Mortgage Disclosure Act of 1975 (12 U.S.C. 2801 et seq.);

(L) the Home Ownership and Equity Protection Act of 1994 (15 U.S.C. 1601 note);

(M) the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 et seq.);

(N) the S.A.F.E. Mortgage Licensing Act of 2008 (12 U.S.C. 5101 et seq.);

(O) the Truth in Lending Act (15 U.S.C. 1601 et seq.);

(P) the Truth in Savings Act (12 U.S.C. 4301 et seq.);

(Q) section 626 of the Omnibus Appropriations Act, 2009 (Public Law 111–8); and

(R) the Interstate Land Sales Full Disclosure Act (15 U.S.C. 1701).

(13) FAIR LENDING.—The term "fair lending" means fair, equitable, and nondiscriminatory access to credit for consumers.

(14) FEDERAL CONSUMER FINANCIAL LAW.—The term "Federal consumer financial law" means the provisions of this title, the enumerated consumer laws, the laws for which authorities are transferred under subtitles F and H, and any rule or order prescribed by the Bureau under this title, an enumerated consumer law, or pursuant to the authorities transferred under subtitles F and H. The term does not include the Federal Trade Commission Act.

(15) FINANCIAL PRODUCT OR SERVICE.—

(A) IN GENERAL.—The term "financial product or service" means—

(i) extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit (other than solely extending commercial credit to a person who originates consumer credit transactions);

(ii) extending or brokering leases of personal or real property that are the functional equivalent of purchase finance arrangements, if—

(I) the lease is on a non-operating basis;

(II) the initial term of the lease is at least 90 days; and

(III) in the case of a lease involving real property, at the inception of the initial lease, the transaction is intended to result in ownership of the leased property to be transferred to the lessee, subject to standards prescribed by the Bureau;

(iii) providing real estate settlement services, except such services excluded under subparagraph (C), or performing appraisals of real estate or personal property;

(iv) engaging in deposit-taking activities, transmitting or exchanging funds, or otherwise acting as a custodian of funds or any financial instrument for use by or on behalf of a consumer;

(v) selling, providing, or issuing stored value or payment instruments, except that, in the case of a sale of, or transaction to reload, stored value, only if the seller exercises substantial control over the terms or conditions of the stored value provided to the consumer where, for purposes of this clause—

(I) a seller shall not be found to exercise substantial control over the terms or conditions of the stored value if the seller is not a party to the contract with the consumer for the stored value product, and another person is principally responsible for establishing the terms or conditions of the stored value; and

(II) advertising the nonfinancial goods or services of the seller on the stored value card or device is not in itself an exercise of substantial control over the terms or conditions;

(vi) providing check cashing, check collection, or check guaranty services;

(vii) providing payments or other financial data processing products or services to a consumer by any technological means, including processing or storing financial or banking data for any payment instrument, or through any payments systems or network used for processing payments data, including payments made through an online banking system or mobile telecommunications network, except that a person shall not be deemed to be a covered person with respect to financial data processing solely because the person—

(I) is a merchant, retailer, or seller of any nonfinancial good or service who engages in financial data processing by transmitting or storing payments data about a consumer exclusively for purpose of initiating payments instructions by the consumer to pay such person for the purchase of, or to complete a commercial transaction for, such nonfinancial good or service sold directly by such person to the consumer; or

(II) provides access to a host server to a person for purposes of enabling that person to establish and maintain a website;

(viii) providing financial advisory services (other than services relating to securities provided by a person regulated by the Commission or a person regulated by a State securities Commission, but only to the extent that such person acts in a regulated capacity) to consumers on individual financial matters or relating to proprietary financial products or services (other than by publishing any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation, including publishing market data, news, or data analytics or investment information or recommendations that are not tailored to the individual needs of a particular consumer), including—

(I) providing credit counseling to any consumer; and

(II) providing services to assist a consumer with debt management or debt settlement, modifying the terms of any extension of credit, or avoiding foreclosure;

(ix) collecting, analyzing, maintaining, or providing consumer report information or other account information, including information relating to the credit history of consumers, used or expected to be used in connection with any decision regarding the offering or provision of a consumer financial product or service, except to the extent that—

(I) a person—

(aa) collects, analyzes, or maintains information that relates solely to the transactions between a consumer and such person;

(bb) provides the information described in item (aa) to an affiliate of such person; or

(cc) provides information that is used or expected to be used solely in any decision regarding the offering or provision of a product or service that is not a consumer financial product or service, including a decision for employment, government licensing, or a residential lease or tenancy involving a consumer; and

(II) the information described in subclause (I)(aa) is not used by such person or affiliate in connection with any decision regarding the offering or provision of a consumer financial product or service to the consumer, other than credit described in section 1027(a)(2)(A);

(x) collecting debt related to any consumer financial product or service; and

(xi) such other financial product or service as may be defined by the Bureau, by regulation, for purposes of this title, if the Bureau finds that such financial product or service is—

(I) entered into or conducted as a subterfuge or with a purpose to evade any Federal consumer financial law; or

(II) permissible for a bank or for a financial holding company to offer or to provide under any provision of a Federal law or regulation applicable to a bank or a financial holding company, and has, or likely will have, a material impact on consumers.

(B) RULE OF CONSTRUCTION.—

(i) IN GENERAL.—For purposes of subparagraph (A)(xi)(II), and subject to clause (ii) of this subparagraph, the following activities provided to a covered person shall not, for purposes of this title, be considered incidental or complementary to a financial activity permissible for a financial holding company to engage in under any provision of a Federal law or regulation applicable to a financial holding company:

(I) Providing information products or services to a covered person for identity authentication.

(II) Providing information products or services for fraud or identify theft detection, prevention, or investigation.

(III) Providing document retrieval or delivery services.

(IV) Providing public records information retrieval.

(V) Providing information products or services for anti-money laundering activities.

(ii) LIMITATION.—Nothing in clause (i) may be construed as modifying or limiting the authority of the Bureau to exercise any—

(I) examination or enforcement powers authority under this title with respect to a covered person or service provider engaging in an activity described in subparagraph (A)(ix); or

(II) powers authorized by this title to prescribe rules, issue orders, or take other actions under any enumerated consumer law or law for which the authorities are transferred under subtitle F or H.

(C) EXCLUSIONS.—The term "financial product or service" does not include—

(i) the business of insurance; or

(ii) electronic conduit services.

(16) FOREIGN EXCHANGE.—The term "foreign exchange" means the exchange, for compensation, of currency of the United States or of a foreign government for currency of another government.

(17) INSURED CREDIT UNION.—The term "insured credit union" has the same meaning as in section 101 of the Federal Credit Union Act (12 U.S.C. 1752).

(18) PAYMENT INSTRUMENT.—The term "payment instrument" means a check, draft, warrant, money order, traveler's check, electronic instrument, or other instrument, payment of funds, or monetary value (other than currency).

(19) PERSON.—The term "person" means an individual, partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity.

(20) PERSON REGULATED BY THE COMMODITY FUTURES TRADING COMMISSION.—The term "person regulated by the Commodity Futures Trading Commission" means any person that is registered, or required by statute or regulation to be registered, with the Commodity Futures Trading Commission, but only to the extent that the activities of such person are subject to the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act.

(21) PERSON REGULATED BY THE COMMISSION.—The term "person regulated by the Commission" means a person who is—

(A) a broker or dealer that is required to be registered under the Securities Exchange Act of 1934;

(B) an investment adviser that is registered under the Investment Advisers Act of 1940;

(C) an investment company that is required to be registered under the Investment Company Act of 1940, and any company that has elected to be regulated as a business development company under that Act;

(D) a national securities exchange that is required to be registered under the Securities Exchange Act of 1934;

(E) a transfer agent that is required to be registered under the Securities Exchange Act of 1934;

(F) a clearing corporation that is required to be registered under the Securities Exchange Act of 1934;

(G) any self-regulatory organization that is required to be registered with the Commission;

(H) any nationally recognized statistical rating organization that is required to be registered with the Commission;

(I) any securities information processor that is required to be registered with the Commission;

(J) any municipal securities dealer that is required to be registered with the Commission;

(K) any other person that is required to be registered with the Commission under the Securities Exchange Act of 1934; and

(L) any employee, agent, or contractor acting on behalf of, registered with, or providing services to, any person described in any of subparagraphs (A) through (K), but only to the extent that any person described in any of subparagraphs (A) through (K), or the employee, agent, or contractor of such person, acts in a regulated capacity.

(22) PERSON REGULATED BY A STATE INSURANCE REGULATOR.—The term "person regulated by a State insurance regulator" means any person that is engaged in the business of

insurance and subject to regulation by any State insurance regulator, but only to the extent that such person acts in such capacity.

(23) PERSON THAT PERFORMS INCOME TAX PREPARATION ACTIVITIES FOR CONSUMERS.—The term "person that performs income tax preparation activities for consumers" means—

(A) any tax return preparer (as defined in section 7701(a)(36) of the Internal Revenue Code of 1986), regardless of whether compensated, but only to the extent that the person acts in such capacity;

(B) any person regulated by the Secretary under section 330 of title 31, United States Code, but only to the extent that the person acts in such capacity; and

(C) any authorized IRS e-file Providers (as defined for purposes of section 7216 of the Internal Revenue Code of 1986), but only to the extent that the person acts in such capacity.

(24) PRUDENTIAL REGULATOR.—The term "prudential regulator" means—

(A) in the case of an insured depository institution or depository institution holding company (as defined in section 3 of the Federal Deposit Insurance Act), or subsidiary of such institution or company, the appropriate Federal banking agency, as that term is defined in section 3 of the Federal Deposit Insurance Act; and

(B) in the case of an insured credit union, the National Credit Union Administration.

(25) RELATED PERSON.—The term "related person"—

(A) shall apply only with respect to a covered person that is not a bank holding company (as that term is defined in section 2 of the Bank Holding Company Act of 1956), credit union, or depository institution;

(B) shall be deemed to mean a covered person for all purposes of any provision of Federal consumer financial law; and

(C) means—

(i) any director, officer, or employee charged with managerial responsibility for, or controlling shareholder of, or agent for, such covered person;

(ii) any shareholder, consultant, joint venture partner, or other person, as determined by the Bureau (by rule or on a case-by-case basis) who materially participates in the conduct of the affairs of such covered person; and

(iii) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in any—

(I) violation of any provision of law or regulation; or

(II) breach of a fiduciary duty.

(26) SERVICE PROVIDER.—

(A) IN GENERAL.—The term "service provider" means any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service, including a person that—

(i) participates in designing, operating, or maintaining the consumer financial product or service; or

(ii) processes transactions relating to the consumer financial product or service (other than unknowingly or incidentally transmitting or processing financial data in a manner that such data is undifferentiated from other types of data of the same form as the person transmits or processes).

(B) EXCEPTIONS.—The term "service provider" does not include a person solely by virtue of such person offering or providing to a covered person—

(i) a support service of a type provided to businesses generally or a similar ministerial service; or

(ii) time or space for an advertisement for a consumer financial product or service through print, newspaper, or electronic media.

(C) RULE OF CONSTRUCTION.—A person that is a service provider shall be deemed to be a covered person to the extent that such person engages in the offering or provision of its own consumer financial product or service.

(27) STATE.—The term "State" means any State, territory, or possession of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, Guam, American Samoa, or the United States Virgin Islands or any federally recognized Indian tribe, as defined by the Secretary of the Interior under section 104(a) of the Federally Recognized Indian Tribe List Act of 1994 (25 U.S.C. 479a–1(a)).

(28) STORED VALUE.—

(A) IN GENERAL.—The term "stored value" means funds or monetary value represented in any electronic format, whether or not specially encrypted, and stored or capable of storage on electronic media in such a way as to be retrievable and transferred electronically, and includes a prepaid debit card or product, or any other similar product, regardless of whether the amount of the funds or monetary value may be increased or reloaded.

(B) EXCLUSION.—Notwithstanding subparagraph (A), the term "stored value" does not include a special purpose card or certificate, which shall be defined for purposes of this paragraph as funds or monetary value represented in any electronic format, whether or not specially encrypted, that is—

(i) issued by a merchant, retailer, or other seller of nonfinancial goods or services;

(ii) redeemable only for transactions with the merchant, retailer, or seller of nonfinancial goods or services or with an affiliate of such person, which affiliate itself is a merchant, retailer, or seller of nonfinancial goods or services;

(iii) issued in a specified amount that, except in the case of a card or product used solely for telephone services, may not be increased or reloaded;

(iv) purchased on a prepaid basis in exchange for payment; and

(v) honored upon presentation to such merchant, retailer, or seller of nonfinancial goods or services or an affiliate of such person, which affiliate itself is a merchant, retailer, or seller of nonfinancial goods or services, only for any nonfinancial goods or services.

(29) TRANSMITTING OR EXCHANGING FUNDS.—The term "transmitting or exchanging funds" means receiving currency, monetary value, or payment instruments from a consumer for the purpose of exchanging or transmitting the same by any means, including transmission by wire, facsimile, electronic transfer, courier, the Internet, or through bill payment services or through other businesses that facilitate third-party transfers within the United States or to or from the United States.

Subtitle A—Bureau of Consumer Financial Protection

SEC. 1011. ESTABLISHMENT OF THE BUREAU OF CONSUMER FINANCIAL PROTECTION.

(a) BUREAU ESTABLISHED.—There is established in the Federal Reserve System, an independent bureau to be known as the "Bureau of Consumer Financial Protection", which shall regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws. The Bureau shall be considered an Executive agency, as defined in section 105 of title 5, United States Code. Except as otherwise provided expressly by law, all Federal laws dealing with public or Federal contracts, property, works, officers, employees, budgets, or funds, including the provisions of chapters 5 and 7 of title 5, shall apply to the exercise of the powers of the Bureau.

(b) DIRECTOR AND DEPUTY DIRECTOR.—

(1) IN GENERAL.—There is established the position of the Director, who shall serve as the head of the Bureau.

(2) APPOINTMENT.—Subject to paragraph (3), the Director shall be appointed by the President, by and with the advice and consent of the Senate.

(3) QUALIFICATION.—The President shall nominate the Director from among individuals who are citizens of the United States.

(4) COMPENSATION.—The Director shall be compensated at the rate prescribed for level II of the Executive Schedule under section 5313 of title 5, United States Code.

(5) DEPUTY DIRECTOR.—There is established the position of Deputy Director, who shall—

(A) be appointed by the Director; and

(B) serve as acting Director in the absence or unavailability of the Director.

(c) TERM.—

(1) IN GENERAL.—The Director shall serve for a term of 5 years.

(2) EXPIRATION OF TERM.—An individual may serve as Director after the expiration of the term for which appointed, until a successor has been appointed and qualified.

(3) REMOVAL FOR CAUSE.—The President may remove the Director for inefficiency, neglect of duty, or malfeasance in office.

(d) SERVICE RESTRICTION.—No Director or Deputy Director may hold any office, position, or employment in any Federal reserve bank, Federal home loan bank, covered person, or service provider during the period of service of such person as Director or Deputy Director.

(e) OFFICES.—The principal office of the Bureau shall be in the District of Columbia. The Director may establish regional offices of the Bureau, including in cities in which the Federal reserve banks, or branches of such banks, are located, in order to carry out the responsibilities assigned to the Bureau under the Federal consumer financial laws.

SEC. 1012. EXECUTIVE AND ADMINISTRATIVE POWERS.

(a) POWERS OF THE BUREAU.—The Bureau is authorized to establish the general policies of the Bureau with respect to all executive and administrative functions, including—

(1) the establishment of rules for conducting the general business of the Bureau, in a manner not inconsistent with this title;

(2) to bind the Bureau and enter into contracts;

(3) directing the establishment and maintenance of divisions or other offices within the Bureau, in order to carry out the responsibilities under the Federal consumer financial laws, and to satisfy the requirements of other applicable law;

(4) to coordinate and oversee the operation of all administrative, enforcement, and research activities of the Bureau;

(5) to adopt and use a seal;

(6) to determine the character of and the necessity for the obligations and expenditures of the Bureau;

(7) the appointment and supervision of personnel employed by the Bureau;

(8) the distribution of business among personnel appointed and supervised by the Director and among administrative units of the Bureau;

(9) the use and expenditure of funds;

(10) implementing the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations, and enforcement actions; and

(11) performing such other functions as may be authorized or required by law.

(b) DELEGATION OF AUTHORITY.—The Director of the Bureau may delegate to any duly authorized employee, representative, or agent any power vested in the Bureau by law.

(c) AUTONOMY OF THE BUREAU.—

(1) COORDINATION WITH THE BOARD OF GOVERNORS.—Notwithstanding any other provision of law applicable to the supervision or examination of persons with respect to Federal consumer financial laws, the Board of Governors may delegate to the Bureau the authorities to examine persons subject to the jurisdiction of the Board of Governors for compliance with the Federal consumer financial laws.

(2) AUTONOMY.—Notwithstanding the authorities granted to the Board of Governors under the Federal Reserve Act, the Board of Governors may not—

(A) intervene in any matter or proceeding before the Director, including examinations or enforcement actions, unless otherwise specifically provided by law;

(B) appoint, direct, or remove any officer or employee of the Bureau; or

(C) merge or consolidate the Bureau, or any of the functions or responsibilities of the Bureau, with any division or office of the Board of Governors or the Federal reserve banks.

(3) RULES AND ORDERS.—No rule or order of the Bureau shall be subject to approval or review by the Board of Governors. The Board of Governors may not delay or prevent the issuance of any rule or order of the Bureau.

(4) RECOMMENDATIONS AND TESTIMONY.—No officer or agency of the United States shall have any authority to require the Director or any other officer of the Bureau to submit legislative recommendations, or testimony or comments on legislation, to any officer or agency of the United States for approval, comments, or review prior to the submission of such recommendations, testimony, or comments to the Congress, if such recommendations, testimony, or comments to the Congress include a statement indicating that the views expressed therein are those of the Director or such officer, and do not necessarily reflect the views of the Board of Governors or the President.

(5) CLARIFICATION OF AUTONOMY OF THE BUREAU IN LEGAL PROCEEDINGS.—The Bureau shall not be liable under any provision of law for any action or inaction of the Board of Governors, and the Board of Governors shall not be liable under any provision of law for any action or inaction of the Bureau.

SEC. 1013. ADMINISTRATION.

(a) PERSONNEL.—

(1) APPOINTMENT.—

(A) IN GENERAL.—The Director may fix the number of, and appoint and direct, all employees of the Bureau, in accordance with the applicable provisions of title 5, United States Code.

(B) EMPLOYEES OF THE BUREAU.—The Director is authorized to employ attorneys, compliance examiners, compliance supervision analysts, economists, statisticians, and other employees as may be deemed necessary to conduct the business of the Bureau. Unless otherwise provided expressly by law, any individual appointed under this section shall be an employee as defined in section 2105 of title 5, United States Code, and subject to the provisions of such title and other laws generally applicable to the employees of an Executive agency.

(C) WAIVER AUTHORITY.—

(i) IN GENERAL.—In making any appointment under subparagraph (A), the Director may waive the requirements of chapter 33 of title 5, United States Code, and the regulations implementing such chapter, to the extent necessary to appoint employees on terms and conditions that are consistent with those set forth in section 11(1) of the Federal Reserve Act (12 U.S.C. 248(1)), while providing for—

(I) fair, credible, and transparent methods of establishing qualification requirements for, recruitment for, and appointments to positions;

(II) fair and open competition and equitable treatment in the consideration and selection of individuals to positions;

(III) fair, credible, and transparent methods of assigning, reassigning, detailing, transferring, and promoting employees.

(ii) VETERANS PREFERENCES.—In implementing this subparagraph, the Director shall comply with the provisions of section 2302(b)(11), regarding veterans' preference requirements, in a manner consistent with that in which such provisions are applied under chapter 33 of title 5, United States Code. The authority under this subparagraph to waive the requirements of that chapter 33 shall expire 5 years after the date of enactment of this Act.

(2) COMPENSATION.—Notwithstanding any otherwise applicable provision of title 5, United States Code, concerning compensation, including the provisions of chapter 51 and chapter 53, the following provisions shall apply with respect to employees of the Bureau:

(A) The rates of basic pay for all employees of the Bureau may be set and adjusted by the Director.

(B) The Director shall at all times provide compensation (including benefits) to each class of employees that, at a minimum, are comparable to the compensation and benefits then being provided by the Board of Governors for the corresponding class of employees.

(C) All such employees shall be compensated (including benefits) on terms and conditions that are consistent with the terms and conditions set forth in section 11(l) of the Federal Reserve Act (12 U.S.C. 248(l)).

(3) BUREAU PARTICIPATION IN FEDERAL RESERVE SYSTEM RETIREMENT PLAN AND FEDERAL RESERVE SYSTEM THRIFT PLAN.—

(A) EMPLOYEE ELECTION.—Employees appointed to the Bureau may elect to participate in either—

(i) both the Federal Reserve System Retirement Plan and the Federal Reserve System Thrift Plan, under the same terms on which such participation is offered to employees of the Board of Governors who participate in such plans and under the terms and conditions specified under section 1064(i)(1)(C); or

(ii) the Civil Service Retirement System under chapter 83 of title 5, United States Code, or the Federal Employees Retirement System under chapter 84 of title 5, United States Code, if previously covered under one of those Federal employee retirement systems.

(B) ELECTION PERIOD.—Bureau employees shall make an election under this paragraph not later than 1 year after the date of appointment by, or transfer under subtitle F to, the Bureau. Participation in, and benefit accruals under, any other retirement plan established or maintained by the Federal Government shall end not later than the date on which participation in, and benefit accruals under, the Federal Reserve System Retirement Plan and Federal Reserve System Thrift Plan begin.

(C) EMPLOYER CONTRIBUTION.—The Bureau shall pay an employer contribution to the Federal Reserve System Retirement Plan, in the amount established as an employer contribution under the Federal Employees Retirement System, as established under chapter 84 of title 5, United States Code, for each Bureau employee who elects to participate in the Federal Reserve System Retirement Plan. The Bureau shall pay an employer contribution to the Federal Reserve System Thrift Plan for each Bureau employee who elects to participate in such plan, as required under the terms of such plan.

(D) CONTROLLED GROUP STATUS.—The Bureau is the same employer as the Federal Reserve System (as comprised of the Board of Governors and each of the 12 Federal reserve banks prior to the date of enactment of this Act) for purposes of subsections (b), (c), (m), and (o) of section 414 of the Internal Revenue Code of 1986, (26 U.S.C. 414).

(4) LABOR-MANAGEMENT RELATIONS.—Chapter 71 of title 5, United States Code, shall apply to the Bureau and the employees of the Bureau.

(5) AGENCY OMBUDSMAN.—

(A) ESTABLISHMENT REQUIRED.—Not later than 180 days after the designated transfer date, the Bureau shall appoint an ombudsman.

(B) DUTIES OF OMBUDSMAN.—The ombudsman appointed in accordance with subparagraph (A) shall—

(i) act as a liaison between the Bureau and any affected person with respect to any problem that such party may have in dealing with the Bureau, resulting from the regulatory activities of the Bureau; and

(ii) assure that safeguards exist to encourage complainants to come forward and preserve confidentiality.

(b) SPECIFIC FUNCTIONAL UNITS.—

(1) RESEARCH.—The Director shall establish a unit whose functions shall include researching, analyzing, and reporting on—

(A) developments in markets for consumer financial products or services, including market areas of alternative consumer financial products or services with high growth rates and areas of risk to consumers;

(B) access to fair and affordable credit for traditionally underserved communities;

(C) consumer awareness, understanding, and use of disclosures and communications regarding consumer financial products or services;

(D) consumer awareness and understanding of costs, risks, and benefits of consumer financial products or services;

(E) consumer behavior with respect to consumer financial products or services, including performance on mortgage loans; and

(F) experiences of traditionally underserved consumers, including un-banked and under-banked consumers.

(2) COMMUNITY AFFAIRS.—The Director shall establish a unit whose functions shall include providing information, guidance, and technical assistance regarding the offering and provision of consumer financial products or services to traditionally underserved consumers and communities.

(3) COLLECTING AND TRACKING COMPLAINTS.—

(A) IN GENERAL.—The Director shall establish a unit whose functions shall include establishing a single, toll-free telephone number, a website, and a database or utilizing an existing database to facilitate the centralized collection of, monitoring of, and response to consumer complaints regarding consumer financial products or services. The Director shall coordinate with the Federal Trade Commission or other Federal agencies to route complaints to such agencies, where appropriate.

(B) ROUTING CALLS TO STATES.—To the extent practicable, State agencies may receive appropriate complaints from the systems established under subparagraph (A), if—

(i) the State agency system has the functional capacity to receive calls or electronic reports routed by the Bureau systems;

(ii) the State agency has satisfied any conditions of participation in the system that the Bureau may establish, including treatment of personally identifiable information and sharing of information on complaint resolution or related compliance procedures and resources; and

(iii) participation by the State agency includes measures necessary to provide for protection of personally identifiable information that conform to the standards for protection of the confidentiality of personally identifiable information and for data integrity and security that apply to the Federal agencies described in subparagraph (D).

(C) REPORTS TO THE CONGRESS.—The Director shall present an annual report to Congress not later than March 31 of each year on the complaints received by the Bureau in the prior year regarding consumer financial products and services. Such report shall include information and analysis about complaint numbers, complaint types, and, where applicable, information about resolution of complaints.

(D) DATA SHARING REQUIRED.—To facilitate preparation of the reports required under subparagraph (C), supervision and enforcement activities, and monitoring of the market for consumer financial products and services, the Bureau shall share consumer complaint information with prudential regulators, the Federal Trade Commission, other Federal agencies, and State agencies, subject to the standards applicable to Federal agencies for protection of the confidentiality of personally identifiable information and for data security and integrity. The prudential regulators, the Federal Trade Commission, and other Federal agencies shall share data relating to consumer complaints regarding consumer financial products and services with the Bureau, subject to the standards applicable to Federal agencies for protection of confidentiality of personally identifiable information and for data security and integrity.

(c) OFFICE OF FAIR LENDING AND EQUAL OPPORTUNITY.—

(1) ESTABLISHMENT.—The Director shall establish within the Bureau the Office of Fair Lending and Equal Opportunity.

(2) FUNCTIONS.—The Office of Fair Lending and Equal Opportunity shall have such powers and duties as the Director may delegate to the Office, including—

(A) providing oversight and enforcement of Federal laws intended to ensure the fair, equitable, and nondiscriminatory access to credit for both individuals and communities that are enforced by the Bureau, including the Equal Credit Opportunity Act and the Home Mortgage Disclosure Act;

(B) coordinating fair lending efforts of the Bureau with other Federal agencies and State regulators, as appropriate, to promote consistent, efficient, and effective enforcement of Federal fair lending laws;

(C) working with private industry, fair lending, civil rights, consumer and community advocates on the promotion of fair lending compliance and education; and

(D) providing annual reports to Congress on the efforts of the Bureau to fulfill its fair lending mandate.

(3) ADMINISTRATION OF OFFICE.—There is established the position of Assistant Director of the Bureau for Fair Lending and Equal Opportunity, who—

(A) shall be appointed by the Director; and

(B) shall carry out such duties as the Director may delegate to such Assistant Director.

(d) OFFICE OF FINANCIAL EDUCATION.—

(1) ESTABLISHMENT.—The Director shall establish an Office of Financial Education, which shall be responsible for developing and implementing initiatives intended to educate and empower consumers to make better informed financial decisions.

(2) OTHER DUTIES.—The Office of Financial Education shall develop and implement a strategy to improve the financial literacy of consumers that includes measurable goals and objectives, in consultation with the Financial Literacy and Education Commission, consistent with the National Strategy for Financial Literacy, through activities including providing opportunities for consumers to access—

(A) financial counseling, including community-based financial counseling, where practicable;

(B) information to assist with the evaluation of credit products and the understanding of credit histories and scores;

(C) savings, borrowing, and other services found at mainstream financial institutions;

(D) activities intended to—

(i) prepare the consumer for educational expenses and the submission of financial aid applications, and other major purchases;

(ii) reduce debt; and

(iii) improve the financial situation of the consumer;

(E) assistance in developing long-term savings strategies; and

(F) wealth building and financial services during the preparation process to claim earned income tax credits and Federal benefits.

(3) COORDINATION.—The Office of Financial Education shall coordinate with other units within the Bureau in carrying out its functions, including—

(A) working with the Community Affairs Office to implement the strategy to improve financial literacy of consumers; and

(B) working with the research unit established by the Director to conduct research related to consumer financial education and counseling.

(4) REPORT.—Not later than 24 months after the designated transfer date, and annually thereafter, the Director shall submit a report on its financial literacy activities and strategy to improve financial literacy of consumers to—

(A) the Committee on Banking, Housing, and Urban Affairs of the Senate; and

(B) the Committee on Financial Services of the House of Representatives.

(5) MEMBERSHIP IN FINANCIAL LITERACY AND EDUCATION COMMISSION.—Section 513(c)(1) of the Financial Literacy and Education Improvement Act (20 U.S.C. 9702(c)(1)) is amended—

(A) in subparagraph (B), by striking "and" at the end;

(B) by redesignating subparagraph (C) as subparagraph (D); and

(C) by inserting after subparagraph (B) the following new subparagraph:

"(C) the Director of the Bureau of Consumer Financial Protection; and".

(6) CONFORMING AMENDMENT.—Section 513(d) of the Financial Literacy and Education Improvement Act (20 U.S.C. 9702(d)) is amended by adding at the end the following: "The Director of the Bureau of Consumer Financial Protection shall serve as the Vice Chairman.".

(7) STUDY AND REPORT ON FINANCIAL LITERACY PROGRAM.—

(A) IN GENERAL.—The Comptroller General of the United States shall conduct a study to identify—

(i) the feasibility of certification of persons providing the programs or performing the activities described in paragraph (2), including recognizing outstanding programs, and developing guidelines and resources for community-based practitioners, including—

(I) a potential certification process and standards for certification;

(II) appropriate certifying entities;

(III) resources required for funding such a process; and

(IV) a cost-benefit analysis of such certification;

(ii) technological resources intended to collect, analyze, evaluate, or promote financial literacy and counseling programs;

(iii) effective methods, tools, and strategies intended to educate and empower consumers about personal finance management; and

(iv) recommendations intended to encourage the development of programs that effectively improve financial education outcomes and empower consumers to make better informed financial decisions based on findings.

(B) REPORT.—Not later than 1 year after the date of enactment of this Act, the Comptroller General of the United States shall submit a report on the results of the study conducted under this paragraph to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

(e) OFFICE OF SERVICE MEMBER AFFAIRS.—

(1) IN GENERAL.—The Director shall establish an Office of Service Member Affairs, which shall be responsible for developing and implementing initiatives for service members and their families intended to—

(A) educate and empower service members and their families to make better informed decisions regarding consumer financial products and services;

(B) coordinate with the unit of the Bureau established under subsection (b)(3), in order to monitor complaints by service members and their families and responses to those complaints by the Bureau or other appropriate Federal or State agency; and

(C) coordinate efforts among Federal and State agencies, as appropriate, regarding consumer protection measures relating to consumer financial products and services offered to, or used by, service members and their families.

(2) COORDINATION.—

(A) REGIONAL SERVICES.—The Director is authorized to assign employees of the Bureau as may be deemed necessary to conduct the business of the Office of Service Member Affairs, including by establishing and maintaining the functions of the Office in regional offices of the Bureau located near military bases, military treatment facilities, or other similar military facilities.

(B) AGREEMENTS.—The Director is authorized to enter into memoranda of understanding and similar agreements with the Department of Defense, including any branch or agency as authorized by the department, in order to carry out the business of the Office of Service Member Affairs.

(3) DEFINITION.—As used in this subsection, the term "service member" means any member of the United States Armed Forces and any member of the National Guard or Reserves.

(f) TIMING.—The Office of Fair Lending and Equal Opportunity, the Office of Financial Education, and the Office of Service Member Affairs shall each be established not later than 1 year after the designated transfer date.

(g) OFFICE OF FINANCIAL PROTECTION FOR OLDER AMERICANS.—

(1) ESTABLISHMENT.—Before the end of the 180-day period beginning on the designated transfer date, the Director shall

establish the Office of Financial Protection for Older Americans, the functions of which shall include activities designed to facilitate the financial literacy of individuals who have attained the age of 62 years or more (in this subsection, referred to as "seniors") on protection from unfair, deceptive, and abusive practices and on current and future financial choices, including through the dissemination of materials to seniors on such topics.

(2) ASSISTANT DIRECTOR.—The Office of Financial Protection for Older Americans (in this subsection referred to as the "Office") shall be headed by an assistant director.

(3) DUTIES.—The Office shall—

(A) develop goals for programs that provide seniors financial literacy and counseling, including programs that—

(i) help seniors recognize warning signs of unfair, deceptive, or abusive practices, protect themselves from such practices;

(ii) provide one-on-one financial counseling on issues including long-term savings and later-life economic security; and

(iii) provide personal consumer credit advocacy to respond to consumer problems caused by unfair, deceptive, or abusive practices;

(B) monitor certifications or designations of financial advisors who advise seniors and alert the Commission and State regulators of certifications or designations that are identified as unfair, deceptive, or abusive;

(C) not later than 18 months after the date of the establishment of the Office, submit to Congress and the Commission any legislative and regulatory recommendations on the best practices for—

(i) disseminating information regarding the legitimacy of certifications of financial advisers who advise seniors;

(ii) methods in which a senior can identify the financial advisor most appropriate for the senior's needs; and

(iii) methods in which a senior can verify a financial advisor's credentials;

(D) conduct research to identify best practices and effective methods, tools, technology and strategies to educate and counsel seniors about personal finance management with a focus on—

(i) protecting themselves from unfair, deceptive, and abusive practices;

(ii) long-term savings; and

(iii) planning for retirement and long-term care;

(E) coordinate consumer protection efforts of seniors with other Federal agencies and State regulators, as appropriate, to promote consistent, effective, and efficient enforcement; and

(F) work with community organizations, non-profit organizations, and other entities that are involved with educating or assisting seniors (including the National Education and Resource Center on Women and Retirement Planning).

SEC. 1014. CONSUMER ADVISORY BOARD.

(a) ESTABLISHMENT REQUIRED.—The Director shall establish a Consumer Advisory Board to advise and consult with the Bureau in the exercise of its functions under the Federal consumer financial laws, and to provide information on emerging practices in the consumer financial products or services industry, including regional trends, concerns, and other relevant information.

(b) MEMBERSHIP.—In appointing the members of the Consumer Advisory Board, the Director shall seek to assemble experts in consumer protection, financial services, community development, fair lending and civil rights, and consumer financial products or services and representatives of depository institutions that primarily serve underserved communities, and representatives of communities that have been significantly impacted by higher-priced mortgage loans, and seek representation of the interests of covered persons and consumers, without regard to party affiliation. Not fewer than 6 members shall be appointed upon the recommendation of the regional Federal Reserve Bank Presidents, on a rotating basis.

(c) MEETINGS.—The Consumer Advisory Board shall meet from time to time at the call of the Director, but, at a minimum, shall meet at least twice in each year.

(d) COMPENSATION AND TRAVEL EXPENSES.—Members of the Consumer Advisory Board who are not full-time employees of the United States shall—

(1) be entitled to receive compensation at a rate fixed by the Director while attending meetings of the Consumer Advisory Board, including travel time; and

(2) be allowed travel expenses, including transportation and subsistence, while away from their homes or regular places of business.

SEC. 1015. COORDINATION.

The Bureau shall coordinate with the Commission, the Commodity Futures Trading Commission, the Federal Trade Commission, and other Federal agencies and State regulators, as appropriate, to promote consistent regulatory treatment of consumer financial and investment products and services.

SEC. 1016. APPEARANCES BEFORE AND REPORTS TO CONGRESS.

(a) APPEARANCES BEFORE CONGRESS.—The Director of the Bureau shall appear before the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services and the Committee on Energy and Commerce of the House of Representatives at semi-annual hearings regarding the reports required under subsection (b).

(b) REPORTS REQUIRED.—The Bureau shall, concurrent with each semi-annual hearing referred to in subsection (a), prepare and submit to the President and to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services and the Committee on Energy and Commerce of the House of Representatives, a report, beginning with the session following the designated transfer date. The Bureau may also submit such report to the Committee on Commerce, Science, and Transportation of the Senate.

(c) CONTENTS.—The reports required by subsection (b) shall include—

(1) a discussion of the significant problems faced by consumers in shopping for or obtaining consumer financial products or services;

(2) a justification of the budget request of the previous year;

(3) a list of the significant rules and orders adopted by the Bureau, as well as other significant initiatives conducted by the Bureau, during the preceding year and the plan of the Bureau for rules, orders, or other initiatives to be undertaken during the upcoming period;

(4) an analysis of complaints about consumer financial products or services that the Bureau has received and collected in its central database on complaints during the preceding year;

(5) a list, with a brief statement of the issues, of the public supervisory and enforcement actions to which the Bureau was a party during the preceding year;

(6) the actions taken regarding rules, orders, and supervisory actions with respect to covered persons which are not credit unions or depository institutions;

(7) an assessment of significant actions by State attorneys general or State regulators relating to Federal consumer financial law;

(8) an analysis of the efforts of the Bureau to fulfill the fair lending mission of the Bureau; and

(9) an analysis of the efforts of the Bureau to increase workforce and contracting diversity consistent with the procedures established by the Office of Minority and Women Inclusion.

SEC. 1017. FUNDING; PENALTIES AND FINES.

(a) TRANSFER OF FUNDS FROM BOARD OF GOVERNORS.—

(1) IN GENERAL.—Each year (or quarter of such year), beginning on the designated transfer date, and each quarter thereafter, the Board of Governors shall transfer to the Bureau from the combined earnings of the Federal Reserve System, the amount determined by the Director to be reasonably necessary to carry out the authorities of the Bureau under Federal consumer financial law, taking into account such other sums made available to the Bureau from the preceding year (or quarter of such year).

(2) FUNDING CAP.—

(A) IN GENERAL.—Notwithstanding paragraph (1), and in accordance with this paragraph, the amount that shall be transferred to the Bureau in each fiscal year shall not exceed a fixed percentage of the total operating expenses of the Federal Reserve System, as reported in the Annual Report, 2009, of the Board of Governors, equal to—

(i) 10 percent of such expenses in fiscal year 2011;

(ii) 11 percent of such expenses in fiscal year 2012; and

(iii) 12 percent of such expenses in fiscal year 2013, and in each year thereafter.

(B) ADJUSTMENT OF AMOUNT.—The dollar amount referred to in subparagraph (A)(iii) shall be adjusted annually, using the percent increase, if any, in the employment cost index for total compensation for State and local government workers published by the Federal Government, or the successor index thereto, for the 12-month period ending on September 30 of the year preceding the transfer.

(C) REVIEWABILITY.—Notwithstanding any other provision in this title, the funds derived from the Federal Reserve System pursuant to this subsection shall not be subject to review by the Committees on Appropriations of the House of Representatives and the Senate.

(3) TRANSITION PERIOD.—Beginning on the date of enactment of this Act and until the designated transfer date, the Board of Governors shall transfer to the Bureau the amount estimated by the Secretary needed to carry out the authorities granted to the Bureau under Federal consumer financial law, from the date of enactment of this Act until the designated transfer date.

(4) BUDGET AND FINANCIAL MANAGEMENT.—

(A) FINANCIAL OPERATING PLANS AND FORECASTS.—The Director shall provide to the Director of the Office of Management and Budget copies of the financial operating plans and forecasts of the Director, as prepared by the Director in the ordinary course of the operations of the Bureau, and copies of the quarterly reports of the financial condition and results of operations of the Bureau, as prepared by the Director in the ordinary course of the operations of the Bureau.

(B) FINANCIAL STATEMENTS.—The Bureau shall prepare annually a statement of—

(i) assets and liabilities and surplus or deficit;

(ii) income and expenses; and

(iii) sources and application of funds.

(C) FINANCIAL MANAGEMENT SYSTEMS.—The Bureau shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements and applicable Federal accounting standards.

(D) ASSERTION OF INTERNAL CONTROLS.—The Director shall provide to the Comptroller General of the United States an assertion as to the effectiveness of the internal controls that apply to financial reporting by the Bureau, using the standards established in section 3512(c) of title 31, United States Code.

(E) RULE OF CONSTRUCTION.—This subsection may not be construed as implying any obligation on the part of the Director to consult with or obtain the consent or approval of the Director of the Office of Management and Budget with respect to any report, plan, forecast, or other information referred to in subparagraph (A) or any jurisdiction or oversight over the affairs or operations of the Bureau.

(F) FINANCIAL STATEMENTS.—The financial statements of the Bureau shall not be consolidated with the financial statements of either the Board of Governors or the Federal Reserve System.

(5) AUDIT OF THE BUREAU.—

(A) IN GENERAL.—The Comptroller General shall annually audit the financial transactions of the Bureau in accordance with the United States generally accepted government auditing standards, as may be prescribed by the Comptroller General of the United States. The audit shall be conducted at the place or places where accounts of the Bureau are normally kept. The representatives of the Government Accountability Office shall have access to the personnel and to all books, accounts, documents, papers, records (including electronic records), reports, files, and all other papers, automated data, things, or property belonging to or under the control of or used or employed by the Bureau pertaining to its financial transactions and necessary to facilitate the audit, and such representatives shall be afforded full facilities for verifying transactions with the balances or securities held by depositories, fiscal agents, and custodians. All such books, accounts, documents, records, reports, files, papers, and property of the Bureau shall remain in possession and custody of the Bureau. The Comptroller General may obtain and duplicate any such books, accounts, documents, records, working papers, automated data and files, or other information relevant to such audit without cost to the Comptroller General, and the right of access of the Comptroller General to such information shall be enforceable pursuant to section 716(c) of title 31, United States Code.

(B) REPORT.—The Comptroller General shall submit to the Congress a report of each annual audit conducted under this subsection. The report to the Congress shall set forth the scope of the audit and shall include the statement of assets and liabilities and surplus or deficit, the statement of income and expenses, the statement of sources and application of funds, and such comments and information as may be deemed necessary to inform Congress of the financial operations and condition of the Bureau, together with such recommendations with respect thereto as the Comptroller General may deem advisable. A copy of each report shall be furnished to the President and to the Bureau at the time submitted to the Congress.

(C) ASSISTANCE AND COSTS.—For the purpose of conducting an audit under this subsection, the Comptroller General may, in the discretion of the Comptroller General, employ by contract, without regard to section 3709 of the Revised Statutes of the United States (41 U.S.C. 5), professional services of firms and organizations of certified public accountants for temporary periods or for special purposes. Upon the request of the Comptroller General, the Director of the Bureau shall transfer to the Government Accountability Office from funds available, the amount requested by the Comptroller General to cover the full costs of any audit and report conducted by the Comptroller General. The Comptroller General shall credit funds transferred to the account established for salaries and expenses of the Government Accountability Office, and such amount shall be available upon receipt and without fiscal year limitation to cover the full costs of the audit and report.

(b) CONSUMER FINANCIAL PROTECTION FUND.—

(1) SEPARATE FUND IN FEDERAL RESERVE ESTABLISHED.—There is established in the Federal Reserve a separate fund, to be known as the "Bureau of Consumer Financial Protection Fund" (referred to in this section as the "Bureau Fund"). The Bureau Fund shall be maintained and established at a Federal reserve bank, in accordance with such requirements as the Board of Governors may impose.

(2) FUND RECEIPTS.—All amounts transferred to the Bureau under subsection (a) shall be deposited into the Bureau Fund.

(3) INVESTMENT AUTHORITY.—

(A) AMOUNTS IN BUREAU FUND MAY BE INVESTED.—The Bureau may request the Board of Governors to direct the investment of the portion of the Bureau Fund that is not, in the judgment of the Bureau, required to meet the current needs of the Bureau.

(B) ELIGIBLE INVESTMENTS.—Investments authorized by this paragraph shall be made in obligations of the United States or obligations that are guaranteed as to principal and interest by the United States, with maturities suitable to the needs of the Bureau Fund, as determined by the Bureau.

(C) INTEREST AND PROCEEDS CREDITED.—The interest on, and the proceeds from the sale or redemption of, any obligations held in the Bureau Fund shall be credited to the Bureau Fund.

(c) USE OF FUNDS.—

(1) IN GENERAL.—Funds obtained by, transferred to, or credited to the Bureau Fund shall be immediately available to the Bureau and under the control of the Director, and shall remain available until expended, to pay the expenses of the Bureau in carrying out its duties and responsibilities. The compensation of the Director and other employees of the Bureau and all other expenses thereof may be paid from, obtained by, transferred to, or credited to the Bureau Fund under this section.

(2) FUNDS THAT ARE NOT GOVERNMENT FUNDS.—Funds obtained by or transferred to the Bureau Fund shall not be construed to be Government funds or appropriated monies.

(3) AMOUNTS NOT SUBJECT TO APPORTIONMENT.—Notwithstanding any other provision of law, amounts in the Bureau Fund and in the Civil Penalty Fund established under subsection (d) shall not be subject to apportionment for purposes of chapter 15 of title 31, United States Code, or under any other authority.

(d) PENALTIES AND FINES.—

(1) ESTABLISHMENT OF VICTIMS RELIEF FUND.—There is established in the Federal Reserve a separate fund, to be known as the "Consumer Financial Civil Penalty Fund" (referred to in this section as the "Civil Penalty Fund"). The Civil Penalty Fund shall be maintained and established at a Federal reserve bank, in accordance with such requirements as the Board of Governors may impose. If the Bureau obtains a civil penalty against any person in any judicial or administrative action under Federal consumer financial laws, the Bureau shall deposit into the Civil Penalty Fund, the amount of the penalty collected.

(2) PAYMENT TO VICTIMS.—Amounts in the Civil Penalty Fund shall be available to the Bureau, without fiscal year limitation, for payments to the victims of activities for which civil penalties have been imposed under the Federal consumer financial laws. To the extent that such victims cannot be located or such payments are otherwise not practicable, the Bureau may use such funds for the purpose of consumer education and financial literacy programs.

(e) AUTHORIZATION OF APPROPRIATIONS; ANNUAL REPORT.—

(1) DETERMINATION REGARDING NEED FOR APPROPRIATED FUNDS.—

(A) IN GENERAL.—The Director is authorized to determine that sums available to the Bureau under this section will not be sufficient to carry out the authorities of the Bureau under Federal consumer financial law for the upcoming year.

(B) REPORT REQUIRED.—When making a determination under subparagraph (A), the Director shall prepare a report regarding the funding of the Bureau, including the assets and liabilities of the Bureau, and the extent to which the funding needs of the Bureau are anticipated to exceed the level of the amount set forth in subsection (a)(2). The Director shall submit the report to the President and to the Committee on Appropriations of the Senate and the Committee on Appropriations of the House of Representatives.

(2) AUTHORIZATION OF APPROPRIATIONS.—If the Director makes the determination and submits the report pursuant to paragraph (1), there are hereby authorized to be appropriated to the Bureau, for the purposes of carrying out the authorities granted in Federal consumer financial law, $200,000,000 for each of fiscal years 2010, 2011, 2012, 2013, and 2014.

(3) APPORTIONMENT.—Notwithstanding any other provision of law, the amounts in paragraph (2) shall be subject to apportionment under section 1517 of title 31, United States Code, and restrictions that generally apply to the use of appropriated funds in title 31, United States Code, and other laws.

(4) ANNUAL REPORT.—The Director shall prepare and submit a report, on an annual basis, to the Committee on Appropriations of the Senate and the Committee on Appropriations of the House of Representatives regarding the financial operating plans and forecasts of the Director, the financial condition and results of operations of the Bureau, and the sources and application of funds of the Bureau, including any funds appropriated in accordance with this subsection.

SEC. 1018. EFFECTIVE DATE.

This subtitle shall become effective on the date of enactment of this Act.

Subtitle B—General Powers of the Bureau

SEC. 1021. PURPOSE, OBJECTIVES, AND FUNCTIONS.

(a) PURPOSE.—The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.

(b) OBJECTIVES.—The Bureau is authorized to exercise its authorities under Federal consumer financial law for the purposes of ensuring that, with respect to consumer financial products and services—

(1) consumers are provided with timely and understandable information to make responsible decisions about financial transactions;

(2) consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination;

(3) outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens;

(4) Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and

(5) markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.

(c) FUNCTIONS.—The primary functions of the Bureau are—

(1) conducting financial education programs;

(2) collecting, investigating, and responding to consumer complaints;

(3) collecting, researching, monitoring, and publishing information relevant to the functioning of markets for consumer financial products and services to identify risks to consumers and the proper functioning of such markets;

(4) subject to sections 1024 through 1026, supervising covered persons for compliance with Federal consumer financial law, and taking appropriate enforcement action to address violations of Federal consumer financial law;

(5) issuing rules, orders, and guidance implementing Federal consumer financial law; and

(6) performing such support activities as may be necessary or useful to facilitate the other functions of the Bureau.

SEC. 1022. RULEMAKING AUTHORITY.

(a) IN GENERAL.—The Bureau is authorized to exercise its authorities under Federal consumer financial law to administer, enforce, and otherwise implement the provisions of Federal consumer financial law.

(b) RULEMAKING, ORDERS, AND GUIDANCE.—

(1) GENERAL AUTHORITY.—The Director may prescribe rules and issue orders and guidance, as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof.

(2) STANDARDS FOR RULEMAKING.—In prescribing a rule under the Federal consumer financial laws—

(A) the Bureau shall consider—

(i) the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule; and

(ii) the impact of proposed rules on covered persons, as described in section 1026, and the impact on consumers in rural areas;

(B) the Bureau shall consult with the appropriate prudential regulators or other Federal agencies prior to proposing a rule and during the comment process regarding consistency with prudential, market, or systemic objectives administered by such agencies; and

(C) if, during the consultation process described in subparagraph (B), a prudential regulator provides the Bureau with a written objection to the proposed rule of the Bureau or a portion thereof, the Bureau shall include in the adopting release a description of the objection and the basis for the Bureau decision, if any, regarding such objection, except that nothing in this clause shall be construed as altering or limiting the procedures under section 1023 that may apply to any rule prescribed by the Bureau.

(3) EXEMPTIONS.—

(A) IN GENERAL.—The Bureau, by rule, may conditionally or unconditionally exempt any class of covered persons, service providers, or consumer financial products or services, from any provision of this title, or from any rule issued under this title, as the Bureau determines necessary or appropriate to carry out the purposes and objectives of this title, taking into consideration the factors in subparagraph (B).

(B) FACTORS.—In issuing an exemption, as permitted under subparagraph (A), the Bureau shall, as appropriate, take into consideration—

(i) the total assets of the class of covered persons;

(ii) the volume of transactions involving consumer financial products or services in which the class of covered persons engages; and

(iii) existing provisions of law which are applicable to the consumer financial product or service and the extent to which such provisions provide consumers with adequate protections.

(4) EXCLUSIVE RULEMAKING AUTHORITY.—

(A) IN GENERAL.—Notwithstanding any other provisions of Federal law and except as provided in section 1061(b)(5), to the extent that a provision of Federal consumer financial law authorizes the Bureau and another Federal agency to issue regulations under that provision of law for purposes of assuring compliance with Federal consumer financial law and any regulations thereunder, the Bureau shall have the exclusive authority to prescribe rules subject to those provisions of law.

(B) DEFERENCE.—Notwithstanding any power granted to any Federal agency or to the Council under this title, and subject to section 1061(b)(5)(E), the deference that a court affords to the Bureau with respect to a determination by the Bureau regarding the meaning or interpretation of any provision of a Federal consumer financial law shall be applied as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law.

(c) MONITORING.—

(1) IN GENERAL.—In order to support its rulemaking and other functions, the Bureau shall monitor for risks to consumers in the offering or provision of consumer financial products or services, including developments in markets for such products or services.

(2) CONSIDERATIONS.—In allocating its resources to perform the monitoring required by this section, the Bureau may consider, among other factors—

(A) likely risks and costs to consumers associated with buying or using a type of consumer financial product or service;

(B) understanding by consumers of the risks of a type of consumer financial product or service;

(C) the legal protections applicable to the offering or provision of a consumer financial product or service, including the extent to which the law is likely to adequately protect consumers;

(D) rates of growth in the offering or provision of a consumer financial product or service;

(E) the extent, if any, to which the risks of a consumer financial product or service may disproportionately affect traditionally underserved consumers; or

(F) the types, number, and other pertinent characteristics of covered persons that offer or provide the consumer financial product or service.

(3) SIGNIFICANT FINDINGS.—

(A) IN GENERAL.—The Bureau shall publish not fewer than 1 report of significant findings of its monitoring required by this subsection in each calendar year, beginning with the first calendar year that begins at least 1 year after the designated transfer date.

(B) CONFIDENTIAL INFORMATION.—The Bureau may make public such information obtained by the Bureau under this section as is in the public interest, through aggregated reports or other appropriate formats designed to protect confidential information in accordance with paragraphs (4), (6), (8), and (9).

(4) COLLECTION OF INFORMATION.—

(A) IN GENERAL.—In conducting any monitoring or assessment required by this section, the Bureau shall have the authority to gather information from time to time regarding the organization, business conduct, markets, and activities of covered persons and service providers.

(B) METHODOLOGY.—In order to gather information described in subparagraph (A), the Bureau may—

(i) gather and compile information from a variety of sources, including examination reports concerning covered persons or service providers, consumer complaints, voluntary surveys and voluntary interviews of consumers, surveys and interviews with covered persons and service providers, and review of available databases; and

(ii) require covered persons and service providers participating in consumer financial services markets to file with the Bureau, under oath or otherwise, in such form and within such reasonable period of time as the Bureau may prescribe by rule or order, annual or special reports, or answers in writing to specific questions, furnishing information described in paragraph (4), as necessary for the Bureau to fulfill the monitoring, assessment, and reporting responsibilities imposed by Congress.

(C) LIMITATION.—The Bureau may not use its authorities under this paragraph to obtain records from covered persons and service providers participating in consumer financial services markets for purposes of gathering or analyzing the personally identifiable financial information of consumers.

(5) LIMITED INFORMATION GATHERING.—In order to assess whether a nondepository is a covered person, as defined in section 1002, the Bureau may require such nondepository to file with the Bureau, under oath or otherwise, in such form and within such reasonable period of time as the Bureau may prescribe by rule or order, annual or special reports, or answers in writing to specific questions.

(6) CONFIDENTIALITY RULES.—

(A) RULEMAKING.—The Bureau shall prescribe rules regarding the confidential treatment of information obtained from persons in connection with the exercise of its authorities under Federal consumer financial law.

(B) ACCESS BY THE BUREAU TO REPORTS OF OTHER REGULATORS.—

(i) EXAMINATION AND FINANCIAL CONDITION REPORTS.—Upon providing reasonable assurances of confidentiality, the Bureau shall have access to any report of examination or financial condition made by a prudential regulator or other Federal agency having jurisdiction over a covered person or service provider, and to all revisions made to any such report.

(ii) PROVISION OF OTHER REPORTS TO THE BUREAU.—In addition to the reports described in clause (i), a prudential regulator or other Federal agency having jurisdiction over a covered person or service provider may, in its discretion, furnish to the Bureau any other report or other confidential supervisory information concerning any insured depository institution, credit union, or other entity examined by such agency under authority of any provision of Federal law.

(C) ACCESS BY OTHER REGULATORS TO REPORTS OF THE BUREAU.—

(i) EXAMINATION REPORTS.—Upon providing reasonable assurances of confidentiality, a prudential regulator, a State regulator, or any other Federal agency having jurisdiction over a covered person or service provider shall have access to any report of examination made by the Bureau with respect to such person, and to all revisions made to any such report.

(ii) PROVISION OF OTHER REPORTS TO OTHER REGULATORS.—In addition to the reports described in clause (i), the Bureau may, in its discretion, furnish to a prudential regulator or other agency having jurisdiction over a covered person or service provider any other report or other confidential supervisory information concerning such person examined by the Bureau under the authority of any other provision of Federal law.

(7) REGISTRATION.—

(A) IN GENERAL.—The Bureau may prescribe rules regarding registration requirements applicable to a covered person, other than an insured depository institution, insured credit union, or related person.

(B) REGISTRATION INFORMATION.—Subject to rules prescribed by the Bureau, the Bureau may publicly disclose registration information to facilitate the ability of consumers to identify covered persons that are registered with the Bureau.

(C) CONSULTATION WITH STATE AGENCIES.—In developing and implementing registration requirements under this paragraph, the Bureau shall consult with State agencies regarding requirements or systems (including coordinated or combined systems for registration), where appropriate.

(8) PRIVACY CONSIDERATIONS.—In collecting information from any person, publicly releasing information held by the Bureau, or requiring covered persons to publicly report information, the Bureau shall take steps to ensure that proprietary, personal, or confidential consumer information that is protected from public disclosure under section 552(b) or 552a of title 5, United States Code, or any other provision of law, is not made public under this title.

(9) CONSUMER PRIVACY.—

(A) IN GENERAL.—The Bureau may not obtain from a covered person or service provider any personally identifiable financial information about a consumer from the financial records of the covered person or service provider, except—

(i) if the financial records are reasonably described in a request by the Bureau and the consumer provides written permission for the disclosure of such information by the covered person or service provider to the Bureau; or

(ii) as may be specifically permitted or required under other applicable provisions of law and in accordance with the Right to Financial Privacy Act of 1978 (12 U.S.C. 3401 et seq.).

(B) TREATMENT OF COVERED PERSON OR SERVICE PROVIDER.—With respect to the application of any provision of the Right to Financial Privacy Act of 1978, to a disclosure by a covered person or service provider subject to this subsection, the covered person or service provider shall be treated as if it were a "financial institution", as defined in section 1101 of that Act (12 U.S.C. 3401).

(d) ASSESSMENT OF SIGNIFICANT RULES.—

(1) IN GENERAL.—The Bureau shall conduct an assessment of each significant rule or order adopted by the Bureau under Federal consumer financial law. The assessment shall address, among other relevant factors, the effectiveness of the rule or order in meeting the purposes and objectives of this title and the specific goals stated by the Bureau. The assessment shall

reflect available evidence and any data that the Bureau reasonably may collect.

(2) REPORTS.—The Bureau shall publish a report of its assessment under this subsection not later than 5 years after the effective date of the subject rule or order.

(3) PUBLIC COMMENT REQUIRED.—Before publishing a report of its assessment, the Bureau shall invite public comment on recommendations for modifying, expanding, or eliminating the newly adopted significant rule or order.

SEC. 1023. REVIEW OF BUREAU REGULATIONS.

(a) REVIEW OF BUREAU REGULATIONS.—On the petition of a member agency of the Council, the Council may set aside a final regulation prescribed by the Bureau, or any provision thereof, if the Council decides, in accordance with subsection (c), that the regulation or provision would put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk.

(b) PETITION.—

(1) PROCEDURE.—An agency represented by a member of the Council may petition the Council, in writing, and in accordance with rules prescribed pursuant to subsection (f), to stay the effectiveness of, or set aside, a regulation if the member agency filing the petition—

(A) has in good faith attempted to work with the Bureau to resolve concerns regarding the effect of the rule on the safety and soundness of the United States banking system or the stability of the financial system of the United States; and

(B) files the petition with the Council not later than 10 days after the date on which the regulation has been published in the Federal Register.

(2) PUBLICATION.—Any petition filed with the Council under this section shall be published in the Federal Register and transmitted contemporaneously with filing to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

(c) STAYS AND SET ASIDES.—

(1) STAY.—

(A) IN GENERAL.—Upon the request of any member agency, the Chairperson of the Council may stay the effectiveness of a regulation for the purpose of allowing appropriate consideration of the petition by the Council.

(B) EXPIRATION.—A stay issued under this paragraph shall expire on the earlier of—

(i) 90 days after the date of filing of the petition under subsection (b); or

(ii) the date on which the Council makes a decision under paragraph (3).

(2) NO ADVERSE INFERENCE.—After the expiration of any stay imposed under this section, no inference shall be drawn regarding the validity or enforceability of a regulation which was the subject of the petition.

(3) VOTE.—

(A) IN GENERAL.—The decision to issue a stay of, or set aside, any regulation under this section shall be made only with the affirmative vote in accordance with subparagraph (B) of 2/3 of the members of the Council then serving.

(B) AUTHORIZATION TO VOTE.—A member of the Council may vote to stay the effectiveness of, or set aside, a final regulation prescribed by the Bureau only if the agency or department represented by that member has—

(i) considered any relevant information provided by the agency submitting the petition and by the Bureau; and

(ii) made an official determination, at a public meeting where applicable, that the regulation which is the subject of the petition would put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk.

(4) DECISIONS TO SET ASIDE.—

(A) EFFECT OF DECISION.—A decision by the Council to set aside a regulation prescribed by the Bureau, or provision thereof, shall render such regulation, or provision thereof, unenforceable.

(B) TIMELY ACTION REQUIRED.—The Council may not issue a decision to set aside a regulation, or provision thereof, which is the subject of a petition under this section after the expiration of the later of—

(i) 45 days following the date of filing of the petition, unless a stay is issued under paragraph (1); or

(ii) the expiration of a stay issued by the Council under this section.

(C) SEPARATE AUTHORITY.—The issuance of a stay under this section does not affect the authority of the Council to set aside a regulation.

(5) DISMISSAL DUE TO INACTION.—A petition under this section shall be deemed dismissed if the Council has not issued a decision to set aside a regulation, or provision thereof, within the period for timely action under paragraph (4)(B).

(6) PUBLICATION OF DECISION.—Any decision under this subsection to issue a stay of, or set aside, a regulation or provision thereof shall be published by the Council in the Federal Register as soon as practicable after the decision is made, with an explanation of the reasons for the decision.

(7) RULEMAKING PROCEDURES INAPPLICABLE.—The notice and comment procedures under section 553 of title 5, United States Code, shall not apply to any decision under this section of the Council to issue a stay of, or set aside, a regulation.

(8) JUDICIAL REVIEW OF DECISIONS BY THE COUNCIL.—A decision by the Council to set aside a regulation prescribed by the Bureau, or provision thereof, shall be subject to review under chapter 7 of title 5, United States Code.

(d) APPLICATION OF OTHER LAW.—Nothing in this section shall be construed as altering, limiting, or restricting the application of any other provision of law, except as otherwise specifically provided in this section, including chapter 5 and chapter 7 of title 5, United States Code, to a regulation which is the subject of a petition filed under this section.

(e) SAVINGS CLAUSE.—Nothing in this section shall be construed as limiting or restricting the Bureau from engaging in a rulemaking in accordance with applicable law.

(f) IMPLEMENTING RULES.—The Council shall prescribe procedural rules to implement this section.

SEC. 1024. SUPERVISION OF NONDEPOSITORY COVERED PERSONS.

(a) SCOPE OF COVERAGE.—

(1) APPLICABILITY.—Notwithstanding any other provision of this title, and except as provided in paragraph (3), this section shall apply to any covered person who—

(A) offers or provides origination, brokerage, or servicing of loans secured by real estate for use by consumers primarily for personal, family, or household purposes, or loan modification or foreclosure relief services in connection with such loans;

(B) is a larger participant of a market for other consumer financial products or services, as defined by rule in accordance with paragraph (2);

(C) the Bureau has reasonable cause to determine, by order, after notice to the covered person and a reasonable opportunity for such covered person to respond, based on complaints collected through the system under section 1013(b)(3) or information from other sources, that such covered person is engaging, or has engaged, in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services;

(D) offers or provides to a consumer any private education loan, as defined in section 140 of the Truth in Lending Act (15 U.S.C. 1650), notwithstanding section 1027(a)(2)(A) and subject to section 1027(a)(2)(C); or

(E) offers or provides to a consumer a payday loan.

(2) RULEMAKING TO DEFINE COVERED PERSONS SUBJECT TO THIS SECTION.—The Bureau shall consult with the Federal Trade Commission prior to issuing a rule, in accordance with paragraph (1)(B), to define covered persons subject to this section. The Bureau shall issue its initial rule not later than 1 year after the designated transfer date.

(3) RULES OF CONSTRUCTION.—

(A) CERTAIN PERSONS EXCLUDED.—This section shall not apply to persons described in section 1025(a) or 1026(a).

(B) ACTIVITY LEVELS.—For purposes of computing activity levels under paragraph (1) or rules issued thereunder, activities of affiliated companies (other than insured depository institutions or insured credit unions) shall be aggregated.

(b) SUPERVISION.—

(1) IN GENERAL.—The Bureau shall require reports and conduct examinations on a periodic basis of persons described in subsection (a)(1) for purposes of—

(A) assessing compliance with the requirements of Federal consumer financial law;

(B) obtaining information about the activities and compliance systems or procedures of such person; and

(C) detecting and assessing risks to consumers and to markets for consumer financial products and services.

(2) RISK-BASED SUPERVISION PROGRAM.—The Bureau shall exercise its authority under paragraph (1) in a manner designed to ensure that such exercise, with respect to persons described in subsection (a)(1), is based on the assessment by the Bureau

of the risks posed to consumers in the relevant product markets and geographic markets, and taking into consideration, as applicable—

(A) the asset size of the covered person;

(B) the volume of transactions involving consumer financial products or services in which the covered person engages;

(C) the risks to consumers created by the provision of such consumer financial products or services;

(D) the extent to which such institutions are subject to oversight by State authorities for consumer protection; and

(E) any other factors that the Bureau determines to be relevant to a class of covered persons.

(3) COORDINATION.—To minimize regulatory burden, the Bureau shall coordinate its supervisory activities with the supervisory activities conducted by prudential regulators and the State bank regulatory authorities, including establishing their respective schedules for examining persons described in subsection (a)(1) and requirements regarding reports to be submitted by such persons.

(4) USE OF EXISTING REPORTS.—The Bureau shall, to the fullest extent possible, use—

(A) reports pertaining to persons described in subsection (a)(1) that have been provided or required to have been provided to a Federal or State agency; and

(B) information that has been reported publicly.

(5) PRESERVATION OF AUTHORITY.—Nothing in this title may be construed as limiting the authority of the Director to require reports from persons described in subsection (a)(1), as permitted under paragraph (1), regarding information owned or under the control of such person, regardless of whether such information is maintained, stored, or processed by another person.

(6) REPORTS OF TAX LAW NONCOMPLIANCE.—The Bureau shall provide the Commissioner of Internal Revenue with any report of examination or related information identifying possible tax law noncompliance.

(7) REGISTRATION, RECORDKEEPING AND OTHER REQUIREMENTS FOR CERTAIN PERSONS.—

(A) IN GENERAL.—The Bureau shall prescribe rules to facilitate supervision of persons described in subsection (a)(1) and assessment and detection of risks to consumers.

(B) RECORDKEEPING.—The Bureau may require a person described in subsection (a)(1), to generate, provide, or retain records for the purposes of facilitating supervision of such persons and assessing and detecting risks to consumers.

(C) REQUIREMENTS CONCERNING OBLIGATIONS.—The Bureau may prescribe rules regarding a person described in subsection (a)(1), to ensure that such persons are legitimate entities and are able to perform their obligations to consumers. Such requirements may include background checks for principals, officers, directors, or key personnel and bonding or other appropriate financial requirements.

(D) CONSULTATION WITH STATE AGENCIES.—In developing and implementing requirements under this paragraph, the Bureau shall consult with State agencies regarding requirements or systems (including coordinated or combined systems for registration), where appropriate.

(c) ENFORCEMENT AUTHORITY.—

(1) THE BUREAU TO HAVE ENFORCEMENT AUTHORITY.—Except as provided in paragraph (3) and section 1061, with respect to any person described in subsection (a)(1), to the extent that Federal law authorizes the Bureau and another Federal agency to enforce Federal consumer financial law, the Bureau shall have exclusive authority to enforce that Federal consumer financial law.

(2) REFERRAL.—Any Federal agency authorized to enforce a Federal consumer financial law described in paragraph (1) may recommend in writing to the Bureau that the Bureau initiate an enforcement proceeding, as the Bureau is authorized by that Federal law or by this title.

(3) COORDINATION WITH THE FEDERAL TRADE COMMISSION.—

(A) IN GENERAL.—The Bureau and the Federal Trade Commission shall negotiate an agreement for coordinating with respect to enforcement actions by each agency regarding the offering or provision of consumer financial products or services by any covered person that is described in subsection (a)(1), or service providers thereto. The agreement shall include procedures for notice to the other agency, where feasible, prior to initiating a civil action to enforce any Federal law regarding the offering or provision of consumer financial products or services.

(B) CIVIL ACTIONS.—Whenever a civil action has been filed by, or on behalf of, the Bureau or the Federal Trade Commission for any violation of any provision of Federal law described in subparagraph (A), or any regulation prescribed under such provision of law—

(i) the other agency may not, during the pendency of that action, institute a civil action under such provision of law against any defendant named in the complaint in such pending action for any violation alleged in the complaint; and

(ii) the Bureau or the Federal Trade Commission may intervene as a party in any such action brought by the other agency, and, upon intervening—

(I) be heard on all matters arising in such enforcement action; and

(II) file petitions for appeal in such actions.

(C) AGREEMENT TERMS.—The terms of any agreement negotiated under subparagraph (A) may modify or supersede the provisions of subparagraph (B).

(D) DEADLINE.—The agencies shall reach the agreement required under subparagraph (A) not later than 6 months after the designated transfer date.

(d) EXCLUSIVE RULEMAKING AND EXAMINATION AUTHORITY.—Notwithstanding any other provision of Federal law and except as provided in section 1061, to the extent that Federal law authorizes the Bureau and another Federal agency to issue regulations or guidance, conduct examinations, or require reports from a person described in subsection (a)(1) under such law for purposes of assuring compliance with Federal consumer financial law and any regulations thereunder, the Bureau shall have the exclusive authority to prescribe rules, issue guidance, conduct examinations, require reports, or issue exemptions with regard to a person described in subsection (a)(1), subject to those provisions of law.

(e) SERVICE PROVIDERS.—A service provider to a person described in subsection (a)(1) shall be subject to the authority of the Bureau under this section, to the same extent as if such service provider were engaged in a service relationship with a bank, and the Bureau were an appropriate Federal banking agency under section 7(c) of the Bank Service Company Act (12 U.S.C. 1867(c)). In conducting any examination or requiring any report from a service provider subject to this subsection, the Bureau shall coordinate with the appropriate prudential regulator, as applicable.

(f) PRESERVATION OF FARM CREDIT ADMINISTRATION AUTHORITY.—No provision of this title may be construed as modifying, limiting, or otherwise affecting the authority of the Farm Credit Administration.

SEC. 1025. SUPERVISION OF VERY LARGE BANKS, SAVINGS ASSOCIATIONS, AND CREDIT UNIONS.

(a) SCOPE OF COVERAGE.—This section shall apply to any covered person that is—

(1) an insured depository institution with total assets of more than $10,000,000,000 and any affiliate thereof; or

(2) an insured credit union with total assets of more than $10,000,000,000 and any affiliate thereof.

(b) SUPERVISION.—

(1) IN GENERAL.—The Bureau shall have exclusive authority to require reports and conduct examinations on a periodic basis of persons described in subsection (a) for purposes of—

(A) assessing compliance with the requirements of Federal consumer financial laws;

(B) obtaining information about the activities subject to such laws and the associated compliance systems or procedures of such persons; and

(C) detecting and assessing associated risks to consumers and to markets for consumer financial products and services.

(2) COORDINATION.—To minimize regulatory burden, the Bureau shall coordinate its supervisory activities with the supervisory activities conducted by prudential regulators and the State bank regulatory authorities, including consultation regarding their respective schedules for examining such persons described in subsection (a) and requirements regarding reports to be submitted by such persons.

(3) USE OF EXISTING REPORTS.—The Bureau shall, to the fullest extent possible, use—

(A) reports pertaining to a person described in subsection (a) that have been provided or required to have been provided to a Federal or State agency; and

(B) information that has been reported publicly.

(4) PRESERVATION OF AUTHORITY.—Nothing in this title may be construed as limiting the authority of the Director to require reports from a person described in subsection (a), as permitted under paragraph (1), regarding information owned

or under the control of such person, regardless of whether such information is maintained, stored, or processed by another person.

(5) REPORTS OF TAX LAW NONCOMPLIANCE.—The Bureau shall provide the Commissioner of Internal Revenue with any report of examination or related information identifying possible tax law noncompliance.

(c) PRIMARY ENFORCEMENT AUTHORITY.—

(1) THE BUREAU TO HAVE PRIMARY ENFORCEMENT AUTHORITY.—To the extent that the Bureau and another Federal agency are authorized to enforce a Federal consumer financial law, the Bureau shall have primary authority to enforce that Federal consumer financial law with respect to any person described in subsection (a).

(2) REFERRAL.—Any Federal agency, other than the Federal Trade Commission, that is authorized to enforce a Federal consumer financial law may recommend, in writing, to the Bureau that the Bureau initiate an enforcement proceeding with respect to a person described in subsection (a), as the Bureau is authorized to do by that Federal consumer financial law.

(3) BACKUP ENFORCEMENT AUTHORITY OF OTHER FEDERAL AGENCY.—If the Bureau does not, before the end of the 120-day period beginning on the date on which the Bureau receives a recommendation under paragraph (2), initiate an enforcement proceeding, the other agency referred to in paragraph (2) may initiate an enforcement proceeding, including performing follow up supervisory and support functions incidental thereto, to assure compliance with such proceeding.

(d) SERVICE PROVIDERS.—A service provider to a person described in subsection (a) shall be subject to the authority of the Bureau under this section, to the same extent as if the Bureau were an appropriate Federal banking agency under section 7(c) of the Bank Service Company Act 12 U.S.C. 1867(c). In conducting any examination or requiring any report from a service provider subject to this subsection, the Bureau shall coordinate with the appropriate prudential regulator.

(e) SIMULTANEOUS AND COORDINATED SUPERVISORY ACTION.—

(1) EXAMINATIONS.—A prudential regulator and the Bureau shall, with respect to each insured depository institution, insured credit union, or other covered person described in subsection (a) that is supervised by the prudential regulator and the Bureau, respectively—

(A) coordinate the scheduling of examinations of the insured depository institution, insured credit union, or other covered person described in subsection (a);

(B) conduct simultaneous examinations of each insured depository institution or insured credit union, unless such institution requests examinations to be conducted separately;

(C) share each draft report of examination with the other agency and permit the receiving agency a reasonable opportunity (which shall not be less than a period of 30 days after the date of receipt) to comment on the draft report before such report is made final; and

(D) prior to issuing a final report of examination or taking supervisory action, take into consideration concerns, if any, raised in the comments made by the other agency.

(2) COORDINATION WITH STATE BANK SUPERVISORS.—The Bureau shall pursue arrangements and agreements with State bank supervisors to coordinate examinations, consistent with paragraph (1).

(3) AVOIDANCE OF CONFLICT IN SUPERVISION.—

(A) REQUEST.—If the proposed supervisory determinations of the Bureau and a prudential regulator (in this section referred to collectively as the "agencies") are conflicting, an insured depository institution, insured credit union, or other covered person described in subsection (a) may request the agencies to coordinate and present a joint statement of coordinated supervisory action.

(B) JOINT STATEMENT.—The agencies shall provide a joint statement under subparagraph (A), not later than 30 days after the date of receipt of the request of the insured depository institution, credit union, or covered person described in subsection (a).

(4) APPEALS TO GOVERNING PANEL.—

(A) IN GENERAL.—If the agencies do not resolve the conflict or issue a joint statement required by subparagraph (B), or if either of the agencies takes or attempts to take any supervisory action relating to the request for the joint statement without the consent of the other agency, an insured depository institution, insured credit union, or other covered person described in subsection (a) may institute an appeal to a governing panel, as provided in this subsection, not later than 30 days after the expiration of the period during which a joint statement is required to be filed under paragraph (3)(B).

(B) COMPOSITION OF GOVERNING PANEL.—The governing panel for an appeal under this paragraph shall be composed of—

(i) a representative from the Bureau and a representative of the prudential regulator, both of whom—

(I) have not participated in the material supervisory determinations under appeal; and

(II) do not directly or indirectly report to the person who participated materially in the supervisory determinations under appeal; and

(ii) one individual representative, to be determined on a rotating basis, from among the Board of Governors, the Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency, other than any agency involved in the subject dispute.

(C) CONDUCT OF APPEAL.—In an appeal under this paragraph—

(i) the insured depository institution, insured credit union, or other covered person described in subsection (a)—

(I) shall include in its appeal all the facts and legal arguments pertaining to the matter; and

(II) may, through counsel, employees, or representatives, appear before the governing panel in person or by telephone; and

(ii) the governing panel—

(I) may request the insured depository institution, insured credit union, or other covered person described in subsection (a), the Bureau, or the prudential regulator to produce additional information relevant to the appeal; and

(II) by a majority vote of its members, shall provide a final determination, in writing, not later than 30 days after the date of filing of an informationally complete appeal, or such longer period as the panel and the insured depository institution, insured credit union, or other covered person described in subsection (a) may jointly agree.

(D) PUBLIC AVAILABILITY OF DETERMINATIONS.—A governing panel shall publish all information contained in a determination by the governing panel, with appropriate redactions of information that would be subject to an exemption from disclosure under section 552 of title 5, United States Code.

(E) PROHIBITION AGAINST RETALIATION.—The Bureau and the prudential regulators shall prescribe rules to provide safeguards from retaliation against the insured depository institution, insured credit union, or other covered person described in subsection (a) instituting an appeal under this paragraph, as well as their officers and employees.

(F) LIMITATION.—The process provided in this paragraph shall not apply to a determination by a prudential regulator to appoint a conservator or receiver for an insured depository institution or a liquidating agent for an insured credit union, as the case may be, or a decision to take action pursuant to section 38 of the Federal Deposit Insurance Act (12 U.S.C. 1831o) or section 212 of the Federal Credit Union Act (112 U.S.C. 1790a), as applicable.

(G) EFFECT ON OTHER AUTHORITY.—Nothing in this section shall modify or limit the authority of the Bureau to interpret, or take enforcement action under, any Federal consumer financial law, or the authority of a prudential regulator to interpret or take enforcement action under any other provision of Federal law for safety and soundness purposes.

SEC. 1026. OTHER BANKS, SAVINGS ASSOCIATIONS, AND CREDIT UNIONS.

(a) SCOPE OF COVERAGE.—This section shall apply to any covered person that is—

(1) an insured depository institution with total assets of $10,000,000,000 or less; or

(2) an insured credit union with total assets of $10,000,000,000 or less.

(b) REPORTS.—The Director may require reports from a person described in subsection (a), as necessary to support the role of the Bureau in implementing Federal consumer financial law, to support its examination activities under subsection (c), and to assess and detect risks to consumers and consumer financial markets.

(1) USE OF EXISTING REPORTS.—The Bureau shall, to the fullest extent possible, use—

(A) reports pertaining to a person described in subsection (a) that have been provided or required to have been provided to a Federal or State agency; and

(B) information that has been reported publicly.

(2) PRESERVATION OF AUTHORITY.—Nothing in this subsection may be construed as limiting the authority of the Director from requiring from a person described in subsection (a), as permitted under paragraph (1), information owned or under the control of such person, regardless of whether such information is maintained, stored, or processed by another person.

(3) REPORTS OF TAX LAW NONCOMPLIANCE.—The Bureau shall provide the Commissioner of Internal Revenue with any report of examination or related information identifying possible tax law noncompliance.

(c) EXAMINATIONS.—

(1) IN GENERAL.—The Bureau may, at its discretion, include examiners on a sampling basis of the examinations performed by the prudential regulator to assess compliance with the requirements of Federal consumer financial law of persons described in subsection (a).

(2) AGENCY COORDINATION.—The prudential regulator shall—

(A) provide all reports, records, and documentation related to the examination process for any institution included in the sample referred to in paragraph (1) to the Bureau on a timely and continual basis;

(B) involve such Bureau examiner in the entire examination process for such person; and

(C) consider input of the Bureau concerning the scope of an examination, conduct of the examination, the contents of the examination report, the designation of matters requiring attention, and examination ratings.

(d) ENFORCEMENT.—

(1) IN GENERAL.—Except for requiring reports under subsection (b), the prudential regulator is authorized to enforce the requirements of Federal consumer financial laws and, with respect to a covered person described in subsection (a), shall have exclusive authority (relative to the Bureau) to enforce such laws .

(2) COORDINATION WITH PRUDENTIAL REGULATOR.—

(A) REFERRAL.—When the Bureau has reason to believe that a person described in subsection (a) has engaged in a material violation of a Federal consumer financial law, the Bureau shall notify the prudential regulator in writing and recommend appropriate action to respond.

(B) RESPONSE.—Upon receiving a recommendation under subparagraph (A), the prudential regulator shall provide a written response to the Bureau not later than 60 days thereafter.

(e) SERVICE PROVIDERS.—A service provider to a substantial number of persons described in subsection (a) shall be subject to the authority of the Bureau under section 1025 to the same extent as if the Bureau were an appropriate Federal bank agency under section 7(c) of the Bank Service Company Act (12 U.S.C. 1867(c)). When conducting any examination or requiring any report from a service provider subject to this subsection, the Bureau shall coordinate with the appropriate prudential regulator.

SEC. 1027. LIMITATIONS ON AUTHORITIES OF THE BUREAU; PRESERVATION OF AUTHORITIES.

(a) EXCLUSION FOR MERCHANTS, RETAILERS, AND OTHER SELLERS OF NONFINANCIAL GOODS OR SERVICES.—

(1) SALE OR BROKERAGE OF NONFINANCIAL GOOD OR SERVICE.—The Bureau may not exercise any rulemaking, supervisory, enforcement or other authority under this title with respect to a person who is a merchant, retailer, or seller of any nonfinancial good or service and is engaged in the sale or brokerage of such nonfinancial good or service, except to the extent that such person is engaged in offering or providing any consumer financial product or service, or is otherwise subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H.

(2) OFFERING OR PROVISION OF CERTAIN CONSUMER FINANCIAL PRODUCTS OR SERVICES IN CONNECTION WITH THE SALE OR BROKERAGE OF NONFINANCIAL GOOD OR SERVICE.—

(A) IN GENERAL.—Except as provided in subparagraph (B), and subject to subparagraph (C), the Bureau may not exercise any rulemaking, supervisory, enforcement, or other authority under this title with respect to a merchant, retailer, or seller of nonfinancial goods or services, but only to the extent that such person—

(i) extends credit directly to a consumer, in a case in which the good or service being provided is not itself a consumer financial product or service (other than credit described in this subparagraph), exclusively for the purpose of enabling that consumer to purchase such nonfinancial good or service directly from the merchant, retailer, or seller;

(ii) directly, or through an agreement with another person, collects debt arising from credit extended as described in clause (i); or

(iii) sells or conveys debt described in clause (i) that is delinquent or otherwise in default.

(B) APPLICABILITY.—Subparagraph (A) does not apply to any credit transaction or collection of debt, other than as described in subparagraph (C)(i), arising from a transaction described in subparagraph (A)—

(i) in which the merchant, retailer, or seller of nonfinancial goods or services assigns, sells or otherwise conveys to another person such debt owed by the consumer (except for a sale of debt that is delinquent or otherwise in default, as described in subparagraph (A)(iii));

(ii) in which the credit extended significantly exceeds the market value of the nonfinancial good or service provided, or the Bureau otherwise finds that the sale of the nonfinancial good or service is done as a subterfuge, so as to evade or circumvent the provisions of this title; or

(iii) in which the merchant, retailer, or seller of nonfinancial goods or services regularly extends credit and the credit is subject to a finance charge.

(C) LIMITATIONS.—

(i) IN GENERAL.—Notwithstanding subparagraph (B), subparagraph (A) shall apply with respect to a merchant, retailer, or seller of nonfinancial goods or services that is not engaged significantly in offering or providing consumer financial products or services.

(ii) EXCEPTION.—Subparagraph (A) and clause (i) of this subparagraph do not apply to any merchant, retailer, or seller of nonfinancial goods or services—

(I) if such merchant, retailer, or seller of nonfinancial goods or services is engaged in a transaction described in subparagraph (B)(i) or (B)(ii); or

(II) to the extent that such merchant, retailer, or seller is subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H, but the Bureau may exercise such authority only with respect to that law.

(D) RULES.—

(i) AUTHORITY OF OTHER AGENCIES.—No provision of this title shall be construed as modifying, limiting, or superseding the supervisory or enforcement authority of the Federal Trade Commission or any other agency (other than the Bureau) with respect to credit extended, or the collection of debt arising from such extension, directly by a merchant or retailer to a consumer exclusively for the purpose of enabling that consumer to purchase nonfinancial goods or services directly from the merchant or retailer.

(ii) SMALL BUSINESSES.—A merchant, retailer, or seller of nonfinancial goods or services that would otherwise be subject to the authority of the Bureau solely by virtue of the application of subparagraph (B)(iii) shall be deemed not to be engaged significantly in offering or providing consumer financial products or services under subparagraph (C)(i), if such person—

(I) only extends credit for the sale of nonfinancial goods or services, as described in subparagraph (A)(i);

(II) retains such credit on its own accounts (except to sell or convey such debt that is delinquent or otherwise in default); and

(III) meets the relevant industry size threshold to be a small business concern, based on annual receipts, pursuant to section 3 of the Small Business Act (15 U.S.C. 632) and the implementing rules thereunder.

(iii) INITIAL YEAR.—A merchant, retailer, or seller of nonfinancial goods or services shall be deemed to meet the relevant industry size threshold described in clause (ii)(III) during the first year of operations of that business concern if, during that year, the receipts of that business concern reasonably are expected to meet that size threshold.

(iv) OTHER STANDARDS FOR SMALL BUSINESS.—With respect to a merchant, retailer, or seller of nonfinancial goods or services that is a classified on a basis other than annual receipts for the purposes of section 3 of the Small Business Act (15 U.S.C. 632) and the implementing rules thereunder, such merchant, retailer, or seller shall be deemed to meet the relevant industry size threshold described in clause (ii)(III) if such merchant, retailer, or seller meets the relevant industry size threshold to be a small business concern based on the number of employees, or other such applicable measure, established under that Act.

(E) EXCEPTION FROM STATE ENFORCEMENT.—To the extent that the Bureau may not exercise authority under this subsection with respect to a merchant, retailer, or seller of nonfinancial goods or services, no action by a State attorney general or State regulator with respect to a claim made under this title may be brought under subsection 1042(a), with respect to an activity described in any of clauses (i) through (iii) of subparagraph (A) by such merchant, retailer, or seller of nonfinancial goods or services.

(b) EXCLUSION FOR REAL ESTATE BROKERAGE ACTIVITIES.—

(1) REAL ESTATE BROKERAGE ACTIVITIES EXCLUDED.—Without limiting subsection (a), and except as permitted in paragraph (2), the Bureau may not exercise any rulemaking, supervisory, enforcement, or other authority under this title with respect to a person that is licensed or registered as a real estate broker or real estate agent, in accordance with State law, to the extent that such person—

(A) acts as a real estate agent or broker for a buyer, seller, lessor, or lessee of real property;

(B) brings together parties interested in the sale, purchase, lease, rental, or exchange of real property;

(C) negotiates, on behalf of any party, any portion of a contract relating to the sale, purchase, lease, rental, or exchange of real property (other than in connection with the provision of financing with respect to any such transaction); or

(D) offers to engage in any activity, or act in any capacity, described in subparagraph (A), (B), or (C).

(2) DESCRIPTION OF ACTIVITIES.—The Bureau may exercise rulemaking, supervisory, enforcement, or other authority under this title with respect to a person described in paragraph (1) when such person is—

(A) engaged in an activity of offering or providing any consumer financial product or service, except that the Bureau may exercise such authority only with respect to that activity; or

(B) otherwise subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H, but the Bureau may exercise such authority only with respect to that law.

(c) EXCLUSION FOR MANUFACTURED HOME RETAILERS AND MODULAR HOME RETAILERS.—

(1) IN GENERAL.—The Director may not exercise any rulemaking, supervisory, enforcement, or other authority over a person to the extent that—

(A) such person is not described in paragraph (2); and

(B) such person—

(i) acts as an agent or broker for a buyer or seller of a manufactured home or a modular home;

(ii) facilitates the purchase by a consumer of a manufactured home or modular home, by negotiating the purchase price or terms of the sales contract (other than providing financing with respect to such transaction); or

(iii) offers to engage in any activity described in clause (i) or (ii).

(2) DESCRIPTION OF ACTIVITIES.—A person is described in this paragraph to the extent that such person is engaged in the offering or provision of any consumer financial product or service or is otherwise subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H.

(3) DEFINITIONS.—For purposes of this subsection, the following definitions shall apply:

(A) MANUFACTURED HOME.—The term "manufactured home" has the same meaning as in section 603 of the National Manufactured Housing Construction and Safety Standards Act of 1974 (42 U.S.C. 5402).

(B) MODULAR HOME.—The term "modular home" means a house built in a factory in 2 or more modules that meet the State or local building codes where the house will be located, and where such modules are transported to the building site, installed on foundations, and completed.

(d) EXCLUSION FOR ACCOUNTANTS AND TAX PREPARERS.—

(1) IN GENERAL.—Except as permitted in paragraph (2), the Bureau may not exercise any rulemaking, supervisory, enforcement, or other authority over—

(A) any person that is a certified public accountant, permitted to practice as a certified public accounting firm, or certified or licensed for such purpose by a State, or any individual who is employed by or holds an ownership interest with respect to a person described in this subparagraph, when such person is performing or offering to perform—

(i) customary and usual accounting activities, including the provision of accounting, tax, advisory, or other services that are subject to the regulatory authority of a State board of accountancy or a Federal authority; or

(ii) other services that are incidental to such customary and usual accounting activities, to the extent that such incidental services are not offered or provided—

(I) by the person separate and apart from such customary and usual accounting activities; or

(II) to consumers who are not receiving such customary and usual accounting activities; or

(B) any person, other than a person described in subparagraph (A) that performs income tax preparation activities for consumers.

(2) DESCRIPTION OF ACTIVITIES.—

(A) IN GENERAL.—Paragraph (1) shall not apply to any person described in paragraph (1)(A) or (1)(B) to the extent that such person is engaged in any activity which is not a customary and usual accounting activity described in paragraph (1)(A) or incidental thereto but which is the offering or provision of any consumer financial product or service, except to the extent that a person described in paragraph (1)(A) is engaged in an activity which is a customary and usual accounting activity described in paragraph (1)(A), or incidental thereto.

(B) NOT A CUSTOMARY AND USUAL ACCOUNTING ACTIVITY.—For purposes of this subsection, extending or brokering credit is not a customary and usual accounting activity, or incidental thereto.

(C) RULE OF CONSTRUCTION.—For purposes of subparagraphs (A) and (B), a person described in paragraph (1)(A) shall not be deemed to be extending credit, if such person is only extending credit directly to a consumer, exclusively for the purpose of enabling such consumer to purchase services described in clause (i) or (ii) of paragraph (1)(A) directly from such person, and such credit is—

(i) not subject to a finance charge; and

(ii) not payable by written agreement in more than 4 installments.

(D) OTHER LIMITATIONS.—Paragraph (1) does not apply to any person described in paragraph (1)(A) or (1)(B) that is otherwise subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H.

(e) EXCLUSION FOR PRACTICE OF LAW.—

(1) IN GENERAL.—Except as provided under paragraph (2), the Bureau may not exercise any supervisory or enforcement authority with respect to an activity engaged in by an attorney as part of the practice of law under the laws of a State in which the attorney is licensed to practice law.

(2) RULE OF CONSTRUCTION.—Paragraph (1) shall not be construed so as to limit the exercise by the Bureau of any supervisory, enforcement, or other authority regarding the offering or provision of a consumer financial product or service described in any subparagraph of section 1002(5)—

(A) that is not offered or provided as part of, or incidental to, the practice of law, occurring exclusively within the scope of the attorney-client relationship; or

(B) that is otherwise offered or provided by the attorney in question with respect to any consumer who is not receiving legal advice or services from the attorney in connection with such financial product or service.

(3) EXISTING AUTHORITY.—Paragraph (1) shall not be construed so as to limit the authority of the Bureau with respect to any attorney, to the extent that such attorney is otherwise subject to any of the enumerated consumer laws or the authorities transferred under subtitle F or H.

(f) EXCLUSION FOR PERSONS REGULATED BY A STATE INSURANCE REGULATOR.—

(1) IN GENERAL.—No provision of this title shall be construed as altering, amending, or affecting the authority of any State insurance regulator to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by a State insurance regulator. Except as provided in paragraph (2), the Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by a State insurance regulator.

(2) DESCRIPTION OF ACTIVITIES.—Paragraph (1) does not apply to any person described in such paragraph to the extent that such person is engaged in the offering or provision of any consumer financial product or service or is otherwise subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H.

(3) STATE INSURANCE AUTHORITY UNDER GRAMM-LEACH-BLILEY.—Notwithstanding paragraph (2), the Bureau shall not exercise any authorities that are granted a State insurance authority under section 505(a)(6) of the Gramm-Leach-Bliley Act with respect to a person regulated by a State insurance authority.

(g) EXCLUSION FOR EMPLOYEE BENEFIT AND COMPENSATION PLANS AND CERTAIN OTHER ARRANGEMENTS UNDER THE INTERNAL REVENUE CODE OF 1986.—

(1) PRESERVATION OF AUTHORITY OF OTHER AGENCIES.—No provision of this title shall be construed as altering, amending, or affecting the authority of the Secretary of the Treasury, the Secretary of Labor, or the Commissioner of Internal Revenue to adopt regulations, initiate enforcement proceedings, or take any actions with respect to any specified plan or arrangement.

(2) ACTIVITIES NOT CONSTITUTING THE OFFERING OR PROVISION OF ANY CONSUMER FINANCIAL PRODUCT OR SERVICE.—For purposes of this title, a person shall not be treated as having engaged in the offering or provision of any consumer financial product or service solely because such person is—

(A) a specified plan or arrangement;

(B) engaged in the activity of establishing or maintaining, for the benefit of employees of such person (or for members of an employee organization), any specified plan or arrangement; or

(C) engaged in the activity of establishing or maintaining a qualified tuition program under section 529(b)(1) of the Internal Revenue Code of 1986 offered by a State or other prepaid tuition program offered by a State.

(3) LIMITATION ON BUREAU AUTHORITY.—

(A) IN GENERAL.—Except as provided under subparagraphs (B) and (C), the Bureau may not exercise any rulemaking or enforcement authority with respect to products or services that relate to any specified plan or arrangement.

(B) BUREAU ACTION PURSUANT TO AGENCY REQUEST.—

(i) AGENCY REQUEST.—The Secretary and the Secretary of Labor may jointly issue a written request to the Bureau regarding implementation of appropriate consumer protection standards under this title with respect to the provision of services relating to any specified plan or arrangement.

(ii) AGENCY RESPONSE.—In response to a request by the Bureau, the Secretary and the Secretary of Labor shall jointly issue a written response, not later than 90 days after receipt of such request, to grant or deny the request of the Bureau regarding implementation of appropriate consumer protection standards under this title with respect to the provision of services relating to any specified plan or arrangement.

(iii) SCOPE OF BUREAU ACTION.—Subject to a request or response pursuant to clause (i) or clause (ii) by the agencies made under this subparagraph, the Bureau may exercise rulemaking authority, and may act to enforce a rule prescribed pursuant to such request or response, in accordance with the provisions of this title. A request or response made by the Secretary and the Secretary of Labor under this subparagraph shall describe the basis for, and scope of, appropriate consumer protection standards to be implemented under this title with respect to the provision of services relating to any specified plan or arrangement.

(C) DESCRIPTION OF PRODUCTS OR SERVICES.—To the extent that a person engaged in providing products or services relating to any specified plan or arrangement is subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H, subparagraph (A) shall not apply with respect to that law.

(4) SPECIFIED PLAN OR ARRANGEMENT.—For purposes of this subsection, the term "specified plan or arrangement" means any plan, account, or arrangement described in section 220, 223, 401(a), 403(a), 403(b), 408, 408A, 529, or 530 of the Internal Revenue Code of 1986, or any employee benefit or compensation plan or arrangement, including a plan that is subject to title I of the Employee Retirement Income Security Act of 1974, or any prepaid tuition program offered by a State.

(h) PERSONS REGULATED BY A STATE SECURITIES COMMISSION.—

(1) IN GENERAL.—No provision of this title shall be construed as altering, amending, or affecting the authority of any securities commission (or any agency or office performing like functions) of any State to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by any securities commission (or any agency or office performing like functions) of any State. Except as permitted in paragraph (2) and subsection (f), the Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by any securities commission (or any agency or office performing like functions) of any State, but only to the extent that the person acts in such regulated capacity.

(2) DESCRIPTION OF ACTIVITIES.—Paragraph (1) shall not apply to any person to the extent such person is engaged in the offering or provision of any consumer financial product or service, or is otherwise subject to any enumerated consumer

law or any law for which authorities are transferred under subtitle F or H.

(i) EXCLUSION FOR PERSONS REGULATED BY THE COMMISSION.—

(1) IN GENERAL.—No provision of this title may be construed as altering, amending, or affecting the authority of the Commission to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by the Commission. The Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by the Commission.

(2) CONSULTATION AND COORDINATION.—Notwithstanding paragraph (1), the Commission shall consult and coordinate, where feasible, with the Bureau with respect to any rule (including any advance notice of proposed rulemaking) regarding an investment product or service that is the same type of product as, or that competes directly with, a consumer financial product or service that is subject to the jurisdiction of the Bureau under this title or under any other law. In carrying out this paragraph, the agencies shall negotiate an agreement to establish procedures for such coordination, including procedures for providing advance notice to the Bureau when the Commission is initiating a rulemaking.

(j) EXCLUSION FOR PERSONS REGULATED BY THE COMMODITY FUTURES TRADING COMMISSION.—

(1) IN GENERAL.—No provision of this title shall be construed as altering, amending, or affecting the authority of the Commodity Futures Trading Commission to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by the Commodity Futures Trading Commission. The Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by the Commodity Futures Trading Commission.

(2) CONSULTATION AND COORDINATION.—Notwithstanding paragraph (1), the Commodity Futures Trading Commission shall consult and coordinate with the Bureau with respect to any rule (including any advance notice of proposed rulemaking) regarding a product or service that is the same type of product as, or that competes directly with, a consumer financial product or service that is subject to the jurisdiction of the Bureau under this title or under any other law.

(k) EXCLUSION FOR PERSONS REGULATED BY THE FARM CREDIT ADMINISTRATION.—

(1) IN GENERAL.—No provision of this title shall be construed as altering, amending, or affecting the authority of the Farm Credit Administration to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by the Farm Credit Administration. The Bureau shall have no authority to exercise any power to enforce this title with respect to a person regulated by the Farm Credit Administration.

(2) DEFINITION.—For purposes of this subsection, the term "person regulated by the Farm Credit Administration" means any Farm Credit System institution that is chartered and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.).

(l) EXCLUSION FOR ACTIVITIES RELATING TO CHARITABLE CONTRIBUTIONS.—

(1) IN GENERAL.—The Director and the Bureau may not exercise any rulemaking, supervisory, enforcement, or other authority, including authority to order penalties, over any activities related to the solicitation or making of voluntary contributions to a tax-exempt organization as recognized by the Internal Revenue Service, by any agent, volunteer, or representative of such organizations to the extent the organization, agent, volunteer, or representative thereof is soliciting or providing advice, information, education, or instruction to any donor or potential donor relating to a contribution to the organization.

(2) LIMITATION.—The exclusion in paragraph (1) does not apply to other activities not described in paragraph (1) that are the offering or provision of any consumer financial product or service, or are otherwise subject to any enumerated consumer law or any law for which authorities are transferred under subtitle F or H.

(m) INSURANCE.—The Bureau may not define as a financial product or service, by regulation or otherwise, engaging in the business of insurance.

(n) LIMITED AUTHORITY OF THE BUREAU.—Notwithstanding subsections (a) through (h) and (l), a person subject to or described in one or more of such provisions—

(1) may be a service provider; and

(2) may be subject to requests from, or requirements imposed by, the Bureau regarding information in order to carry out the responsibilities and functions of the Bureau and in accordance with section 1022, 1052, or 1053.

(o) NO AUTHORITY TO IMPOSE USURY LIMIT.—No provision of this title shall be construed as conferring authority on the Bureau to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law.

(p) ATTORNEY GENERAL.—No provision of this title, including section 1024(c)(1), shall affect the authorities of the Attorney General under otherwise applicable provisions of law.

(q) SECRETARY OF THE TREASURY.—No provision of this title shall affect the authorities of the Secretary, including with respect to prescribing rules, initiating enforcement proceedings, or taking other actions with respect to a person that performs income tax preparation activities for consumers.

(r) DEPOSIT INSURANCE AND SHARE INSURANCE.—Nothing in this title shall affect the authority of the Corporation under the Federal Deposit Insurance Act or the National Credit Union Administration Board under the Federal Credit Union Act as to matters related to deposit insurance and share insurance, respectively.

(s) FAIR HOUSING ACT.—No provision of this title shall be construed as affecting any authority arising under the Fair Housing Act.

SEC. 1028. AUTHORITY TO RESTRICT MANDATORY PRE-DISPUTE ARBITRATION.

(a) STUDY AND REPORT.—The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.

(b) FURTHER AUTHORITY.—The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).

(c) LIMITATION.—The authority described in subsection (b) may not be construed to prohibit or restrict a consumer from entering into a voluntary arbitration agreement with a covered person after a dispute has arisen.

(d) EFFECTIVE DATE.—Notwithstanding any other provision of law, any regulation prescribed by the Bureau under subsection (b) shall apply, consistent with the terms of the regulation, to any agreement between a consumer and a covered person entered into after the end of the 180-day period beginning on the effective date of the regulation, as established by the Bureau.

SEC. 1029. EXCLUSION FOR AUTO DEALERS.

(a) SALE, SERVICING, AND LEASING OF MOTOR VEHICLES EXCLUDED.—Except as permitted in subsection (b), the Bureau may not exercise any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both.

(b) CERTAIN FUNCTIONS EXCEPTED.—Subsection (a) shall not apply to any person, to the extent that such person—

(1) provides consumers with any services related to residential or commercial mortgages or self-financing transactions involving real property;

(2) operates a line of business—

(A) that involves the extension of retail credit or retail leases involving motor vehicles; and

(B) in which—

(i) the extension of retail credit or retail leases are provided directly to consumers; and

(ii) the contract governing such extension of retail credit or retail leases is not routinely assigned to an unaffiliated third party finance or leasing source; or

(3) offers or provides a consumer financial product or service not involving or related to the sale, financing, leasing, rental, repair, refurbishment, maintenance, or other servicing of motor vehicles, motor vehicle parts, or any related or ancillary product or service.

(c) PRESERVATION OF AUTHORITIES OF OTHER AGENCIES.—Except as provided in subsections (b) and (d), nothing in this title, including subtitle F, shall be construed as modifying, limiting, or superseding the operation of any provision of Federal law, or otherwise affecting the authority of the Board of Governors, the Federal Trade Commission, or any other Federal agency, with respect to a person described in subsection (a).

(d) FEDERAL TRADE COMMISSION AUTHORITY.—Notwithstanding section 18 of the Federal Trade Commission Act, the Federal Trade

Commission is authorized to prescribe rules under sections 5 and 18(a)(1)(B) of the Federal Trade Commission Act. in accordance with section 553 of title 5, United States Code, with respect to a person described in subsection (a).

(e) COORDINATION WITH OFFICE OF SERVICE MEMBER AFFAIRS.—The Board of Governors and the Federal Trade Commission shall coordinate with the Office of Service Member Affairs, to ensure that—

(1) service members and their families are educated and empowered to make better informed decisions regarding consumer financial products and services offered by motor vehicle dealers, with a focus on motor vehicle dealers in the proximity of military installations; and

(2) complaints by service members and their families concerning such motor vehicle dealers are effectively monitored and responded to, and where appropriate, enforcement action is pursued by the authorized agencies.

(f) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

(1) MOTOR VEHICLE.—The term "motor vehicle" means—

(A) any self-propelled vehicle designed for transporting persons or property on a street, highway, or other road;

(B) recreational boats and marine equipment;

(C) motorcycles;

(D) motor homes, recreational vehicle trailers, and slide-in campers, as those terms are defined in sections 571.3 and 575.103 (d) of title 49, Code of Federal Regulations, or any successor thereto; and

(E) other vehicles that are titled and sold through dealers.

(2) MOTOR VEHICLE DEALER.—The term "motor vehicle dealer" means any person or resident in the United States, or any territory of the United States, who—

(A) is licensed by a State, a territory of the United States, or the District of Columbia to engage in the sale of motor vehicles; and

(B) takes title to, holds an ownership in, or takes physical custody of motor vehicles.

SEC. 1029A. EFFECTIVE DATE.

This subtitle shall become effective on the designated transfer date, except that sections 1022, 1024, and 1025(e) shall become effective on the date of enactment of this Act.

Subtitle C—Specific Bureau Authorities

SEC. 1031. PROHIBITING UNFAIR, DECEPTIVE, OR ABUSIVE ACTS OR PRACTICES.

(a) IN GENERAL.—The Bureau may take any action authorized under subtitle E to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.

(b) RULEMAKING.—The Bureau may prescribe rules applicable to a covered person or service provider identifying as unlawful unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. Rules under this section may include requirements for the purpose of preventing such acts or practices.

(c) UNFAIRNESS.—

(1) IN GENERAL.—The Bureau shall have no authority under this section to declare an act or practice in connection with a transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service, to be unlawful on the grounds that such act or practice is unfair, unless the Bureau has a reasonable basis to conclude that—

(A) the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and

(B) such substantial injury is not outweighed by countervailing benefits to consumers or to competition.

(2) CONSIDERATION OF PUBLIC POLICIES.—In determining whether an act or practice is unfair, the Bureau may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination.

(d) ABUSIVE.—The Bureau shall have no authority under this section to declare an act or practice abusive in connection with the provision of a consumer financial product or service, unless the act or practice—

(1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or

(2) takes unreasonable advantage of—

(A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;

(B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or

(C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

(e) CONSULTATION.—In prescribing rules under this section, the Bureau shall consult with the Federal banking agencies, or other Federal agencies, as appropriate, concerning the consistency of the proposed rule with prudential, market, or systemic objectives administered by such agencies.

(f) CONSIDERATION OF SEASONAL INCOME.—The rules of the Bureau under this section shall provide, with respect to an extension of credit secured by residential real estate or a dwelling, if documented income of the borrower, including income from a small business, is a repayment source for an extension of credit secured by residential real estate or a dwelling, the creditor may consider the seasonality and irregularity of such income in the underwriting of and scheduling of payments for such credit.

SEC. 1032. DISCLOSURES.

(a) IN GENERAL.—The Bureau may prescribe rules to ensure that the features of any consumer financial product or service, both initially and over the term of the product or service, are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with the product or service, in light of the facts and circumstances.

(b) MODEL DISCLOSURES.—

(1) IN GENERAL.—Any final rule prescribed by the Bureau under this section requiring disclosures may include a model form that may be used at the option of the covered person for provision of the required disclosures.

(2) FORMAT.—A model form issued pursuant to paragraph (1) shall contain a clear and conspicuous disclosure that, at a minimum—

(A) uses plain language comprehensible to consumers;

(B) contains a clear format and design, such as an easily readable type font; and

(C) succinctly explains the information that must be communicated to the consumer.

(3) CONSUMER TESTING.—Any model form issued pursuant to this subsection shall be validated through consumer testing.

(c) BASIS FOR RULEMAKING.—In prescribing rules under this section, the Bureau shall consider available evidence about consumer awareness, understanding of, and responses to disclosures or communications about the risks, costs, and benefits of consumer financial products or services.

(d) SAFE HARBOR.—Any covered person that uses a model form included with a rule issued under this section shall be deemed to be in compliance with the disclosure requirements of this section with respect to such model form.

(e) TRIAL DISCLOSURE PROGRAMS.—

(1) IN GENERAL.—The Bureau may permit a covered person to conduct a trial program that is limited in time and scope, subject to specified standards and procedures, for the purpose of providing trial disclosures to consumers that are designed to improve upon any model form issued pursuant to subsection (b)(1), or any other model form issued to implement an enumerated statute, as applicable.

(2) SAFE HARBOR.—The standards and procedures issued by the Bureau shall be designed to encourage covered persons to conduct trial disclosure programs. For the purposes of administering this subsection, the Bureau may establish a limited period during which a covered person conducting a trial disclosure program shall be deemed to be in compliance with, or may be exempted from, a requirement of a rule or an enumerated consumer law.

(3) PUBLIC DISCLOSURE.—The rules of the Bureau shall provide for public disclosure of trial disclosure programs, which public disclosure may be limited, to the extent necessary to encourage covered persons to conduct effective trials.

(f) COMBINED MORTGAGE LOAN DISCLOSURE.—Not later than 1 year after the designated transfer date, the Bureau shall propose for public comment rules and model disclosures that combine the disclosures required under the Truth in Lending Act and sections 4 and 5 of the Real Estate Settlement Procedures Act of 1974, into a single, integrated disclosure for mortgage loan transactions covered by those laws, unless the Bureau determines that any proposal issued by the Board of Governors and the Secretary of Housing and Urban Development carries out the same purpose.

SEC. 1033. CONSUMER RIGHTS TO ACCESS INFORMATION.

(a) IN GENERAL.—Subject to rules prescribed by the Bureau, a covered person shall make available to a consumer, upon request, information in the control or possession of the covered person concerning the consumer financial product or service that the consumer obtained from such covered person, including information relating to any transaction, series of transactions, or to the account including costs, charges and usage data. The information shall be made available in an electronic form usable by consumers.

(b) EXCEPTIONS.—A covered person may not be required by this section to make available to the consumer—

(1) any confidential commercial information, including an algorithm used to derive credit scores or other risk scores or predictors;

(2) any information collected by the covered person for the purpose of preventing fraud or money laundering, or detecting, or making any report regarding other unlawful or potentially unlawful conduct;

(3) any information required to be kept confidential by any other provision of law; or

(4) any information that the covered person cannot retrieve in the ordinary course of its business with respect to that information.

(c) NO DUTY TO MAINTAIN RECORDS.—Nothing in this section shall be construed to impose any duty on a covered person to maintain or keep any information about a consumer.

(d) STANDARDIZED FORMATS FOR DATA.—The Bureau, by rule, shall prescribe standards applicable to covered persons to promote the development and use of standardized formats for information, including through the use of machine readable files, to be made available to consumers under this section.

(e) CONSULTATION.—The Bureau shall, when prescribing any rule under this section, consult with the Federal banking agencies and the Federal Trade Commission to ensure, to the extent appropriate, that the rules—

(1) impose substantively similar requirements on covered persons;

(2) take into account conditions under which covered persons do business both in the United States and in other countries; and

(3) do not require or promote the use of any particular technology in order to develop systems for compliance.

SEC. 1034. RESPONSE TO CONSUMER COMPLAINTS AND INQUIRIES.

(a) TIMELY REGULATOR RESPONSE TO CONSUMERS.—The Bureau shall establish, in consultation with the appropriate Federal regulatory agencies, reasonable procedures to provide a timely response to consumers, in writing where appropriate, to complaints against, or inquiries concerning, a covered person, including—

(1) steps that have been taken by the regulator in response to the complaint or inquiry of the consumer;

(2) any responses received by the regulator from the covered person; and

(3) any follow-up actions or planned follow-up actions by the regulator in response to the complaint or inquiry of the consumer.

(b) TIMELY RESPONSE TO REGULATOR BY COVERED PERSON.—A covered person subject to supervision and primary enforcement by the Bureau pursuant to section 1025 shall provide a timely response, in writing where appropriate, to the Bureau, the prudential regulators, and any other agency having jurisdiction over such covered person concerning a consumer complaint or inquiry, including—

(1) steps that have been taken by the covered person to respond to the complaint or inquiry of the consumer;

(2) responses received by the covered person from the consumer; and

(3) follow-up actions or planned follow-up actions by the covered person to respond to the complaint or inquiry of the consumer.

(c) PROVISION OF INFORMATION TO CONSUMERS.—

(1) IN GENERAL.—A covered person subject to supervision and primary enforcement by the Bureau pursuant to section 1025 shall, in a timely manner, comply with a consumer request for information in the control or possession of such covered person concerning the consumer financial product or service that the consumer obtained from such covered person, including supporting written documentation, concerning the account of the consumer.

(2) EXCEPTIONS.—A covered person subject to supervision and primary enforcement by the Bureau pursuant to section 1025, a prudential regulator, and any other agency having jurisdiction over a covered person subject to supervision and primary enforcement by the Bureau pursuant to section 1025 may not be required by this section to make available to the consumer—

(A) any confidential commercial information, including an algorithm used to derive credit scores or other risk scores or predictors;

(B) any information collected by the covered person for the purpose of preventing fraud or money laundering, or detecting or making any report regarding other unlawful or potentially unlawful conduct;

(C) any information required to be kept confidential by any other provision of law; or

(D) any nonpublic or confidential information, including confidential supervisory information.

(d) AGREEMENTS WITH OTHER AGENCIES.—The Bureau shall enter into a memorandum of understanding with any affected Federal regulatory agency regarding procedures by which any covered person, and the prudential regulators, and any other agency having jurisdiction over a covered person, including the Secretary of the Department of Housing and Urban Development and the Secretary of Education, shall comply with this section.

SEC. 1035. PRIVATE EDUCATION LOAN OMBUDSMAN.

(a) ESTABLISHMENT.—The Secretary, in consultation with the Director, shall designate a Private Education Loan Ombudsman (in this section referred to as the "Ombudsman") within the Bureau, to provide timely assistance to borrowers of private education loans.

(b) PUBLIC INFORMATION.—The Secretary and the Director shall disseminate information about the availability and functions of the Ombudsman to borrowers and potential borrowers, as well as institutions of higher education, lenders, guaranty agencies, loan servicers, and other participants in private education student loan programs.

(c) FUNCTIONS OF OMBUDSMAN.—The Ombudsman designated under this subsection shall—

(1) in accordance with regulations of the Director, receive, review, and attempt to resolve informally complaints from borrowers of loans described in subsection (a), including, as appropriate, attempts to resolve such complaints in collaboration with the Department of Education and with institutions of higher education, lenders, guaranty agencies, loan servicers, and other participants in private education loan programs;

(2) not later than 90 days after the designated transfer date, establish a memorandum of understanding with the student loan ombudsman established under section 141(f) of the Higher Education Act of 1965 (20 U.S.C. 1018(f)), to ensure coordination in providing assistance to and serving borrowers seeking to resolve complaints related to their private education or Federal student loans;

(3) compile and analyze data on borrower complaints regarding private education loans; and

(4) make appropriate recommendations to the Director, the Secretary, the Secretary of Education, the Committee on Banking, Housing, and Urban Affairs and the Committee on Health, Education, Labor, and Pensions of the Senate and the Committee on Financial Services and the Committee on Education and Labor of the House of Representatives.

(d) ANNUAL REPORTS.—

(1) IN GENERAL.—The Ombudsman shall prepare an annual report that describes the activities, and evaluates the effectiveness of the Ombudsman during the preceding year.

(2) SUBMISSION.—The report required by paragraph (1) shall be submitted on the same date annually to the Secretary, the Secretary of Education, the Committee on Banking, Housing, and Urban Affairs and the Committee on Health, Education, Labor, and Pensions of the Senate and the Committee on Financial Services and the Committee on Education and Labor of the House of Representatives.

(e) DEFINITIONS.—For purposes of this section, the terms "private education loan" and "institution of higher education" have the same meanings as in section 140 of the Truth in Lending Act (15 U.S.C. 1650).

SEC. 1036. PROHIBITED ACTS.

(a) IN GENERAL.—It shall be unlawful for—

(1) any covered person or service provider—

(A) to offer or provide to a consumer any financial product or service not in conformity with Federal consumer financial law, or otherwise commit any act or omission in violation of a Federal consumer financial law; or

(B) to engage in any unfair, deceptive, or abusive act or practice;

(2) any covered person or service provider to fail or refuse, as required by Federal consumer financial law, or any rule or order issued by the Bureau thereunder—

(A) to permit access to or copying of records;

(B) to establish or maintain records; or

(C) to make reports or provide information to the Bureau; or

(3) any person to knowingly or recklessly provide substantial assistance to a covered person or service provider in violation of the provisions of section 1031, or any rule or order issued thereunder, and notwithstanding any provision of this title, the provider of such substantial assistance shall be deemed to be in violation of that section to the same extent as the person to whom such assistance is provided.

(b) EXCEPTION.—No person shall be held to have violated subsection (a)(1) solely by virtue of providing or selling time or space to a covered person or service provider placing an advertisement.

SEC. 1037. EFFECTIVE DATE.

This subtitle shall take effect on the designated transfer date.

Subtitle D—Preservation of State Law

SEC. 1041. RELATION TO STATE LAW.

(a) IN GENERAL.—

(1) RULE OF CONSTRUCTION.—This title, other than sections 1044 through 1048, may not be construed as annulling, altering, or affecting, or exempting any person subject to the provisions of this title from complying with, the statutes, regulations, orders, or interpretations in effect in any State, except to the extent that any such provision of law is inconsistent with the provisions of this title, and then only to the extent of the inconsistency.

(2) GREATER PROTECTION UNDER STATE LAW.—For purposes of this subsection, a statute, regulation, order, or interpretation in effect in any State is not inconsistent with the provisions of this title if the protection that such statute, regulation, order, or interpretation affords to consumers is greater than the protection provided under this title. A determination regarding whether a statute, regulation, order, or interpretation in effect in any State is inconsistent with the provisions of this title may be made by the Bureau on its own motion or in response to a nonfrivolous petition initiated by any interested person.

(b) RELATION TO OTHER PROVISIONS OF ENUMERATED CONSUMER LAWS THAT RELATE TO STATE LAW.—No provision of this title, except as provided in section 1083, shall be construed as modifying, limiting, or superseding the operation of any provision of an enumerated consumer law that relates to the application of a law in effect in any State with respect to such Federal law.

(c) ADDITIONAL CONSUMER PROTECTION REGULATIONS IN RESPONSE TO STATE ACTION.—

(1) NOTICE OF PROPOSED RULE REQUIRED.—The Bureau shall issue a notice of proposed rulemaking whenever a majority of the States has enacted a resolution in support of the establishment or modification of a consumer protection regulation by the Bureau.

(2) BUREAU CONSIDERATIONS REQUIRED FOR ISSUANCE OF FINAL REGULATION.—Before prescribing a final regulation based upon a notice issued pursuant to paragraph (1), the Bureau shall take into account whether—

(A) the proposed regulation would afford greater protection to consumers than any existing regulation;

(B) the intended benefits of the proposed regulation for consumers would outweigh any increased costs or inconveniences for consumers, and would not discriminate unfairly against any category or class of consumers; and

(C) a Federal banking agency has advised that the proposed regulation is likely to present an unacceptable safety and soundness risk to insured depository institutions.

(3) EXPLANATION OF CONSIDERATIONS.—The Bureau—

(A) shall include a discussion of the considerations required in paragraph (2) in the Federal Register notice of a final regulation prescribed pursuant to this subsection; and

(B) whenever the Bureau determines not to prescribe a final regulation, shall publish an explanation of such determination in the Federal Register, and provide a copy of such explanation to each State that enacted a resolution in support of the proposed regulation, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives.

(4) RESERVATION OF AUTHORITY.—No provision of this subsection shall be construed as limiting or restricting the authority of the Bureau to enhance consumer protection standards established pursuant to this title in response to its own motion or in response to a request by any other interested person.

(5) RULE OF CONSTRUCTION.—No provision of this subsection shall be construed as exempting the Bureau from complying with subchapter II of chapter 5 of title 5, United States Code.

(6) DEFINITION.—For purposes of this subsection, the term "consumer protection regulation" means a regulation that the Bureau is authorized to prescribe under the Federal consumer financial laws.

SEC. 1042. PRESERVATION OF ENFORCEMENT POWERS OF STATES.

(a) IN GENERAL.—

(1) ACTION BY STATE.—Except as provided in paragraph (2), the attorney general (or the equivalent thereof) of any State may bring a civil action in the name of such State in any district court of the United States in that State or in State court that is located in that State and that has jurisdiction over the defendant, to enforce provisions of this title or regulations issued under this title, and to secure remedies under provisions of this title or remedies otherwise provided under other law. A State regulator may bring a civil action or other appropriate proceeding to enforce the provisions of this title or regulations issued under this title with respect to any entity that is State-chartered, incorporated, licensed, or otherwise authorized to do business under State law (except as provided in paragraph (2)), and to secure remedies under provisions of this title or remedies otherwise provided under other provisions of law with respect to such an entity.

(2) ACTION BY STATE AGAINST NATIONAL BANK OR FEDERAL SAVINGS ASSOCIATION TO ENFORCE RULES.—

(A) IN GENERAL.—Except as permitted under subparagraph (B), the attorney general (or equivalent thereof) of any State may not bring a civil action in the name of such State against a national bank or Federal savings association to enforce a provision of this title.

(B) ENFORCEMENT OF RULES PERMITTED.—The attorney general (or the equivalent thereof) of any State may bring a civil action in the name of such State against a national bank or Federal savings association in any district court of the United States in the State or in State court that is located in that State and that has jurisdiction over the defendant to enforce a regulation prescribed by the Bureau under a provision of this title and to secure remedies under provisions of this title or remedies otherwise provided under other law.

(3) RULE OF CONSTRUCTION.—No provision of this title shall be construed as modifying, limiting, or superseding the operation of any provision of an enumerated consumer law that relates to the authority of a State attorney general or State regulator to enforce such Federal law.

(b) CONSULTATION REQUIRED.—

(1) NOTICE.—

(A) IN GENERAL.—Before initiating any action in a court or other administrative or regulatory proceeding against any covered person as authorized by subsection (a) to enforce any provision of this title, including any regulation prescribed by the Bureau under this title, a State attorney general or State regulator shall timely provide a copy of the complete complaint to be filed and written notice describing such action or proceeding to the Bureau and the prudential regulator, if any, or the designee thereof.

(B) EMERGENCY ACTION.—If prior notice is not practicable, the State attorney general or State regulator shall provide a copy of the complete complaint and the notice to the Bureau and the prudential regulator, if any, immediately upon instituting the action or proceeding.

(C) CONTENTS OF NOTICE.—The notification required under this paragraph shall, at a minimum, describe—

(i) the identity of the parties;

(ii) the alleged facts underlying the proceeding; and

(iii) whether there may be a need to coordinate the prosecution of the proceeding so as not to interfere with any action, including any rulemaking, undertaken by the Bureau, a prudential regulator, or another Federal agency.

(2) BUREAU RESPONSE.—In any action described in paragraph (1), the Bureau may—

(A) intervene in the action as a party;

(B) upon intervening—

(i) remove the action to the appropriate United States district court, if the action was not originally brought there; and

(ii) be heard on all matters arising in the action; and

(C) appeal any order or judgment, to the same extent as any other party in the proceeding may.

(c) REGULATIONS.—The Bureau shall prescribe regulations to implement the requirements of this section and, from time to time, provide guidance in order to further coordinate actions with the State attorneys general and other regulators.

(d) PRESERVATION OF STATE AUTHORITY.—

(1) STATE CLAIMS.—No provision of this section shall be construed as altering, limiting, or affecting the authority of a State attorney general or any other regulatory or enforcement agency or authority to bring an action or other regulatory proceeding arising solely under the law in effect in that State.

(2) STATE SECURITIES REGULATORS.—No provision of this title shall be construed as altering, limiting, or affecting the authority of a State securities commission (or any agency or office performing like functions) under State law to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by such commission or authority.

(3) STATE INSURANCE REGULATORS.—No provision of this title shall be construed as altering, limiting, or affecting the authority of a State insurance commission or State insurance regulator under State law to adopt rules, initiate enforcement proceedings, or take any other action with respect to a person regulated by such commission or regulator.

SEC. 1043. PRESERVATION OF EXISTING CONTRACTS.

This title, and regulations, orders, guidance, and interpretations prescribed, issued, or established by the Bureau, shall not be construed to alter or affect the applicability of any regulation, order, guidance, or interpretation prescribed, issued, and established by the Comptroller of the Currency or the Director of the Office of Thrift Supervision regarding the applicability of State law under Federal banking law to any contract entered into on or before the date of enactment of this Act, by national banks, Federal savings associations, or subsidiaries thereof that are regulated and supervised by the Comptroller of the Currency or the Director of the Office of Thrift Supervision, respectively.

SEC. 1044. STATE LAW PREEMPTION STANDARDS FOR NATIONAL BANKS AND SUBSIDIARIES CLARIFIED.

(a) IN GENERAL.—Chapter one of title LXII of the Revised Statutes of the United States (12 U.S.C. 21 et seq.) is amended by inserting after section 5136B the following new section:

"SEC. 5136C. STATE LAW PREEMPTION STANDARDS FOR NATIONAL BANKS AND SUBSIDIARIES CLARIFIED.

"(a) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

"(1) NATIONAL BANK.—The term 'national bank' includes—

"(A) any bank organized under the laws of the United States; and

"(B) any Federal branch established in accordance with the International Banking Act of 1978.

"(2) STATE CONSUMER FINANCIAL LAWS.—The term 'State consumer financial law' means a State law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized for national banks to engage in), or any account related thereto, with respect to a consumer.

"(3) OTHER DEFINITIONS.—The terms 'affiliate', 'subsidiary', 'includes', and 'including' have the same meanings as in section 3 of the Federal Deposit Insurance Act.

"(b) PREEMPTION STANDARD.—

"(1) IN GENERAL.—State consumer financial laws are preempted, only if—

"(A) application of a State consumer financial law would have a discriminatory effect on national banks, in comparison with the effect of the law on a bank chartered by that State;

"(B) in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in Barnett Bank of Marion County, N. A. v. Nelson, Florida Insurance Commissioner, et al., 517 U.S. 25 (1996), the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers; and any preemption determination under this subparagraph may be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law; or

"(C) the State consumer financial law is preempted by a provision of Federal law other than this title.

"(2) SAVINGS CLAUSE.—This title and section 24 of the Federal Reserve Act (12 U.S.C. 371) do not preempt, annul, or affect the applicability of any State law to any subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is chartered as a national bank).

"(3) CASE-BY-CASE BASIS.—

"(A) DEFINITION.—As used in this section the term 'case-by-case basis' refers to a determination pursuant to this section made by the Comptroller concerning the impact of a particular State consumer financial law on any national bank that is subject to that law, or the law of any other State with substantively equivalent terms.

"(B) CONSULTATION.—When making a determination on a case-by-case basis that a State consumer financial law of another State has substantively equivalent terms as one that the Comptroller is preempting, the Comptroller shall first consult with the Bureau of Consumer Financial Protection and shall take the views of the Bureau into account when making the determination.

"(4) RULE OF CONSTRUCTION.—This title does not occupy the field in any area of State law.

"(5) STANDARDS OF REVIEW.—

"(A) PREEMPTION.—A court reviewing any determinations made by the Comptroller regarding preemption of a State law by this title or section 24 of the Federal Reserve Act (12 U.S.C. 371) shall assess the validity of such determinations, depending upon the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency, the consistency with other valid determinations made by the agency, and other factors which the court finds persuasive and relevant to its decision.

"(B) SAVINGS CLAUSE.—Except as provided in subparagraph (A), nothing in this section shall affect the deference that a court may afford to the Comptroller in making determinations regarding the meaning or interpretation of title LXII of the Revised Statutes of the United States or other Federal laws.

"(6) COMPTROLLER DETERMINATION NOT DELEGABLE.—Any regulation, order, or determination made by the Comptroller of the Currency under paragraph (1)(B) shall be made by the Comptroller, and shall not be delegable to another officer or employee of the Comptroller of the Currency.

"(c) SUBSTANTIAL EVIDENCE.—No regulation or order of the Comptroller of the Currency prescribed under subsection (b)(1)(B), shall be interpreted or applied so as to invalidate, or otherwise declare inapplicable to a national bank, the provision of the State consumer financial law, unless substantial evidence, made on the record of the proceeding, supports the specific finding regarding the preemption of such provision in accordance with the legal standard of the decision of the Supreme Court of the United States in Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al., 517 U.S. 25 (1996).

"(d) PERIODIC REVIEW OF PREEMPTION DETERMINATIONS.—

"(1) IN GENERAL.—The Comptroller of the Currency shall periodically conduct a review, through notice and public comment, of each determination that a provision of Federal law preempts a State consumer financial law. The agency shall conduct such review within the 5-year period after prescribing or otherwise issuing such determination, and at least once during each 5-year period thereafter. After conducting the review of, and inspecting the comments made on, the determination, the agency shall publish a notice in the Federal Register announcing the decision to continue or rescind the determination or a proposal to amend the determination. Any such notice of a proposal to amend a determination and the subsequent resolution of such proposal shall comply with the procedures set forth in subsections (a) and (b) of section 5244 of the Revised Statutes of the United States (12 U.S.C. 43 (a), (b)).

"(2) REPORTS TO CONGRESS.—At the time of issuing a review conducted under paragraph (1), the Comptroller of the Currency shall submit a report regarding such review to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate. The report submitted to the respective committees shall address whether the agency intends to continue, rescind, or propose to amend any determination that a provision of Federal law preempts a State consumer financial law, and the reasons therefor.

"(e) APPLICATION OF STATE CONSUMER FINANCIAL LAW TO SUBSIDIARIES AND AFFILIATES.—Notwithstanding any provision of this title or section 24 of Federal Reserve Act (12 U.S.C. 371), a State consumer financial law shall apply to a subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is chartered as a national bank) to the same extent that the State consumer financial law applies to any person, corporation, or other entity subject to such State law.

"(f) PRESERVATION OF POWERS RELATED TO CHARGING INTEREST.—No provision of this title shall be construed as altering or otherwise affecting the authority conferred by section 5197 of the Revised Statutes of the United States (12 U.S.C. 85) for the charging of interest by a national bank at the rate allowed by the laws of the State, territory, or district where the bank is located, including with respect to the meaning of 'interest' under such provision.

"(g) TRANSPARENCY OF OCC PREEMPTION DETERMINATIONS.—The Comptroller of the Currency shall publish and update no less frequently than quarterly, a list of preemption determinations by the Comptroller of the Currency then in effect that identifies the activities and practices covered by each determination and the requirements and constraints determined to be preempted.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter one of title LXII of the Revised Statutes of the United States is amended by inserting after the item relating to section 5136B the following new item:

"Sec. 5136C. State law preemption standards for national banks and subsidiaries clarified.".

SEC. 1045. CLARIFICATION OF LAW APPLICABLE TO NONDEPOSITORY INSTITUTION SUBSIDIARIES.

Section 5136C of the Revised Statutes of the United States (as added by this subtitle) is amended by adding at the end the following:

"(h) CLARIFICATION OF LAW APPLICABLE TO NONDEPOSITORY INSTITUTION SUBSIDIARIES AND AFFILIATES OF NATIONAL BANKS.—

"(1) DEFINITIONS.—For purposes of this subsection, the terms 'depository institution', 'subsidiary', and 'affiliate' have the same meanings as in section 3 of the Federal Deposit Insurance Act.

"(2) RULE OF CONSTRUCTION.—No provision of this title or section 24 of the Federal Reserve Act (12 U.S.C. 371) shall be construed as preempting, annulling, or affecting the applicability of State law to any subsidiary, affiliate, or agent of a national bank (other than a subsidiary, affiliate, or agent that is chartered as a national bank).".

SEC. 1046. STATE LAW PREEMPTION STANDARDS FOR FEDERAL SAVINGS ASSOCIATIONS AND SUBSIDIARIES CLARIFIED.

(a) IN GENERAL.—The Home Owners' Loan Act (12 U.S.C. 1461 et seq.) is amended by inserting after section 5 the following new section:

"SEC. 6. STATE LAW PREEMPTION STANDARDS FOR FEDERAL SAVINGS ASSOCIATIONS CLARIFIED.

"(a) IN GENERAL.—Any determination by a court or by the Director or any successor officer or agency regarding the relation of State law to a provision of this Act or any regulation or order prescribed under this Act shall be made in accordance with the laws and legal standards applicable to national banks regarding the preemption of State law.

"(b) PRINCIPLES OF CONFLICT PREEMPTION APPLICABLE.—Notwithstanding the authorities granted under sections 4 and 5, this Act does not occupy the field in any area of State law.".

(b) CLERICAL AMENDMENT.—The table of sections for the Home Owners' Loan Act (12 U.S.C. 1461 et seq.) is amended by striking the item relating to section 6 and inserting the following new item:

SEC. 1047. VISITORIAL STANDARDS FOR NATIONAL BANKS AND SAVINGS ASSOCIATIONS.

(a) NATIONAL BANKS.—Section 5136C of the Revised Statutes of the United States (as added by this subtitle) is amended by adding at the end the following:

"(i) VISITORIAL POWERS.—

"(1) IN GENERAL.—In accordance with the decision of the Supreme Court of the United States in Cuomo v. Clearing House Assn., L. L. C. (129 S. Ct. 2710 (2009)), no provision of this title which relates to visitorial powers or otherwise limits or restricts the visitorial authority to which any national bank is subject shall be construed as limiting or restricting the authority of any attorney general (or other chief law enforcement officer) of any State to bring an action against a national bank in a court of appropriate jurisdiction to enforce an applicable law and to seek relief as authorized by such law.

"(j) ENFORCEMENT ACTIONS.—The ability of the Comptroller of the Currency to bring an enforcement action under this title or section 5 of the Federal Trade Commission Act does not preclude any private party from enforcing rights granted under Federal or State law in the courts.".

(b) SAVINGS ASSOCIATIONS.—Section 6 of the Home Owners' Loan Act (as added by this title) is amended by adding at the end the following:

"(c) VISITORIAL POWERS.—The provisions of sections 5136C(i) of the Revised Statutes of the United States shall apply to Federal savings associations, and any subsidiary thereof, to the same extent and in the same manner as if such savings associations, or subsidiaries thereof, were national banks or subsidiaries of national banks, respectively."

"(d) ENFORCEMENT ACTIONS.—The ability of the Comptroller of the Currency to bring an enforcement action under this Act or section 5 of the Federal Trade Commission Act does not preclude any private party from enforcing rights granted under Federal or State law in the courts.".

SEC. 1048. EFFECTIVE DATE.

This subtitle shall become effective on the designated transfer date.

Subtitle E—Enforcement Powers

SEC. 1051. DEFINITIONS.

For purposes of this subtitle, the following definitions shall apply:

(1) BUREAU INVESTIGATION.—The term "Bureau investigation" means any inquiry conducted by a Bureau investigator for the purpose of ascertaining whether any person is or has

been engaged in any conduct that is a violation, as defined in this section.

(2) BUREAU INVESTIGATOR.—The term "Bureau investigator" means any attorney or investigator employed by the Bureau who is charged with the duty of enforcing or carrying into effect any Federal consumer financial law.

(3) CUSTODIAN.—The term "custodian" means the custodian or any deputy custodian designated by the Bureau.

(4) DOCUMENTARY MATERIAL.—The term "documentary material" includes the original or any copy of any book, document, record, report, memorandum, paper, communication, tabulation, chart, logs, electronic files, or other data or data compilations stored in any medium.

(5) VIOLATION.—The term "violation" means any act or omission that, if proved, would constitute a violation of any provision of Federal consumer financial law.

SEC. 1052. INVESTIGATIONS AND ADMINISTRATIVE DISCOVERY.

(a) JOINT INVESTIGATIONS.—

(1) IN GENERAL.—The Bureau or, where appropriate, a Bureau investigator, may engage in joint investigations and requests for information, as authorized under this title.

(2) FAIR LENDING.—The authority under paragraph (1) includes matters relating to fair lending, and where appropriate, joint investigations with, and requests for information from, the Secretary of Housing and Urban Development, the Attorney General of the United States, or both.

(b) SUBPOENAS.—

(1) IN GENERAL.—The Bureau or a Bureau investigator may issue subpoenas for the attendance and testimony of witnesses and the production of relevant papers, books, documents, or other material in connection with hearings under this title.

(2) FAILURE TO OBEY.—In the case of contumacy or refusal to obey a subpoena issued pursuant to this paragraph and served upon any person, the district court of the United States for any district in which such person is found, resides, or transacts business, upon application by the Bureau or a Bureau investigator and after notice to such person, may issue an order requiring such person to appear and give testimony or to appear and produce documents or other material.

(3) CONTEMPT.—Any failure to obey an order of the court under this subsection may be punished by the court as a contempt thereof.

(c) DEMANDS.—

(1) IN GENERAL.—Whenever the Bureau has reason to believe that any person may be in possession, custody, or control of any documentary material or tangible things, or may have any information, relevant to a violation, the Bureau may, before the institution of any proceedings under the Federal consumer financial law, issue in writing, and cause to be served upon such person, a civil investigative demand requiring such person to—

(A) produce such documentary material for inspection and copying or reproduction in the form or medium requested by the Bureau;

(B) submit such tangible things;

(C) file written reports or answers to questions;

(D) give oral testimony concerning documentary material, tangible things, or other information; or

(E) furnish any combination of such material, answers, or testimony.

(2) REQUIREMENTS.—Each civil investigative demand shall state the nature of the conduct constituting the alleged violation which is under investigation and the provision of law applicable to such violation.

(3) PRODUCTION OF DOCUMENTS.—Each civil investigative demand for the production of documentary material shall—

(A) describe each class of documentary material to be produced under the demand with such definiteness and certainty as to permit such material to be fairly identified;

(B) prescribe a return date or dates which will provide a reasonable period of time within which the material so demanded may be assembled and made available for inspection and copying or reproduction; and

(C) identify the custodian to whom such material shall be made available.

(4) PRODUCTION OF THINGS.—Each civil investigative demand for the submission of tangible things shall—

(A) describe each class of tangible things to be submitted under the demand with such definiteness and certainty as to permit such things to be fairly identified;

(B) prescribe a return date or dates which will provide a reasonable period of time within which the things so demanded may be assembled and submitted; and

(C) identify the custodian to whom such things shall be submitted.

(5) DEMAND FOR WRITTEN REPORTS OR ANSWERS.—Each civil investigative demand for written reports or answers to questions shall—

(A) propound with definiteness and certainty the reports to be produced or the questions to be answered;

(B) prescribe a date or dates at which time written reports or answers to questions shall be submitted; and

(C) identify the custodian to whom such reports or answers shall be submitted.

(6) ORAL TESTIMONY.—Each civil investigative demand for the giving of oral testimony shall—

(A) prescribe a date, time, and place at which oral testimony shall be commenced; and

(B) identify a Bureau investigator who shall conduct the investigation and the custodian to whom the transcript of such investigation shall be submitted.

(7) SERVICE.—Any civil investigative demand issued, and any enforcement petition filed, under this section may be served—

(A) by any Bureau investigator at any place within the territorial jurisdiction of any court of the United States; and

(B) upon any person who is not found within the territorial jurisdiction of any court of the United States—

(i) in such manner as the Federal Rules of Civil Procedure prescribe for service in a foreign nation; and

(ii) to the extent that the courts of the United States have authority to assert jurisdiction over such person, consistent with due process, the United States District Court for the District of Columbia shall have the same jurisdiction to take any action respecting compliance with this section by such person that such district court would have if such person were personally within the jurisdiction of such district court.

(8) METHOD OF SERVICE.—Service of any civil investigative demand or any enforcement petition filed under this section may be made upon a person, including any legal entity, by—

(A) delivering a duly executed copy of such demand or petition to the individual or to any partner, executive officer, managing agent, or general agent of such person, or to any agent of such person authorized by appointment or by law to receive service of process on behalf of such person;

(B) delivering a duly executed copy of such demand or petition to the principal office or place of business of the person to be served; or

(C) depositing a duly executed copy in the United States mails, by registered or certified mail, return receipt requested, duly addressed to such person at the principal office or place of business of such person.

(9) PROOF OF SERVICE.—

(A) IN GENERAL.—A verified return by the individual serving any civil investigative demand or any enforcement petition filed under this section setting forth the manner of such service shall be proof of such service.

(B) RETURN RECEIPTS.—In the case of service by registered or certified mail, such return shall be accompanied by the return post office receipt of delivery of such demand or enforcement petition.

(10) PRODUCTION OF DOCUMENTARY MATERIAL.—The production of documentary material in response to a civil investigative demand shall be made under a sworn certificate, in such form as the demand designates, by the person, if a natural person, to whom the demand is directed or, if not a natural person, by any person having knowledge of the facts and circumstances relating to such production, to the effect that all of the documentary material required by the demand and in the possession, custody, or control of the person to whom the demand is directed has been produced and made available to the custodian.

(11) SUBMISSION OF TANGIBLE THINGS.—The submission of tangible things in response to a civil investigative demand shall be made under a sworn certificate, in such form as the demand designates, by the person to whom the demand is directed or, if not a natural person, by any person having knowledge of the facts and circumstances relating to such production, to the effect that all of the tangible things required by the demand and in the possession, custody, or control of the person to whom the demand is directed have been submitted to the custodian.

(12) SEPARATE ANSWERS.—Each reporting requirement or question in a civil investigative demand shall be answered separately and fully in writing under oath, unless it is objected

to, in which event the reasons for the objection shall be stated in lieu of an answer, and it shall be submitted under a sworn certificate, in such form as the demand designates, by the person, if a natural person, to whom the demand is directed or, if not a natural person, by any person responsible for answering each reporting requirement or question, to the effect that all information required by the demand and in the possession, custody, control, or knowledge of the person to whom the demand is directed has been submitted.

(13) TESTIMONY.—

(A) IN GENERAL.—

(i) OATH AND RECORDATION.—The examination of any person pursuant to a demand for oral testimony served under this subsection shall be taken before an officer authorized to administer oaths and affirmations by the laws of the United States or of the place at which the examination is held. The officer before whom oral testimony is to be taken shall put the witness on oath or affirmation and shall personally, or by any individual acting under the direction of and in the presence of the officer, record the testimony of the witness.

(ii) TRANSCRIPTION.—The testimony shall be taken stenographically and transcribed.

(iii) TRANSMISSION TO CUSTODIAN.—After the testimony is fully transcribed, the officer investigator before whom the testimony is taken shall promptly transmit a copy of the transcript of the testimony to the custodian.

(B) PARTIES PRESENT.—Any Bureau investigator before whom oral testimony is to be taken shall exclude from the place where the testimony is to be taken all other persons, except the person giving the testimony, the attorney for that person, the officer before whom the testimony is to be taken, an investigator or representative of an agency with which the Bureau is engaged in a joint investigation, and any stenographer taking such testimony.

(C) LOCATION.—The oral testimony of any person taken pursuant to a civil investigative demand shall be taken in the judicial district of the United States in which such person resides, is found, or transacts business, or in such other place as may be agreed upon by the Bureau investigator before whom the oral testimony of such person is to be taken and such person.

(D) ATTORNEY REPRESENTATION.—

(i) IN GENERAL.—Any person compelled to appear under a civil investigative demand for oral testimony pursuant to this section may be accompanied, represented, and advised by an attorney.

(ii) AUTHORITY.—The attorney may advise a person described in clause (i), in confidence, either upon the request of such person or upon the initiative of the attorney, with respect to any question asked of such person.

(iii) OBJECTIONS.—A person described in clause (i), or the attorney for that person, may object on the record to any question, in whole or in part, and such person shall briefly state for the record the reason for the objection. An objection may properly be made, received, and entered upon the record when it is claimed that such person is entitled to refuse to answer the question on grounds of any constitutional or other legal right or privilege, including the privilege against self-incrimination, but such person shall not otherwise object to or refuse to answer any question, and such person or attorney shall not otherwise interrupt the oral examination.

(iv) REFUSAL TO ANSWER.—If a person described in clause (i) refuses to answer any question—

(I) the Bureau may petition the district court of the United States pursuant to this section for an order compelling such person to answer such question; and

(II) if the refusal is on grounds of the privilege against self-incrimination, the testimony of such person may be compelled in accordance with the provisions of section 6004 of title 18, United States Code.

(E) TRANSCRIPTS.—For purposes of this subsection—

(i) after the testimony of any witness is fully transcribed, the Bureau investigator shall afford the witness (who may be accompanied by an attorney) a reasonable opportunity to examine the transcript;

(ii) the transcript shall be read to or by the witness, unless such examination and reading are waived by the witness;

(iii) any changes in form or substance which the witness desires to make shall be entered and identified upon the transcript by the Bureau investigator, with a statement of the reasons given by the witness for making such changes;

(iv) the transcript shall be signed by the witness, unless the witness in writing waives the signing, is ill, cannot be found, or refuses to sign; and

(v) if the transcript is not signed by the witness during the 30-day period following the date on which the witness is first afforded a reasonable opportunity to examine the transcript, the Bureau investigator shall sign the transcript and state on the record the fact of the waiver, illness, absence of the witness, or the refusal to sign, together with any reasons given for the failure to sign.

(F) CERTIFICATION BY INVESTIGATOR.—The Bureau investigator shall certify on the transcript that the witness was duly sworn by him or her and that the transcript is a true record of the testimony given by the witness, and the Bureau investigator shall promptly deliver the transcript or send it by registered or certified mail to the custodian.

(G) COPY OF TRANSCRIPT.—The Bureau investigator shall furnish a copy of the transcript (upon payment of reasonable charges for the transcript) to the witness only, except that the Bureau may for good cause limit such witness to inspection of the official transcript of his testimony.

(H) WITNESS FEES.—Any witness appearing for the taking of oral testimony pursuant to a civil investigative demand shall be entitled to the same fees and mileage which are paid to witnesses in the district courts of the United States.

(d) CONFIDENTIAL TREATMENT OF DEMAND MATERIAL.—

(1) IN GENERAL.—Documentary materials and tangible things received as a result of a civil investigative demand shall be subject to requirements and procedures regarding confidentiality, in accordance with rules established by the Bureau.

(2) DISCLOSURE TO CONGRESS.—No rule established by the Bureau regarding the confidentiality of materials submitted to, or otherwise obtained by, the Bureau shall be intended to prevent disclosure to either House of Congress or to an appropriate committee of the Congress, except that the Bureau is permitted to adopt rules allowing prior notice to any party that owns or otherwise provided the material to the Bureau and had designated such material as confidential.

(e) PETITION FOR ENFORCEMENT.—

(1) IN GENERAL.—Whenever any person fails to comply with any civil investigative demand duly served upon him under this section, or whenever satisfactory copying or reproduction of material requested pursuant to the demand cannot be accomplished and such person refuses to surrender such material, the Bureau, through such officers or attorneys as it may designate, may file, in the district court of the United States for any judicial district in which such person resides, is found, or transacts business, and serve upon such person, a petition for an order of such court for the enforcement of this section.

(2) SERVICE OF PROCESS.—All process of any court to which application may be made as provided in this subsection may be served in any judicial district.

(f) PETITION FOR ORDER MODIFYING OR SETTING ASIDE DEMAND.—

(1) IN GENERAL.—Not later than 20 days after the service of any civil investigative demand upon any person under subsection (b), or at any time before the return date specified in the demand, whichever period is shorter, or within such period exceeding 20 days after service or in excess of such return date as may be prescribed in writing, subsequent to service, by any Bureau investigator named in the demand, such person may file with the Bureau a petition for an order by the Bureau modifying or setting aside the demand.

(2) COMPLIANCE DURING PENDENCY.—The time permitted for compliance with the demand in whole or in part, as determined proper and ordered by the Bureau, shall not run during the pendency of a petition under paragraph (1) at the Bureau, except that such person shall comply with any portions of the demand not sought to be modified or set aside.

(3) SPECIFIC GROUNDS.—A petition under paragraph (1) shall specify each ground upon which the petitioner relies in seeking relief, and may be based upon any failure of the demand to comply with the provisions of this section, or upon any constitutional or other legal right or privilege of such person.

(g) CUSTODIAL CONTROL.—At any time during which any custodian is in custody or control of any documentary material, tangible things, reports, answers to questions, or transcripts of oral testimony given by any person in compliance with any civil investigative demand, such person may file, in the district court of the United States for the judicial district within which the office of such custodian is situated, and serve upon such custodian, a petition for an order of such court requiring the performance by such custodian of any duty imposed upon him by this section or rule promulgated by the Bureau.

(h) JURISDICTION OF COURT.—

(1) IN GENERAL.—Whenever any petition is filed in any district court of the United States under this section, such court shall have jurisdiction to hear and determine the matter so presented, and to enter such order or orders as may be required to carry out the provisions of this section.

(2) APPEAL.—Any final order entered as described in paragraph (1) shall be subject to appeal pursuant to section 1291 of title 28, United States Code.

SEC. 1053. HEARINGS AND ADJUDICATION PROCEEDINGS.

(a) IN GENERAL.—The Bureau is authorized to conduct hearings and adjudication proceedings with respect to any person in the manner prescribed by chapter 5 of title 5, United States Code in order to ensure or enforce compliance with—

(1) the provisions of this title, including any rules prescribed by the Bureau under this title; and

(2) any other Federal law that the Bureau is authorized to enforce, including an enumerated consumer law, and any regulations or order prescribed thereunder, unless such Federal law specifically limits the Bureau from conducting a hearing or adjudication proceeding and only to the extent of such limitation.

(b) SPECIAL RULES FOR CEASE-AND-DESIST PROCEEDINGS.—

(1) ORDERS AUTHORIZED.—

(A) IN GENERAL.—If, in the opinion of the Bureau, any covered person or service provider is engaging or has engaged in an activity that violates a law, rule, or any condition imposed in writing on the person by the Bureau, the Bureau may, subject to sections 1024, 1025, and 1026, issue and serve upon the covered person or service provider a notice of charges in respect thereof.

(B) CONTENT OF NOTICE.—The notice under subparagraph (A) shall contain a statement of the facts constituting the alleged violation or violations, and shall fix a time and place at which a hearing will be held to determine whether an order to cease and desist should issue against the covered person or service provider, such hearing to be held not earlier than 30 days nor later than 60 days after the date of service of such notice, unless an earlier or a later date is set by the Bureau, at the request of any party so served.

(C) CONSENT.—Unless the party or parties served under subparagraph (B) appear at the hearing personally or by a duly authorized representative, such person shall be deemed to have consented to the issuance of the cease-and-desist order.

(D) PROCEDURE.—In the event of consent under subparagraph (C), or if, upon the record, made at any such hearing, the Bureau finds that any violation specified in the notice of charges has been established, the Bureau may issue and serve upon the covered person or service provider an order to cease and desist from the violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the covered person or service provider to cease and desist from the subject activity, and to take affirmative action to correct the conditions resulting from any such violation.

(2) EFFECTIVENESS OF ORDER.—A cease-and-desist order shall become effective at the expiration of 30 days after the date of service of an order under paragraph (1) upon the covered person or service provider concerned (except in the case of a cease-and-desist order issued upon consent, which shall become effective at the time specified therein), and shall remain effective and enforceable as provided therein, except to such extent as the order is stayed, modified, terminated, or set aside by action of the Bureau or a reviewing court.

(3) DECISION AND APPEAL.—Any hearing provided for in this subsection shall be held in the Federal judicial district or in the territory in which the residence or principal office or place of business of the person is located unless the person consents to another place, and shall be conducted in accordance with the provisions of chapter 5 of title 5 of the United States Code. After such hearing, and within 90 days after the Bureau has notified the parties that the case has been submitted to the Bureau for final decision, the Bureau shall render its decision (which shall include findings of fact upon which its decision is predicated) and shall issue and serve upon each party to the proceeding an order or orders consistent with the provisions of this section. Judicial review of any such order shall be exclusively as provided in this subsection. Unless a petition for review is timely filed in a court of appeals of the United States, as provided in paragraph (4), and thereafter until the record in the proceeding has been filed as provided in paragraph (4), the Bureau may at any time, upon such notice and in such manner as the Bureau shall determine proper, modify, terminate, or set aside any such order. Upon filing of the record as provided, the Bureau may modify, terminate, or set aside any such order with permission of the court.

(4) APPEAL TO COURT OF APPEALS.—Any party to any proceeding under this subsection may obtain a review of any order served pursuant to this subsection (other than an order issued with the consent of the person concerned) by the filing in the court of appeals of the United States for the circuit in which the principal office of the covered person is located, or in the United States Court of Appeals for the District of Columbia Circuit, within 30 days after the date of service of such order, a written petition praying that the order of the Bureau be modified, terminated, or set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Bureau, and thereupon the Bureau shall file in the court the record in the proceeding, as provided in section 2112 of title 28 of the United States Code. Upon the filing of such petition, such court shall have jurisdiction, which upon

the filing of the record shall except as provided in the last sentence of paragraph (3) be exclusive, to affirm, modify, terminate, or set aside, in whole or in part, the order of the Bureau. Review of such proceedings shall be had as provided in chapter 7 of title 5 of the United States Code. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court of the United States, upon certiorari, as provided in section 1254 of title 28 of the United States Code.

(5) NO STAY.—The commencement of proceedings for judicial review under paragraph (4) shall not, unless specifically ordered by the court, operate as a stay of any order issued by the Bureau.

(c) SPECIAL RULES FOR TEMPORARY CEASE-AND-DESIST PROCEEDINGS.—

(1) IN GENERAL.—Whenever the Bureau determines that the violation specified in the notice of charges served upon a person, including a service provider, pursuant to subsection (b), or the continuation thereof, is likely to cause the person to be insolvent or otherwise prejudice the interests of consumers before the completion of the proceedings conducted pursuant to subsection (b), the Bureau may issue a temporary order requiring the person to cease and desist from any such violation or practice and to take affirmative action to prevent or remedy such insolvency or other condition pending completion of such proceedings. Such order may include any requirement authorized under this subtitle. Such order shall become effective upon service upon the person and, unless set aside, limited, or suspended by a court in proceedings authorized by paragraph (2), shall remain effective and enforceable pending the completion of the administrative proceedings pursuant to such notice and until such time as the Bureau shall dismiss the charges specified in such notice, or if a cease-and-desist order is issued against the person, until the effective date of such order.

(2) APPEAL.—Not later than 10 days after the covered person or service provider concerned has been served with a temporary cease-and-desist order, the person may apply to the United States district court for the judicial district in which the residence or principal office or place of business of the person is located, or the United States District Court for the District of Columbia, for an injunction setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order pending the completion of the administrative proceedings pursuant to the notice of charges served upon the person under subsection (b), and such court shall have jurisdiction to issue such injunction.

(3) INCOMPLETE OR INACCURATE RECORDS.—

(A) TEMPORARY ORDER.—If a notice of charges served under subsection (b) specifies, on the basis of particular facts and circumstances, that the books and records of a covered person or service provider are so incomplete or inaccurate that the Bureau is unable to determine the financial condition of that person or the details or purpose of any transaction or transactions that may have a material effect on the financial condition of that person, the Bureau may issue a temporary order requiring—

(i) the cessation of any activity or practice which gave rise, whether in whole or in part, to the incomplete or inaccurate state of the books or records; or

(ii) affirmative action to restore such books or records to a complete and accurate state, until the completion of the proceedings under subsection (b)(1).

(B) EFFECTIVE PERIOD.—Any temporary order issued under subparagraph (A)—

(i) shall become effective upon service; and

(ii) unless set aside, limited, or suspended by a court in proceedings under paragraph (2), shall remain in effect and enforceable until the earlier of—

(I) the completion of the proceeding initiated under subsection (b) in connection with the notice of charges; or

(II) the date the Bureau determines, by examination or otherwise, that the books and records of the covered person or service provider are accurate and reflect the financial condition thereof.

(d) SPECIAL RULES FOR ENFORCEMENT OF ORDERS.—

(1) IN GENERAL.—The Bureau may in its discretion apply to the United States district court within the jurisdiction of which the principal office or place of business of the person is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such court shall have jurisdiction and power to order and require compliance herewith.

(2) EXCEPTION.—Except as otherwise provided in this subsection, no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order or to review, modify, suspend, terminate, or set aside any such notice or order.

(e) RULES.—The Bureau shall prescribe rules establishing such procedures as may be necessary to carry out this section.

SEC. 1054. LITIGATION AUTHORITY.

(a) IN GENERAL.—If any person violates a Federal consumer financial law, the Bureau may, subject to sections 1024, 1025, and 1026, commence a civil action against such person to impose a civil penalty or to seek all appropriate legal and equitable relief including a permanent or temporary injunction as permitted by law.

(b) REPRESENTATION.—The Bureau may act in its own name and through its own attorneys in enforcing any provision of this title, rules thereunder, or any other law or regulation, or in any action, suit, or proceeding to which the Bureau is a party.

(c) COMPROMISE OF ACTIONS.—The Bureau may compromise or settle any action if such compromise is approved by the court.

(d) NOTICE TO THE ATTORNEY GENERAL.—

(1) IN GENERAL.—When commencing a civil action under Federal consumer financial law, or any rule thereunder, the Bureau shall notify the Attorney General and, with respect to a civil action against an insured depository institution or insured credit union, the appropriate prudential regulator.

(2) NOTICE AND COORDINATION.—

(A) NOTICE OF OTHER ACTIONS.—In addition to any notice required under paragraph (1), the Bureau shall notify the Attorney General concerning any action, suit, or proceeding to which the Bureau is a party, except an action, suit, or proceeding that involves the offering or provision of consumer financial products or services.

(B) COORDINATION.—In order to avoid conflicts and promote consistency regarding litigation of matters under Federal law, the Attorney General and the Bureau shall consult regarding the coordination of investigations and proceedings, including by negotiating an agreement for coordination by not later than 180 days after the designated transfer date. The agreement under this subparagraph shall include provisions to ensure that parallel investigations and proceedings involving the Federal consumer financial laws are conducted in a manner that avoids conflicts and does not impede the ability of the Attorney General to prosecute violations of Federal criminal laws.

(C) RULE OF CONSTRUCTION.—Nothing in this paragraph shall be construed to limit the authority of the Bureau under this title, including the authority to interpret Federal consumer financial law.

(e) APPEARANCE BEFORE THE SUPREME COURT.—The Bureau may represent itself in its own name before the Supreme Court of the United States, provided that the Bureau makes a written request to the Attorney General within the 10-day period which begins on the date of entry of the judgment which would permit any party to file a petition for writ of certiorari, and the Attorney General concurs with such request or fails to take action within 60 days of the request of the Bureau.

(f) FORUM.—Any civil action brought under this title may be brought in a United States district court or in any court of competent jurisdiction of a state in a district in which the defendant is located or resides or is doing business, and such court shall have jurisdiction to enjoin such person and to require compliance with any Federal consumer financial law.

(g) TIME FOR BRINGING ACTION.—

(1) IN GENERAL.—Except as otherwise permitted by law or equity, no action may be brought under this title more than 3 years after the date of discovery of the violation to which an action relates.

(2) LIMITATIONS UNDER OTHER FEDERAL LAWS.—

(A) IN GENERAL.—An action arising under this title does not include claims arising solely under enumerated consumer laws.

(B) BUREAU AUTHORITY.—In any action arising solely under an enumerated consumer law, the Bureau may commence, defend, or intervene in the action in accordance with the requirements of that provision of law, as applicable.

(C) TRANSFERRED AUTHORITY.—In any action arising solely under laws for which authorities were transferred under subtitles F and H, the Bureau may commence, defend, or intervene in the action in accordance with the requirements of that provision of law, as applicable.

SEC. 1055. RELIEF AVAILABLE.

(a) ADMINISTRATIVE PROCEEDINGS OR COURT ACTIONS.—

(1) JURISDICTION.—The court (or the Bureau, as the case may be) in an action or adjudication proceeding brought under Federal consumer financial law, shall have jurisdiction to grant any appropriate legal or equitable relief with respect to a violation of Federal consumer financial law, including a violation of a rule or order prescribed under a Federal consumer financial law.

(2) RELIEF.—Relief under this section may include, without limitation—

(A) rescission or reformation of contracts;

(B) refund of moneys or return of real property;

(C) restitution;

(D) disgorgement or compensation for unjust enrichment;

(E) payment of damages or other monetary relief;

(F) public notification regarding the violation, including the costs of notification;

(G) limits on the activities or functions of the person; and

(H) civil money penalties, as set forth more fully in subsection (c).

(3) NO EXEMPLARY OR PUNITIVE DAMAGES.—Nothing in this subsection shall be construed as authorizing the imposition of exemplary or punitive damages.

(b) RECOVERY OF COSTS.—In any action brought by the Bureau, a State attorney general, or any State regulator to enforce any Federal consumer financial law, the Bureau, the State attorney general, or the State regulator may recover its costs in connection with prosecuting such action if the Bureau, the State attorney general, or the State regulator is the prevailing party in the action.

(c) CIVIL MONEY PENALTY IN COURT AND ADMINISTRATIVE ACTIONS.—

(1) IN GENERAL.—Any person that violates, through any act or omission, any provision of Federal consumer financial law shall forfeit and pay a civil penalty pursuant to this subsection.

(2) PENALTY AMOUNTS.—

(A) FIRST TIER.—For any violation of a law, rule, or final order or condition imposed in writing by the Bureau, a civil penalty may not exceed $5,000 for each day during which such violation or failure to pay continues.

(B) SECOND TIER.—Notwithstanding paragraph (A), for any person that recklessly engages in a violation of a Federal consumer financial law, a civil penalty may not exceed $25,000 for each day during which such violation continues.

(C) THIRD TIER.—Notwithstanding subparagraphs (A) and (B), for any person that knowingly violates a Federal consumer financial law, a civil penalty may not exceed $1,000,000 for each day during which such violation continues.

(3) MITIGATING FACTORS.—In determining the amount of any penalty assessed under paragraph (2), the Bureau or the court shall take into account the appropriateness of the penalty with respect to—

(A) the size of financial resources and good faith of the person charged;

(B) the gravity of the violation or failure to pay;

(C) the severity of the risks to or losses of the consumer, which may take into account the number of products or services sold or provided;

(D) the history of previous violations; and

(E) such other matters as justice may require.

(4) AUTHORITY TO MODIFY OR REMIT PENALTY.—The Bureau may compromise, modify, or remit any penalty which may be assessed or had already been assessed under paragraph (2). The amount of such penalty, when finally determined, shall be exclusive of any sums owed by the person to the United States in connection with the costs of the proceeding, and may be deducted from any sums owing by the United States to the person charged.

(5) NOTICE AND HEARING.—No civil penalty may be assessed under this subsection with respect to a violation of any Federal consumer financial law, unless—

(A) the Bureau gives notice and an opportunity for a hearing to the person accused of the violation; or

(B) the appropriate court has ordered such assessment and entered judgment in favor of the Bureau.

SEC. 1056. REFERRALS FOR CRIMINAL PROCEEDINGS.

If the Bureau obtains evidence that any person, domestic or foreign, has engaged in conduct that may constitute a violation of Federal criminal law, the Bureau shall transmit such evidence to the Attorney General of the United States, who may institute criminal proceedings under appropriate law. Nothing in this section affects any other authority of the Bureau to disclose information.

SEC. 1057. EMPLOYEE PROTECTION.

(a) IN GENERAL.—No covered person or service provider shall terminate or in any other way discriminate against, or cause to be terminated or discriminated against, any covered employee or any authorized representative of covered employees by reason of the fact that such employee or representative, whether at the initiative of the employee or in the ordinary course of the duties of the employee (or any person acting pursuant to a request of the employee), has—

(1) provided, caused to be provided, or is about to provide or cause to be provided, information to the employer, the Bureau, or any other State, local, or Federal, government authority or law enforcement agency relating to any violation of, or any act or omission that the employee reasonably believes to be a violation of, any provision of this title or any other provision of law that is subject to the jurisdiction of the Bureau, or any rule, order, standard, or prohibition prescribed by the Bureau;

(2) testified or will testify in any proceeding resulting from the administration or enforcement of any provision of this title or any other provision of law that is subject to the jurisdiction of the Bureau, or any rule, order, standard, or prohibition prescribed by the Bureau;

(3) filed, instituted, or caused to be filed or instituted any proceeding under any Federal consumer financial law; or

(4) objected to, or refused to participate in, any activity, policy, practice, or assigned task that the employee (or other such person) reasonably believed to be in violation of any law,

rule, order, standard, or prohibition, subject to the jurisdiction of, or enforceable by, the Bureau.

(b) DEFINITION OF COVERED EMPLOYEE.—For the purposes of this section, the term "covered employee" means any individual performing tasks related to the offering or provision of a consumer financial product or service.

(c) PROCEDURES AND TIMETABLES.—

(1) COMPLAINT.—

(A) IN GENERAL.—A person who believes that he or she has been discharged or otherwise discriminated against by any person in violation of subsection (a) may, not later than 180 days after the date on which such alleged violation occurs, file (or have any person file on his or her behalf) a complaint with the Secretary of Labor alleging such discharge or discrimination and identifying the person responsible for such act.

(B) ACTIONS OF SECRETARY OF LABOR.—Upon receipt of such a complaint, the Secretary of Labor shall notify, in writing, the person named in the complaint who is alleged to have committed the violation, of—

(i) the filing of the complaint;

(ii) the allegations contained in the complaint;

(iii) the substance of evidence supporting the complaint; and

(iv) opportunities that will be afforded to such person under paragraph (2).

(2) INVESTIGATION BY SECRETARY OF LABOR.—

(A) IN GENERAL.—Not later than 60 days after the date of receipt of a complaint filed under paragraph (1), and after affording the complainant and the person named in the complaint who is alleged to have committed the violation that is the basis for the complaint an opportunity to submit to the Secretary of Labor a written response to the complaint and an opportunity to meet with a representative of the Secretary of Labor to present statements from witnesses, the Secretary of Labor shall—

(i) initiate an investigation and determine whether there is reasonable cause to believe that the complaint has merit; and

(ii) notify the complainant and the person alleged to have committed the violation of subsection (a), in writing, of such determination.

(B) NOTICE OF RELIEF AVAILABLE.—If the Secretary of Labor concludes that there is reasonable cause to believe that a violation of subsection (a) has occurred, the Secretary of Labor shall, together with the notice under subparagraph (A)(ii), issue a preliminary order providing the relief prescribed by paragraph (4)(B).

(C) REQUEST FOR HEARING.—Not later than 30 days after the date of receipt of notification of a determination of the Secretary of Labor under this paragraph, either the person alleged to have committed the violation or the complainant may file objections to the findings or preliminary order, or both, and request a hearing on the record. The filing of such objections shall not operate to stay any reinstatement remedy contained in the preliminary order. Any such hearing shall be conducted expeditiously, and if a hearing is not requested in such 30-day period, the preliminary order shall be deemed a final order that is not subject to judicial review.

(3) GROUNDS FOR DETERMINATION OF COMPLAINTS.—

(A) IN GENERAL.—The Secretary of Labor shall dismiss a complaint filed under this subsection, and shall not conduct an investigation otherwise required under paragraph (2), unless the complainant makes a prima facie showing that any behavior described in paragraphs (1) through (4) of subsection (a) was a contributing factor in the unfavorable personnel action alleged in the complaint.

(B) REBUTTAL EVIDENCE.—Notwithstanding a finding by the Secretary of Labor that the complainant has made the showing required under subparagraph (A), no investigation otherwise required under paragraph (2) shall be conducted, if the employer demonstrates, by clear and convincing evidence, that the employer would have taken the same unfavorable personnel action in the absence of that behavior.

(C) EVIDENTIARY STANDARDS.—The Secretary of Labor may determine that a violation of subsection (a) has occurred only if the complainant demonstrates that any behavior described in paragraphs (1) through (4) of subsection (a) was a contributing factor in the unfavorable personnel action alleged in the complaint. Relief may not be ordered under subparagraph (A) if the employer demonstrates by clear and convincing evidence that the employer would have taken the same unfavorable personnel action in the absence of that behavior.

(4) ISSUANCE OF FINAL ORDERS; REVIEW PROCEDURES.—

(A) TIMING.—Not later than 120 days after the date of conclusion of any hearing under paragraph (2), the Secretary of Labor shall issue a final order providing the relief prescribed by this paragraph or denying the complaint. At any time before issuance of a final order, a proceeding under this subsection may be terminated on the basis of a settlement agreement entered into by the Secretary of Labor, the complainant, and the person alleged to have committed the violation.

(B) PENALTIES.—

(i) ORDER OF SECRETARY OF LABOR.—If, in response to a complaint filed under paragraph (1), the Secretary of Labor determines that a violation of subsection (a) has occurred, the Secretary of Labor shall order the person who committed such violation—

(I) to take affirmative action to abate the violation;

(II) to reinstate the complainant to his or her former position, together with compensation (including back pay) and restore the terms, conditions, and privileges associated with his or her employment; and

(III) to provide compensatory damages to the complainant.

(ii) PENALTY.—If an order is issued under clause (i), the Secretary of Labor, at the request of the complainant, shall assess against the person against whom the order is issued, a sum equal to the aggregate amount of all costs and expenses (including attorney fees and expert witness fees) reasonably incurred, as determined by the Secretary of Labor, by the complainant for, or in connection with, the bringing of the complaint upon which the order was issued.

(C) PENALTY FOR FRIVOLOUS CLAIMS.—If the Secretary of Labor finds that a complaint under paragraph (1) is frivolous or has been brought in bad faith, the Secretary of Labor may award to the prevailing employer a reasonable attorney fee, not exceeding $1,000, to be paid by the complainant.

(D) DE NOVO REVIEW.—

(i) FAILURE OF THE SECRETARY TO ACT.—If the Secretary of Labor has not issued a final order within 210 days after the date of filing of a complaint under this subsection, or within 90 days after the date of receipt of a written determination, the complainant may bring an action at law or equity for de novo review in the appropriate district court of the United States having jurisdiction, which shall have jurisdiction over such an action without regard to the amount in controversy, and which action shall, at the request of either party to such action, be tried by the court with a jury.

(ii) PROCEDURES.—A proceeding under clause (i) shall be governed by the same legal burdens of proof specified in paragraph (3). The court shall have jurisdiction to grant all relief necessary to make the employee whole, including injunctive relief and compensatory damages, including—

(I) reinstatement with the same seniority status that the employee would have had, but for the discharge or discrimination;

(II) the amount of back pay, with interest; and

(III) compensation for any special damages sustained as a result of the discharge or discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.

(E) OTHER APPEALS.—Unless the complainant brings an action under subparagraph (D), any person adversely affected or aggrieved by a final order issued under subparagraph (A) may file a petition for review of the order in the United States Court of Appeals for the circuit in which the violation with respect to which the order was issued, allegedly occurred or the circuit in which the complainant resided on the date of such violation, not later than 60 days after the date of the issuance of the final order of the Secretary of Labor under subparagraph (A). Review shall conform to chapter 7 of title 5, United States Code. The commencement of proceedings under this subparagraph shall not, unless ordered by the court, operate as a stay of the order. An order of the Secretary of Labor with respect to which review could have been obtained under this subparagraph shall not be subject to judicial review in any criminal or other civil proceeding.

(5) FAILURE TO COMPLY WITH ORDER.—

(A) ACTIONS BY THE SECRETARY.—If any person has failed to comply with a final order issued under paragraph (4), the Secretary of Labor may file a civil action in the United States district court for the district in which the violation was found to have occurred, or in the United States district court for the District of Columbia, to enforce such order. In actions brought under this paragraph, the district courts shall have jurisdiction to grant all appropriate relief including injunctive relief and compensatory damages.

(B) CIVIL ACTIONS TO COMPEL COMPLIANCE.—A person on whose behalf an order was issued under paragraph (4) may commence a civil action against the person to whom such order was issued to require compliance with such order. The appropriate United States district court shall have jurisdiction, without regard to the amount in controversy or the citizenship of the parties, to enforce such order.

(C) AWARD OF COSTS AUTHORIZED.—The court, in issuing any final order under this paragraph, may award costs of litigation (including reasonable attorney and expert witness fees) to any party, whenever the court determines such award is appropriate.

(D) MANDAMUS PROCEEDINGS.—Any nondiscretionary duty imposed by this section shall be enforceable in a mandamus proceeding brought under section 1361 of title 28, United States Code.

(d) UNENFORCEABILITY OF CERTAIN AGREEMENTS.—

(1) NO WAIVER OF RIGHTS AND REMEDIES.—Except as provided under paragraph (3), and notwithstanding any other provision of law, the rights and remedies provided for in this section may not be waived by any agreement, policy, form, or condition of employment, including by any predispute arbitration agreement.

(2) NO PREDISPUTE ARBITRATION AGREEMENTS.—Except as provided under paragraph (3), and notwithstanding any other provision of law, no predispute arbitration agreement shall be valid or enforceable to the extent that it requires arbitration of a dispute arising under this section.

(3) EXCEPTION.—Notwithstanding paragraphs (1) and (2), an arbitration provision in a collective bargaining agreement shall be enforceable as to disputes arising under subsection (a)(4), unless the Bureau determines, by rule, that such provision is inconsistent with the purposes of this title.

SEC. 1058. EFFECTIVE DATE.

This subtitle shall become effective on the designated transfer date.

Subtitle F—Transfer of Functions and Personnel; Transitional Provisions

SEC. 1061. TRANSFER OF CONSUMER FINANCIAL PROTECTION FUNCTIONS.

(a) DEFINED TERMS.—For purposes of this subtitle—

(1) the term "consumer financial protection functions" means—

(A) all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines; and

(B) the examination authority described in subsection (c)(1), with respect to a person described in subsection 1025(a); and

(2) the terms "transferor agency" and "transferor agencies" mean, respectively—

(A) the Board of Governors (and any Federal reserve bank, as the context requires), the Federal Deposit Insurance Corporation, the Federal Trade Commission, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Department of Housing and Urban Development, and the heads of those agencies; and

(B) the agencies listed in subparagraph (A), collectively.

(b) IN GENERAL.—Except as provided in subsection (c), consumer financial protection functions are transferred as follows:

(1) BOARD OF GOVERNORS.—

(A) TRANSFER OF FUNCTIONS.—All consumer financial protection functions of the Board of Governors are transferred to the Bureau.

(B) BOARD OF GOVERNORS AUTHORITY.—The Bureau shall have all powers and duties that were vested in the Board of Governors, relating to consumer financial protection functions, on the day before the designated transfer date.

(2) COMPTROLLER OF THE CURRENCY.—

(A) TRANSFER OF FUNCTIONS.—All consumer financial protection functions of the Comptroller of the Currency are transferred to the Bureau.

(B) COMPTROLLER AUTHORITY.—The Bureau shall have all powers and duties that were vested in the Comptroller of the Currency, relating to consumer financial protection functions, on the day before the designated transfer date.

(3) DIRECTOR OF THE OFFICE OF THRIFT SUPERVISION.—

(A) TRANSFER OF FUNCTIONS.—All consumer financial protection functions of the Director of the Office of Thrift Supervision are transferred to the Bureau.

(B) DIRECTOR AUTHORITY.—The Bureau shall have all powers and duties that were vested in the Director of the Office of Thrift Supervision, relating to consumer financial protection functions, on the day before the designated transfer date.

(4) FEDERAL DEPOSIT INSURANCE CORPORATION.—

(A) TRANSFER OF FUNCTIONS.—All consumer financial protection functions of the Federal Deposit Insurance Corporation are transferred to the Bureau.

(B) CORPORATION AUTHORITY.—The Bureau shall have all powers and duties that were vested in the Federal Deposit Insurance Corporation, relating to consumer financial protection functions, on the day before the designated transfer date.

(5) FEDERAL TRADE COMMISSION.—

(A) TRANSFER OF FUNCTIONS.—The authority of the Federal Trade Commission under an enumerated consumer law to prescribe rules, issue guidelines, or conduct a study or issue a report mandated under such law shall be transferred to the Bureau on the designated transfer date. Nothing in this title shall be construed to require a mandatory transfer of any employee of the Federal Trade Commission.

(B) BUREAU AUTHORITY.—

(i) IN GENERAL.—The Bureau shall have all powers and duties under the enumerated consumer laws to prescribe rules, issue guidelines, or to conduct studies or issue reports mandated by such laws, that were vested in the Federal Trade Commission on the day before the designated transfer date.

(ii) FEDERAL TRADE COMMISSION ACT.—Subject to subtitle B, the Bureau may enforce a rule prescribed under the Federal Trade Commission Act by the Federal Trade Commission with respect to an unfair or deceptive act or practice to the extent that such rule applies to a covered person or service provider with respect to the offering or provision of a consumer financial product or service as if it were a rule prescribed under section 1031 of this title.

(C) AUTHORITY OF THE FEDERAL TRADE COMMISSION.—

(i) IN GENERAL.—No provision of this title shall be construed as modifying, limiting, or otherwise affecting the authority of the Federal Trade Commission (including its authority with respect to affiliates described in section 1025(a)(1)) under the Federal Trade Commission Act or any other law, other than the authority under an enumerated consumer law to prescribe rules, issue official guidelines, or conduct a study or issue a report mandated under such law.

(ii) COMMISSION AUTHORITY RELATING TO RULES PRESCRIBED BY THE BUREAU.—Subject to subtitle B, the Federal Trade Commission shall have authority to enforce under the Federal Trade Commission Act (15 U.S.C. 41 et seq.) a rule prescribed by the Bureau under this title with respect to a covered person subject to the jurisdiction of the Federal Trade Commission under that Act, and a violation of such a rule by such a person shall be treated as a violation of a rule issued under section 18 of that Act (15 U.S.C. 57a) with respect to unfair or deceptive acts or practices.

(D) COORDINATION.—To avoid duplication of or conflict between rules prescribed by the Bureau under section 1031 of this title and the Federal Trade Commission under section 18(a)(1)(B) of the Federal Trade Commission Act that apply to a covered person or service provider with respect to the offering or provision of consumer financial products or services, the agencies shall negotiate an agreement with respect to rulemaking by each agency, including consultation with the other agency prior to proposing a rule and during the comment period.

(E) DEFERENCE.—No provision of this title shall be construed as altering, limiting, expanding, or otherwise affecting the deference that a court affords to the—

(i) Federal Trade Commission in making determinations regarding the meaning or interpretation of any provision of the Federal Trade Commission Act, or of any other Federal law for which the Commission has authority to prescribe rules; or

(ii) Bureau in making determinations regarding the meaning or interpretation of any provision of a Federal consumer financial law (other than any law described in clause (i)).

(6) NATIONAL CREDIT UNION ADMINISTRATION.—

(A) TRANSFER OF FUNCTIONS.—All consumer financial protection functions of the National Credit Union Administration are transferred to the Bureau.

(B) NATIONAL CREDIT UNION ADMINISTRATION AUTHORITY.—The Bureau shall have all powers and duties that were vested in the National Credit Union Administration, relating to consumer financial protection functions, on the day before the designated transfer date.

(7) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.—

(A) TRANSFER OF FUNCTIONS.—All consumer protection functions of the Secretary of the Department of Housing and Urban Development relating to the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 et seq.), the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (12 U.S.C. 5102 et seq.), and the Interstate Land Sales Full Disclosure Act (15 U.S.C. 1701 et seq.) are transferred to the Bureau.

(B) AUTHORITY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.—The Bureau shall have all powers and duties that were vested in the Secretary of the Department of Housing and Urban Development relating to the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 et seq.), the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (12 U.S.C. 5101 et seq.), and the Interstate Land Sales Full Disclosure Act (15 U.S.C. 1701 et seq.), on the day before the designated transfer date.

(c) AUTHORITIES OF THE PRUDENTIAL REGULATORS.—

(1) EXAMINATION.—A transferor agency that is a prudential regulator shall have—

(A) authority to require reports from and conduct examinations for compliance with Federal consumer financial laws with respect to a person described in section 1025(a), that is incidental to the backup and enforcement procedures provided to the regulator under section 1025(c); and

(B) exclusive authority (relative to the Bureau) to require reports from and conduct examinations for compliance with Federal consumer financial laws with respect to a person described in section 1026(a), except as provided to the Bureau under subsections (b) and (c) of section 1026.

(2) ENFORCEMENT.—

(A) LIMITATION.—The authority of a transferor agency that is a prudential regulator to enforce compliance with Federal consumer financial laws with respect to a person described in section 1025(a), shall be limited to the backup and enforcement procedures in described in section 1025(c).

(B) EXCLUSIVE AUTHORITY.—A transferor agency that is a prudential regulator shall have exclusive authority (relative to the Bureau) to enforce compliance with Federal consumer financial laws with respect to a person described in section 1026(a), except as provided to the Bureau under subsections (b) and (c) of section 1026.

(C) STATUTORY ENFORCEMENT.—For purposes of carrying out the authorities under, and subject to the limitations of, subtitle B, each prudential regulator may enforce compliance with the requirements imposed under this title, and any rule or order prescribed by the Bureau under this title, under—

(i) the Federal Credit Union Act (12 U.S.C. 1751 et seq.), by the National Credit Union Administration Board with respect to any covered person or service provider that is an insured credit union, or service provider thereto, or any affiliate of an insured credit union, who is subject to the jurisdiction of the Board under that Act; and

(ii) section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to a covered person or service provider that is a person described in section 3(q) of that Act and who is subject to the jurisdiction of that agency, as set forth in sections 3(q) and 8 of the Federal Deposit Insurance Act; or

(iii) the Bank Service Company Act (12 U.S.C. 1861 et seq.).

(d) EFFECTIVE DATE.—Subsections (b) and (c) shall become effective on the designated transfer date.

SEC. 1062. DESIGNATED TRANSFER DATE.

(a) IN GENERAL.—Not later than 60 days after the date of enactment of this Act, the Secretary shall—

(1) in consultation with the Chairman of the Board of Governors, the Chairperson of the Corporation, the Chairman of the Federal Trade Commission, the Chairman of the National Credit Union Administration Board, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Secretary of the Department of Housing and Urban Development, and the Director of the Office of Management and Budget, designate a single calendar date for the transfer of functions to the Bureau under section 1061; and

(2) publish notice of that designated date in the Federal Register.

(b) CHANGING DESIGNATION.—The Secretary—

(1) may, in consultation with the Chairman of the Board of Governors, the Chairperson of the Federal Deposit Insurance Corporation, the Chairman of the Federal Trade Commission, the Chairman of the National Credit Union Administration

Board, the Comptroller of the Currency, the Director of the Office of Thrift Supervision, the Secretary of the Department of Housing and Urban Development, and the Director of the Office of Management and Budget, change the date designated under subsection (a); and

(2) shall publish notice of any changed designated date in the Federal Register.

(c) PERMISSIBLE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), any date designated under this section shall be not earlier than 180 days, nor later than 12 months, after the date of enactment of this Act.

(2) EXTENSION OF TIME.—The Secretary may designate a date that is later than 12 months after the date of enactment of this Act if the Secretary transmits to appropriate committees of Congress—

(A) a written determination that orderly implementation of this title is not feasible before the date that is 12 months after the date of enactment of this Act;

(B) an explanation of why an extension is necessary for the orderly implementation of this title; and

(C) a description of the steps that will be taken to effect an orderly and timely implementation of this title within the extended time period.

(3) EXTENSION LIMITED.—In no case may any date designated under this section be later than 18 months after the date of enactment of this Act.

SEC. 1063. SAVINGS PROVISIONS.

(a) BOARD OF GOVERNORS.—

(1) EXISTING RIGHTS, DUTIES, AND OBLIGATIONS NOT AFFECTED.—Section 1061(b)(1) does not affect the validity of any right, duty, or obligation of the United States, the Board of Governors (or any Federal reserve bank), or any other person that—

(A) arises under any provision of law relating to any consumer financial protection function of the Board of Governors transferred to the Bureau by this title; and

(B) existed on the day before the designated transfer date.

(2) CONTINUATION OF SUITS.—No provision of this Act shall abate any proceeding commenced by or against the Board of Governors (or any Federal reserve bank) before the designated transfer date with respect to any consumer financial protection function of the Board of Governors (or any Federal reserve bank) transferred to the Bureau by this title, except that the Bureau, subject to sections 1024, 1025, and 1026, shall be substituted for the Board of Governors (or Federal reserve bank) as a party to any such proceeding as of the designated transfer date.

(b) FEDERAL DEPOSIT INSURANCE CORPORATION.—

(1) EXISTING RIGHTS, DUTIES, AND OBLIGATIONS NOT AFFECTED.—Section 1061(b)(4) does not affect the validity of any right, duty, or obligation of the United States, the Federal Deposit Insurance Corporation, the Board of Directors of that Corporation, or any other person, that—

(A) arises under any provision of law relating to any consumer financial protection function of the Federal Deposit Insurance Corporation transferred to the Bureau by this title; and

(B) existed on the day before the designated transfer date.

(2) CONTINUATION OF SUITS.—No provision of this Act shall abate any proceeding commenced by or against the Federal Deposit Insurance Corporation (or the Board of Directors of that Corporation) before the designated transfer date with respect to any consumer financial protection function of the Federal Deposit Insurance Corporation transferred to the Bureau by this title, except that the Bureau, subject to sections 1024, 1025, and 1026, shall be substituted for the Federal Deposit Insurance Corporation (or Board of Directors) as a party to any such proceeding as of the designated transfer date.

(c) FEDERAL TRADE COMMISSION.—Section 1061(b)(5) does not affect the validity of any right, duty, or obligation of the United States, the Federal Trade Commission, or any other person, that—

(1) arises under any provision of law relating to any consumer financial protection function of the Federal Trade Commission transferred to the Bureau by this title; and

(2) existed on the day before the designated transfer date.

(d) NATIONAL CREDIT UNION ADMINISTRATION.—

(1) EXISTING RIGHTS, DUTIES, AND OBLIGATIONS NOT AFFECTED.—Section 1061(b)(6) does not affect the validity of any right, duty, or obligation of the United States, the National Credit Union Administration, the National Credit Union Administration Board, or any other person, that—

(A) arises under any provision of law relating to any consumer financial protection function of the National Credit Union Administration transferred to the Bureau by this title; and

(B) existed on the day before the designated transfer date.

(2) CONTINUATION OF SUITS.—No provision of this Act shall abate any proceeding commenced by or against the National Credit Union Administration (or the National Credit Union Administration Board) before the designated transfer date with respect to any consumer financial protection function of the National Credit Union Administration transferred to the Bureau by this title, except that the Bureau, subject to sections 1024, 1025, and 1026, shall be substituted for the National Credit Union Administration (or National Credit Union Administration Board) as a party to any such proceeding as of the designated transfer date.

(e) OFFICE OF THE COMPTROLLER OF THE CURRENCY.—

(1) EXISTING RIGHTS, DUTIES, AND OBLIGATIONS NOT AFFECTED.—Section 1061(b)(2) does not affect the validity of any right, duty, or obligation of the United States, the Comptroller of the Currency, the Office of the Comptroller of the Currency, or any other person, that—

(A) arises under any provision of law relating to any consumer financial protection function of the Comptroller of the Currency transferred to the Bureau by this title; and

(B) existed on the day before the designated transfer date.

(2) CONTINUATION OF SUITS.—No provision of this Act shall abate any proceeding commenced by or against the Comptroller of the Currency (or the Office of the Comptroller of the Currency) with respect to any consumer financial protection function of the Comptroller of the Currency transferred to the Bureau by this title before the designated transfer date, except that the Bureau, subject to sections 1024, 1025, and 1026, shall be substituted for the Comptroller of the Currency (or the Office of the Comptroller of the Currency) as a party to any such proceeding as of the designated transfer date.

(f) OFFICE OF THRIFT SUPERVISION.—

(1) EXISTING RIGHTS, DUTIES, AND OBLIGATIONS NOT AFFECTED.—Section 1061(b)(3) does not affect the validity of any right, duty, or obligation of the United States, the Director of the Office of Thrift Supervision, the Office of Thrift Supervision, or any other person, that—

(A) arises under any provision of law relating to any consumer financial protection function of the Director of the Office of Thrift Supervision transferred to the Bureau by this title; and

(B) that existed on the day before the designated transfer date.

(2) CONTINUATION OF SUITS.—No provision of this Act shall abate any proceeding commenced by or against the Director of the Office of Thrift Supervision (or the Office of Thrift Supervision) with respect to any consumer financial protection function of the Director of the Office of Thrift Supervision transferred to the Bureau by this title before the designated transfer date, except that the Bureau, subject to sections 1024, 1025, and 1026, shall be substituted for the Director (or the Office of Thrift Supervision) as a party to any such proceeding as of the designated transfer date.

(g) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT.—

(1) EXISTING RIGHTS, DUTIES, AND OBLIGATIONS NOT AFFECTED.—Section 1061(b)(7) shall not affect the validity of any right, duty, or obligation of the United States, the Secretary of the Department of Housing and Urban Development (or the Department of Housing and Urban Development), or any other person, that—

(A) arises under any provision of law relating to any function of the Secretary of the Department of Housing and Urban Development with respect to the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 et seq.), the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (12 U.S.C. 5102 et seq.), or the Interstate Land Sales Full Disclosure Act (15 U.S.C. 1701 et seq) transferred to the Bureau by this title; and

(B) existed on the day before the designated transfer date.

(2) CONTINUATION OF SUITS.—This title shall not abate any proceeding commenced by or against the Secretary of the Department of Housing and Urban Development (or the Department of Housing and Urban Development) with respect to any consumer financial protection function of the Secretary

of the Department of Housing and Urban Development transferred to the Bureau by this title before the designated transfer date, except that the Bureau, subject to sections 1024, 1025, and 1026, shall be substituted for the Secretary of the Department of Housing and Urban Development (or the Department of Housing and Urban Development) as a party to any such proceeding as of the designated transfer date.

(h) CONTINUATION OF EXISTING ORDERS, RULINGS, DETERMINATIONS, AGREEMENTS, AND RESOLUTIONS.—

(1) IN GENERAL.—Except as provided in paragraph (2) and under subsection (i), all orders, resolutions, determinations, agreements, and rulings that have been issued, made, prescribed, or allowed to become effective by any transferor agency or by a court of competent jurisdiction, in the performance of consumer financial protection functions that are transferred by this title and that are in effect on the day before the designated transfer date, shall continue in effect, and shall continue to be enforceable by the appropriate transferor agency, according to the terms of those orders, resolutions, determinations, agreements, and rulings, and shall not be enforceable by or against the Bureau.

(2) EXCEPTION FOR ORDERS APPLICABLE TO PERSONS DESCRIBED IN SECTION 1025(a).—All orders, resolutions, determinations, agreements, and rulings that have been issued, made, prescribed, or allowed to become effective by any transferor agency or by a court of competent jurisdiction, in the performance of consumer financial protection functions that are transferred by this title and that are in effect on the day before the designated transfer date with respect to any person described in section 1025(a), shall continue in effect, according to the terms of those orders, resolutions, determinations, agreements, and rulings, and shall be enforceable by or against the Bureau or transferor agency.

(i) IDENTIFICATION OF RULES AND ORDERS CONTINUED.—Not later than the designated transfer date, the Bureau—

(1) shall, after consultation with the head of each transferor agency, identify the rules and orders that will be enforced by the Bureau; and

(2) shall publish a list of such rules and orders in the Federal Register.

(j) STATUS OF RULES PROPOSED OR NOT YET EFFECTIVE.—

(1) PROPOSED RULES.—Any proposed rule of a transferor agency which that agency, in performing consumer financial protection functions transferred by this title, has proposed before the designated transfer date, but has not been published as a final rule before that date, shall be deemed to be a proposed rule of the Bureau.

(2) RULES NOT YET EFFECTIVE.—Any interim or final rule of a transferor agency which that agency, in performing consumer financial protection functions transferred by this title, has published before the designated transfer date, but which has not become effective before that date, shall become effective as a rule of the Bureau according to its terms.

SEC. 1064. TRANSFER OF CERTAIN PERSONNEL.

(a) IN GENERAL.—

(1) CERTAIN FEDERAL RESERVE SYSTEM EMPLOYEES TRANSFERRED.—

(A) IDENTIFYING EMPLOYEES FOR TRANSFER.—The Bureau and the Board of Governors shall—

(i) jointly determine the number of employees of the Board of Governors necessary to perform or support the consumer financial protection functions of the Board of Governors that are transferred to the Bureau by this title; and

(ii) consistent with the number determined under clause (i), jointly identify employees of the Board of Governors for transfer to the Bureau, in a manner that the Bureau and the Board of Governors, in their sole discretion, determine equitable.

(B) IDENTIFIED EMPLOYEES TRANSFERRED.—All employees of the Board of Governors identified under subparagraph (A)(ii) shall be transferred to the Bureau for employment.

(C) FEDERAL RESERVE BANK EMPLOYEES.—Employees of any Federal reserve bank who are performing consumer financial protection functions on behalf of the Board of Governors shall be treated as employees of the Board of Governors for purposes of subparagraphs (A) and (B).

(2) CERTAIN FDIC EMPLOYEES TRANSFERRED.—

(A) IDENTIFYING EMPLOYEES FOR TRANSFER.—The Bureau and the Board of Directors of the Federal Deposit Insurance Corporation shall—

(i) jointly determine the number of employees of that Corporation necessary to perform or support the consumer financial protection functions of the Corporation that are transferred to the Bureau by this title; and

(ii) consistent with the number determined under clause (i), jointly identify employees of the Corporation for transfer to the Bureau, in a manner that the Bureau and the Board of Directors of the Corporation, in their sole discretion, determine equitable.

(B) IDENTIFIED EMPLOYEES TRANSFERRED.—All employees of the Corporation identified under subparagraph (A)(ii) shall be transferred to the Bureau for employment.

(3) CERTAIN NCUA EMPLOYEES TRANSFERRED.—

(A) IDENTIFYING EMPLOYEES FOR TRANSFER.—The Bureau and the National Credit Union Administration Board shall—

(i) jointly determine the number of employees of the National Credit Union Administration necessary to perform or support the consumer financial protection functions of the National Credit Union Administration that are transferred to the Bureau by this title; and

(ii) consistent with the number determined under clause (i), jointly identify employees of the National Credit Union Administration for transfer to the Bureau, in a manner that the Bureau and the National Credit Union Administration Board, in their sole discretion, determine equitable.

(B) IDENTIFIED EMPLOYEES TRANSFERRED.—All employees of the National Credit Union Administration identified under subparagraph (A)(ii) shall be transferred to the Bureau for employment.

(4) CERTAIN OFFICE OF THE COMPTROLLER OF THE CURRENCY EMPLOYEES TRANSFERRED.—

(A) IDENTIFYING EMPLOYEES FOR TRANSFER.—The Bureau and the Comptroller of the Currency shall—

(i) jointly determine the number of employees of the Office of the Comptroller of the Currency necessary to perform or support the consumer financial protection functions of the Office of the Comptroller of the Currency that are transferred to the Bureau by this title; and

(ii) consistent with the number determined under clause (i), jointly identify employees of the Office of the Comptroller of the Currency for transfer to the Bureau, in a manner that the Bureau and the Office of the Comptroller of the Currency, in their sole discretion, determine equitable.

(B) IDENTIFIED EMPLOYEES TRANSFERRED.—All employees of the Office of the Comptroller of the Currency identified under subparagraph (A)(ii) shall be transferred to the Bureau for employment.

(5) CERTAIN OFFICE OF THRIFT SUPERVISION EMPLOYEES TRANSFERRED.—

(A) IDENTIFYING EMPLOYEES FOR TRANSFER.—The Bureau and the Director of the Office of Thrift Supervision shall—

(i) jointly determine the number of employees of the Office of Thrift Supervision necessary to perform or support the consumer financial protection functions of the Office of Thrift Supervision that are transferred to the Bureau by this title; and

(ii) consistent with the number determined under clause (i), jointly identify employees of the Office of Thrift Supervision for transfer to the Bureau, in a manner that the Bureau and the Office of Thrift Supervision, in their sole discretion, determine equitable.

(B) IDENTIFIED EMPLOYEES TRANSFERRED.—All employees of the Office of Thrift Supervision identified under subparagraph (A)(ii) shall be transferred to the Bureau for employment.

(6) CERTAIN EMPLOYEES OF DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT TRANSFERRED.—

(A) IDENTIFYING EMPLOYEES FOR TRANSFER.—The Bureau and the Secretary of the Department of Housing and Urban Development shall—

(i) jointly determine the number of employees of the Department of Housing and Urban Development necessary to perform or support the consumer protection functions of the Department that are transferred to the Bureau by this title; and

(ii) consistent with the number determined under clause (i), jointly identify employees of the Department of Housing and Urban Development for transfer to the Bureau in a manner that the Bureau and the

Secretary of the Department of Housing and Urban Development, in their sole discretion, deem equitable.

(B) IDENTIFIED EMPLOYEES TRANSFERRED.—All employees of the Department of Housing and Urban Development identified under subparagraph (A)(ii) shall be transferred to the Bureau for employment.

(7) CONSUMER EDUCATION, FINANCIAL LITERACY, CONSUMER COMPLAINTS, AND RESEARCH FUNCTIONS.—The Bureau and each of the transferor agencies (except the Federal Trade Commission) shall jointly determine the number of employees and the types and grades of employees necessary to perform the functions of the Bureau under subtitle A, including consumer education, financial literacy, policy analysis, responses to consumer complaints and inquiries, research, and similar functions. All employees jointly identified under this paragraph shall be transferred to the Bureau for employment.

(8) AUTHORITY OF THE PRESIDENT TO RESOLVE DISPUTES.—

(A) ACTION AUTHORIZED.—In the event that the Bureau and a transferor agency are unable to reach an agreement under paragraphs (1) through (7) by the designated transfer date, the President, or the designee thereof, may issue an order or directive to the transferor agency to effect the transfer of personnel and property under this subtitle.

(B) TRANSMITTAL TO CONGRESS REQUIRED.—If an order or directive is issued under subparagraph (A), the President shall transmit a copy of the written determination made with respect to such order or directive, including an explanation for the need for the order or directive, to the Committee on Banking, Housing, and Urban Affairs and the Committee on Appropriations of the Senate and the Committee on Financial Services and the Committee on Appropriations of the House of Representatives.

(C) SUNSET.—The authority provided in this paragraph shall terminate 3 years after the designated transfer date.

(9) APPOINTMENT AUTHORITY FOR EXCEPTED SERVICE AND SENIOR EXECUTIVE SERVICE TRANSFERRED.—

(A) IN GENERAL.—In the case of an employee occupying a position in the excepted service or the Senior Executive Service, any appointment authority established pursuant to law or regulations of the Office of Personnel Management for filling such positions shall be transferred, subject to subparagraph (B).

(B) DECLINING TRANSFERS ALLOWED.—An agency or entity may decline to make a transfer of authority under subparagraph (A) (and the employees appointed pursuant thereto) to the extent that such authority relates to positions excepted from the competitive service because of their confidential, policy-making, policy-determining, or policy-advocating character, and non-career positions in the Senior Executive Service (within the meaning of section 3132(a)(7) of title 5, United States Code).

(b) TIMING OF TRANSFERS AND POSITION ASSIGNMENTS.—Each employee to be transferred under this section shall—

(1) be transferred not later than 90 days after the designated transfer date; and

(2) receive notice of a position assignment not later than 120 days after the effective date of his or her transfer.

(c) TRANSFER OF FUNCTION.—

(1) IN GENERAL.—Notwithstanding any other provision of law, the transfer of employees shall be deemed a transfer of functions for the purpose of section 3503 of title 5, United States Code.

(2) PRIORITY OF THIS TITLE.—If any provisions of this title conflict with any protection provided to transferred employees under section 3503 of title 5, United States Code, the provisions of this title shall control.

(d) EQUAL STATUS AND TENURE POSITIONS.—

(1) EMPLOYEES TRANSFERRED FROM THE FEDERAL RESERVE SYSTEM, FDIC, HUD, NCUA, OCC, AND OTS.—Each employee transferred to the Bureau from the Board of Governors, a Federal reserve bank, the Federal Deposit Insurance Corporation, the Department of Housing and Urban Development, the National Credit Union Administration, the Office of the Comptroller of the Currency, or the Office of Thrift Supervision shall be placed in a position at the Bureau with the same status and tenure as that employee held on the day before the designated transfer date.

(2) EMPLOYEES TRANSFERRED FROM THE FEDERAL RESERVE SYSTEM.—For purposes of determining the status and position placement of a transferred employee, any period of service with the Board of Governors or a Federal reserve bank shall be credited as a period of service with a Federal agency.

(e) ADDITIONAL CERTIFICATION REQUIREMENTS LIMITED.—Examiners transferred to the Bureau are not subject to any additional certification requirements before being placed in a comparable examiner position at the Bureau examining the same types of institutions as they examined before they were transferred.

(f) PERSONNEL ACTIONS LIMITED.—

(1) 2-YEAR PROTECTION.—Except as provided in paragraph (2), each transferred employee holding a permanent position on the day before the designated transfer date may not, during the 2-year period beginning on the designated transfer date, be involuntarily separated, or involuntarily reassigned outside his or her locality pay area.

(2) EXCEPTIONS.—Paragraph (1) does not limit the right of the Bureau—

(A) to separate an employee for cause or for unacceptable performance;

(B) to terminate an appointment to a position excepted from the competitive service because of its confidential policy-making, policy-determining, or policy-advocating character; or

(C) to reassign a supervisory employee outside of his or her locality pay area when the Bureau determines that the reassignment is necessary for the efficient operation of the Bureau.

(g) PAY.—

(1) 2-YEAR PROTECTION.—

(A) IN GENERAL.—Except as provided in paragraph (2), each transferred employee shall, during the 2-year period beginning on the designated transfer date, receive pay at a rate equal to not less than the basic rate of pay (including any geographic differential) that the employee received during the pay period immediately preceding the date of transfer.

(B) LIMITATION.—Notwithstanding subparagraph (A), if the employee was receiving a higher rate of basic pay on a temporary basis (because of a temporary assignment, temporary promotion, or other temporary action) immediately before the date of transfer, the Bureau may reduce the rate of basic pay on the date on which the rate would have been reduced but for the transfer, and the protected rate for the remainder of the 2-year period shall be the reduced rate that would have applied, but for the transfer.

(2) EXCEPTIONS.—Paragraph (1) does not limit the right of the Bureau to reduce the rate of basic pay of a transferred employee—

(A) for cause;

(B) for unacceptable performance; or

(C) with the consent of the employee.

(3) PROTECTION ONLY WHILE EMPLOYED.—Paragraph (1) applies to a transferred employee only while that employee remains employed by the Bureau.

(4) PAY INCREASES PERMITTED.—Paragraph (1) does not limit the authority of the Bureau to increase the pay of a transferred employee.

(h) REORGANIZATION.—

(1) BETWEEN 1ST AND 3RD YEAR.—

(A) IN GENERAL.—If the Bureau determines, during the 2-year period beginning 1 year after the designated transfer date, that a reorganization of the staff of the Bureau is required—

(i) that reorganization shall be deemed a "substantial reorganization" for purposes of affording affected employees retirement under section 8336(d)(2) or 8414(b)(1)(B) of title 5, United States Code;

(ii) before the reorganization occurs, all employees in the same locality pay area as defined by the Office of Personnel Management shall be placed in a uniform position classification system; and

(iii) any resulting reduction in force shall be governed by the provisions of chapter 35 of title 5, United States Code, except that the Bureau shall—

(I) establish competitive areas (as that term is defined in regulations issued by the Office of Personnel Management) to include at a minimum all employees in the same locality pay area as defined by the Office of Personnel Management;

(II) establish competitive levels (as that term is defined in regulations issued by the Office of Personnel Management) without regard to whether the particular employees have been appointed to positions in the competitive service or the excepted service; and

(III) afford employees appointed to positions in the excepted service (other than to a position excepted from the competitive service because of its confidential policy-making, policy-determining, or policy-advocating character) the same assignment rights to positions within the Bureau as employees appointed to positions in the competitive service.

(B) SERVICE CREDIT FOR REDUCTIONS IN FORCE.—For purposes of this paragraph, periods of service with a Federal home loan bank, a joint office of the Federal home loan banks, the Board of Governors, a Federal reserve bank, the Federal Deposit Insurance Corporation, or the National Credit Union Administration shall be credited as periods of service with a Federal agency.

(2) AFTER 3RD YEAR.—

(A) IN GENERAL.—If the Bureau determines, at any time after the 3-year period beginning on the designated transfer date, that a reorganization of the staff of the Bureau is required, any resulting reduction in force shall be governed by the provisions of chapter 35 of title 5, United States Code, except that the Bureau shall establish competitive levels (as that term is defined in regulations issued by the Office of Personnel Management) without regard to types of appointment held by particular employees transferred under this section.

(B) SERVICE CREDIT FOR REDUCTIONS IN FORCE.—For purposes of this paragraph, periods of service with a Federal home loan bank, a joint office of the Federal home loan banks, the Board of Governors, a Federal reserve bank, the Federal Deposit Insurance Corporation, or the National Credit Union Administration shall be credited as periods of service with a Federal agency.

(i) BENEFITS.—

(1) RETIREMENT BENEFITS FOR TRANSFERRED EMPLOYEES.—

(A) IN GENERAL.—

(i) CONTINUATION OF EXISTING RETIREMENT PLAN.—Unless an election is made under clause (iii) or subparagraph (B), each employee transferred pursuant to this subtitle shall remain enrolled in the existing retirement plan of that employee as of the date of transfer, through any period of continuous employment with the Bureau.

(ii) EMPLOYER CONTRIBUTION.—The Bureau shall pay any employer contributions to the existing retirement plan of each transferred employee, as required under that plan.

(iii) OPTION TO ELECT INTO THE FEDERAL RESERVE SYSTEM RETIREMENT PLAN AND FEDERAL RESERVE SYSTEM THRIFT PLAN.—Any employee transferred pursuant to this subtitle may, during the 1-year period beginning 6 months after the designated transfer date, elect to end their participation and benefit accruals under their existing retirement plan or plans and elect to participate in both the Federal Reserve System Retirement Plan and the Federal Reserve System Thrift Plan, through any period of continuous employment with the Bureau, under the same terms as are applicable to Federal Reserve System transferred employees, as provided in subparagraph (C). An election of coverage by the Federal Reserve System Retirement Plan and the Federal Reserve System Thrift Plan shall begin on the day following the end of the 18-

month period beginning on the designated transfer date, and benefit accruals under the existing retirement plan of the transferred employee shall end on the last day of the 18-month period beginning on the designated transfer date If an employee elects to participate in the Federal Reserve System Retirement Plan and the Federal Reserve System Thrift Plan, all of the service of the employee that was creditable under their existing retirement plan shall be transferred to the Federal Reserve System Retirement Plan on the day following the end of the 18-month period beginning on the designated transfer date.

(iv) BUREAU CONTRIBUTION.—The Bureau shall pay an employer contribution to the Federal Reserve System Retirement Plan, in the amount established as an employer contribution under the Federal Employees Retirement System, as established under chapter 84 of title 5, United States Code, for each Bureau employee who elects to participate in the Federal Reserve System Retirement Plan under this subparagraph. The Bureau shall pay an employer contribution to the Federal Reserve System Thrift Plan for each Bureau employee who elects to participate in such plan, as required under the terms of the Federal Reserve System Thrift Plan.

(v) ADDITIONAL FUNDING.—The Bureau shall transfer to the Federal Reserve System Retirement Plan an amount determined by the Board of Governors, in consultation with the Bureau, to be necessary to reimburse the Federal Reserve System Retirement Plan for the costs to such plan of providing benefits to employees electing coverage under the Federal Reserve System Retirement Plan under subparagraph (iii), and who were transferred to the Bureau from outside of the Federal Reserve System.

(vi) OPTION TO ELECT INTO THRIFT PLAN CREATED BY THE BUREAU.—If the Bureau chooses to establish a thrift plan, the employees transferred pursuant to this subtitle shall have the option to elect, under such terms and conditions as the Bureau may establish, coverage under such a thrift plan established by the Bureau. Transferred employees may not remain in the thrift plan of the agency from which the employee transferred under this subtitle, if the employee elects to participate in a thrift plan established by the Bureau.

(B) OPTION FOR EMPLOYEES TRANSFERRED FROM FEDERAL RESERVE SYSTEM TO BE SUBJECT TO THE FEDERAL EMPLOYEE RETIREMENT PROGRAM.—

(i) ELECTION.—Any Federal Reserve System transferred employee who was enrolled in the Federal Reserve System Retirement Plan on the day before the date of his or her transfer to the Bureau may, during the 1-year period beginning 6 months after the designated transfer date, elect to be subject to the Federal Employee Retirement Program.

(ii) EFFECTIVE DATE OF COVERAGE.—An election of coverage by the Federal Employee Retirement Program under this subparagraph shall begin on the day following the end of the 18-month period beginning on the designated transfer date, and benefit accruals under the existing retirement plan of the Federal Reserve System transferred employee shall end on the last day of the 18-month period beginning on the designated transfer date.

(C) BUREAU PARTICIPATION IN FEDERAL RESERVE SYSTEM RETIREMENT PLAN.—

(i) BENEFITS PROVIDED.—Federal Reserve System employees transferred pursuant to this subtitle shall continue to be eligible to participate in the Federal Reserve System Retirement Plan and Federal Reserve System Thrift Plan through any period of continuous employment with the Bureau, unless the employee makes an election under subparagraph (A)(vi) or (B). The retirement benefits, formulas, and features offered to the Federal Reserve System transferred employees shall be the same as those offered to employees of the Board of Governors who participate in the Federal Reserve System Retirement Plan and the Federal Reserve System Thrift Plan, as amended from time to time.

(ii) LIMITATION.—The Bureau shall not have responsibility or authority—

(I) to amend an existing retirement plan (including the Federal Reserve System Retirement Plan or Federal Reserve System Thrift Plan);

(II) for administering an existing retirement plan (including the Federal Reserve System Retirement Plan or Federal Reserve System Thrift Plan); or

(III) for ensuring the plans comply with applicable laws, fiduciary rules, and related responsibilities.

(iii) TAX QUALIFIED STATUS.—Notwithstanding any other provision of law, providing benefits to Federal Reserve System employees transferred to the Bureau pursuant to this subtitle, and to employees who elect coverage pursuant to subparagraph (A)(iii) or under section 1013(a)(2)(B), shall not cause any existing retirement plan (including the Federal Reserve System Retirement Plan and the Federal Reserve System Thrift Plan) to lose its tax-qualified status under sections 401(a) and 501(a) of the Internal Revenue Code of 1986.

(iv) BUREAU CONTRIBUTION.—The Bureau shall pay any employer contributions to the existing retirement plan (including the Federal Reserve System Retirement Plan and the Federal Reserve System Thrift Plan) for each Federal Reserve System transferred employee participating in those plans, as required under the plan, after the designated transfer date.

(v) CONTROLLED GROUP STATUS.—The Bureau is the same employer as the Federal Reserve System (as comprised of the Board of Governors and each of the 12 Federal reserve banks prior to the date of enactment of this Act) for purposes of subsections (b), (c), (m), and (o) of section 414 of the Internal Revenue Code of 1986 (26 U.S.C. 414).

(D) DEFINITIONS.—For purposes of this paragraph—

(i) the term "existing retirement plan" means, with respect to an employee transferred pursuant to this subtitle, the retirement plan (including the Financial Institutions Retirement Fund) and any associated thrift savings plan, of the agency from which the employee was transferred under this subtitle, in which the employee was enrolled on the day before the date on which the employee was transferred;

(ii) the term "Federal Employee Retirement Program" means either the Civil Service Retirement System established under chapter 83 of title 5, United States Code, or the Federal Employees Retirement System established under chapter 84 of title 5, United States Code, depending upon the service history of the individual;

(iii) the term "Federal Reserve System transferred employee" means a transferred employee who is an employee of the Board of Governors or a Federal reserve bank on the day before the designated transfer date, and who is transferred to the Bureau on the designated transfer date pursuant to this subtitle;

(iv) the term "Federal Reserve System Retirement Plan" means the Retirement Plan for Employees of the Federal Reserve System; and

(v) the term "Federal Reserve System Thrift Plan" means the Thrift Plan for Employees of the Federal Reserve System.

(2) BENEFITS OTHER THAN RETIREMENT BENEFITS FOR TRANSFERRED EMPLOYEES.—

(A) DURING 1ST YEAR.—

(i) EXISTING PLANS CONTINUE.—Each employee transferred pursuant to this subtitle may, for 1 year after the designated transfer date, retain membership in any other employee benefit program of the agency or bank from which the employee transferred, including a medical, dental, vision, long term care, or life insurance program, to which the employee belonged on the day before the designated transfer date.

(ii) EMPLOYER CONTRIBUTION.—The Bureau shall reimburse the agency or bank from which an employee was transferred for any cost incurred by that agency or bank in continuing to extend coverage in the benefit program to the employee, as required under that program or negotiated agreements.

(B) MEDICAL, DENTAL, VISION, OR LIFE INSURANCE AFTER FIRST YEAR.—If, at the end of the 1-year period beginning on the designated transfer date, the Bureau has not established its own, or arranged for participation in another entity's, medical, dental, vision, or life insurance program, an employee transferred pursuant to this subtitle who was a member of such a program at the agency or

Federal reserve bank from which the employee transferred may, before the coverage of that employee ends under subparagraph (A)(i), elect to enroll, without regard to any regularly scheduled open season, in—

(i) the enhanced dental benefits program established under chapter 89A of title 5, United States Code;

(ii) the enhanced vision benefits established under chapter 89B of title 5, United States Code;

(iii) the Federal Employees Group Life Insurance Program established under chapter 87 of title 5, United States Code, without regard to any requirement of insurability; and

(iv) the Federal Employees Health Benefits Program established under chapter 89 of title 5, United States Code.

(C) LONG TERM CARE INSURANCE AFTER 1ST YEAR.—If, at the end of the 1-year period beginning on the designated transfer date, the Bureau has not established its own, or arranged for participation in another entity's, long term care insurance program, an employee transferred pursuant to this subtitle who was a member of such a program at the agency or Federal reserve bank from which the employee transferred may, before the coverage of that employee ends under subparagraph (A)(i), elect to apply for coverage under the Federal Long Term Care Insurance Program established under chapter 90 of title 5, United States Code, under the underwriting requirements applicable to a new active workforce member (as defined in part 875 of title 5, Code of Federal Regulations).

(D) EMPLOYEE CONTRIBUTION.—An individual enrolled in the Federal Employees Health Benefits program shall pay any employee contribution required by the plan.

(E) ADDITIONAL FUNDING.—The Bureau shall transfer to the Federal Employees Health Benefits Fund established under section 8909 of title 5, United States Code, an amount determined by the Director of the Office of Personnel Management, after consultation with the Bureau and the Office of Management and Budget, to be necessary to reimburse the Fund for the cost to the Fund of providing benefits under this paragraph.

(F) CREDIT FOR TIME ENROLLED IN OTHER PLANS.—For employees transferred under this title, enrollment in a health benefits plan administered by a transferor agency or a Federal reserve bank, as the case may be, immediately before enrollment in a health benefits plan under chapter 89 of title 5, United States Code, shall be considered as enrollment in a health benefits plan under that chapter for purposes of section 8905(b)(1)(A) of title 5, United States Code.

(G) SPECIAL PROVISIONS TO ENSURE CONTINUATION OF LIFE INSURANCE BENEFITS.—

(i) IN GENERAL.—An annuitant (as defined in section 8901(3) of title 5, United States Code) who is enrolled in a life insurance plan administered by a transferor agency on the day before the designated transfer date shall be eligible for coverage by a life insurance plan under sections 8706(b), 8714a, 8714b, and 8714c of title 5, United States Code, or in a life insurance plan established by the Bureau, without regard to any regularly scheduled open season and requirement of insurability.

(ii) EMPLOYEE CONTRIBUTION.—An individual enrolled in a life insurance plan under this subparagraph shall pay any employee contribution required by the plan.

(iii) ADDITIONAL FUNDING.—The Bureau shall transfer to the Employees' Life Insurance Fund established under section 8714 of title 5, United States Code, an amount determined by the Director of the Office of Personnel Management, after consultation with the Bureau and the Office of Management and Budget, to be necessary to reimburse the Fund for the cost to the Fund of providing benefits under this subparagraph not otherwise paid for by the employee under clause (ii).

(iv) CREDIT FOR TIME ENROLLED IN OTHER PLANS.—For employees transferred under this title, enrollment in a life insurance plan administered by a transferor agency immediately before enrollment in a life insurance plan under chapter 87 of title 5, United States Code, shall be considered as enrollment in a life insurance plan under that chapter for purposes of section 8706(b)(1)(A) of title 5, United States Code.

(3) OPM RULES.—The Office of Personnel Management shall issue such rules as are necessary to carry out this subsection.

(j) IMPLEMENTATION OF UNIFORM PAY AND CLASSIFICATION SYSTEM.—Not later than 2 years after the designated transfer date, the Bureau shall implement a uniform pay and classification system for all employees transferred under this title.

(k) EQUITABLE TREATMENT.—In administering the provisions of this section, the Bureau—

(1) shall take no action that would unfairly disadvantage transferred employees relative to each other based on their prior employment by the Board of Governors, the Federal Deposit Insurance Corporation, the Department of Housing and Urban Development, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, a Federal reserve bank, a Federal home loan bank, or a joint office of the Federal home loan banks; and

(2) may take such action as is appropriate in individual cases so that employees transferred under this section receive equitable treatment, with respect to the status, tenure, pay, benefits (other than benefits under programs administered by the Office of Personnel Management), and accrued leave or vacation time of those employees, for prior periods of service with any Federal agency, including the Board of Governors, the Corporation, the Department of Housing and Urban Development, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, a Federal reserve bank, a Federal home loan bank, or a joint office of the Federal home loan banks.

(l) IMPLEMENTATION.—In implementing the provisions of this section, the Bureau shall coordinate with the Office of Personnel Management and other entities having expertise in matters related to employment to ensure a fair and orderly transition for affected employees.

SEC. 1065. INCIDENTAL TRANSFERS.

(a) INCIDENTAL TRANSFERS AUTHORIZED.—The Director of the Office of Management and Budget, in consultation with the Secretary, shall make such additional incidental transfers and dispositions of assets and liabilities held, used, arising from, available, or to be made available, in connection with the functions transferred by this title, as the Director may determine necessary to accomplish the purposes of this title.

(b) SUNSET.—The authority provided in this section shall terminate 5 years after the date of enactment of this Act.

SEC. 1066. INTERIM AUTHORITY OF THE SECRETARY.

(a) IN GENERAL.—The Secretary is authorized to perform the functions of the Bureau under this subtitle until the Director of the Bureau is confirmed by the Senate in accordance with section 1011.

(b) INTERIM ADMINISTRATIVE SERVICES BY THE DEPARTMENT OF THE TREASURY.—The Department of the Treasury may provide administrative services necessary to support the Bureau before the designated transfer date.

SEC. 1067. TRANSITION OVERSIGHT.

(a) PURPOSE.—The purpose of this section is to ensure that the Bureau—

(1) has an orderly and organized startup;

(2) attracts and retains a qualified workforce; and

(3) establishes comprehensive employee training and benefits programs.

(b) REPORTING REQUIREMENT.—

(1) IN GENERAL.—The Bureau shall submit an annual report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives that includes the plans described in paragraph (2).

(2) PLANS.—The plans described in this paragraph are as follows:

(A) TRAINING AND WORKFORCE DEVELOPMENT PLAN.—The Bureau shall submit a training and workforce development plan that includes, to the extent practicable—

(i) identification of skill and technical expertise needs and actions taken to meet those requirements;

(ii) steps taken to foster innovation and creativity;

(iii) leadership development and succession planning; and

(iv) effective use of technology by employees.

(B) WORKPLACE FLEXIBILITIES PLAN.—The Bureau shall submit a workforce flexibility plan that includes, to the extent practicable—

(i) telework;

(ii) flexible work schedules;

(iii) phased retirement;

(iv) reemployed annuitants;

(v) part-time work;
(vi) job sharing;
(vii) parental leave benefits and childcare assistance;
(viii) domestic partner benefits;
(ix) other workplace flexibilities; or
(x) any combination of the items described in clauses (i) through (ix).

(C) RECRUITMENT AND RETENTION PLAN.—The Bureau shall submit a recruitment and retention plan that includes, to the extent practicable, provisions relating to—
(i) the steps necessary to target highly qualified applicant pools with diverse backgrounds;
(ii) streamlined employment application processes;
(iii) the provision of timely notification of the status of employment applications to applicants; and
(iv) the collection of information to measure indicators of hiring effectiveness.

(c) EXPIRATION.—The reporting requirement under subsection (b) shall terminate 5 years after the date of enactment of this Act.

(d) RULE OF CONSTRUCTION.—Nothing in this section may be construed to affect—
(1) a collective bargaining agreement, as that term is defined in section 7103(a)(8) of title 5, United States Code, that is in effect on the date of enactment of this Act; or
(2) the rights of employees under chapter 71 of title 5, United States Code.

(e) PARTICIPATION IN EXAMINATIONS.—In order to prepare the Bureau to conduct examinations under section 1025 upon the designated transfer date, the Bureau and the applicable prudential regulator may agree to include, on a sampling basis, examiners on examinations of the compliance with Federal consumer financial law of institutions described in section 1025(a) conducted by the prudential regulators prior to the designated transfer date.

Subtitle G—Regulatory Improvements

SEC. 1071. SMALL BUSINESS DATA COLLECTION.

(a) IN GENERAL.—The Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.) is amended by inserting after section 704A the following:

"SEC. 704B. SMALL BUSINESS LOAN DATA COLLECTION.

"(a) PURPOSE.—The purpose of this section is to facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses.

"(b) INFORMATION GATHERING.—Subject to the requirements of this section, in the case of any application to a financial institution for credit for women-owned, minority-owned, or small business, the financial institution shall—
"(1) inquire whether the business is a women-owned, minority-owned, or small business, without regard to whether such application is received in person, by mail, by telephone,

by electronic mail or other form of electronic transmission, or by any other means, and whether or not such application is in response to a solicitation by the financial institution; and

"(2) maintain a record of the responses to such inquiry, separate from the application and accompanying information.

"(c) RIGHT TO REFUSE.—Any applicant for credit may refuse to provide any information requested pursuant to subsection (b) in connection with any application for credit.

"(d) NO ACCESS BY UNDERWRITERS.—

"(1) LIMITATION.—Where feasible, no loan underwriter or other officer or employee of a financial institution, or any affiliate of a financial institution, involved in making any determination concerning an application for credit shall have access to any information provided by the applicant pursuant to a request under subsection (b) in connection with such application.

"(2) LIMITED ACCESS.—If a financial institution determines that a loan underwriter or other officer or employee of a financial institution, or any affiliate of a financial institution, involved in making any determination concerning an application for credit should have access to any information provided by the applicant pursuant to a request under subsection (b), the financial institution shall provide notice to the applicant of the access of the underwriter to such information, along with notice that the financial institution may not discriminate on the basis of such information.

"(e) FORM AND MANNER OF INFORMATION.—

"(1) IN GENERAL.—Each financial institution shall compile and maintain, in accordance with regulations of the Bureau, a record of the information provided by any loan applicant pursuant to a request under subsection (b).

"(2) ITEMIZATION.—Information compiled and maintained under paragraph (1) shall be itemized in order to clearly and conspicuously disclose—

"(A) the number of the application and the date on which the application was received;

"(B) the type and purpose of the loan or other credit being applied for;

"(C) the amount of the credit or credit limit applied for, and the amount of the credit transaction or the credit limit approved for such applicant;

"(D) the type of action taken with respect to such application, and the date of such action;

"(E) the census tract in which is located the principal place of business of the women-owned, minority-owned, or small business loan applicant;

"(F) the gross annual revenue of the business in the last fiscal year of the women-owned, minority-owned, or small business loan applicant preceding the date of the application;

"(G) the race, sex, and ethnicity of the principal owners of the business; and

"(H) any additional data that the Bureau determines would aid in fulfilling the purposes of this section.

"(3) NO PERSONALLY IDENTIFIABLE INFORMATION.—In compiling and maintaining any record of information under this section, a financial institution may not include in such record the name, specific address (other than the census tract required under paragraph (1)(E)), telephone number, electronic mail address, or any other personally identifiable information concerning any individual who is, or is connected with, the women-owned, minority-owned, or small business loan applicant.

"(4) DISCRETION TO DELETE OR MODIFY PUBLICLY AVAILABLE DATA.—The Bureau may, at its discretion, delete or modify data collected under this section which is or will be available to the public, if the Bureau determines that the deletion or modification of the data would advance a privacy interest.

"(f) AVAILABILITY OF INFORMATION.—

"(1) SUBMISSION TO BUREAU.—The data required to be compiled and maintained under this section by any financial institution shall be submitted annually to the Bureau.

"(2) AVAILABILITY OF INFORMATION.—Information compiled and maintained under this section shall be—

"(A) retained for not less than 3 years after the date of preparation;

"(B) made available to any member of the public, upon request, in the form required under regulations prescribed by the Bureau;

"(C) annually made available to the public generally by the Bureau, in such form and in such manner as is determined by the Bureau, by regulation.

"(3) COMPILATION OF AGGREGATE DATA.—The Bureau may, at its discretion—

"(A) compile and aggregate data collected under this section for its own use; and

"(B) make public such compilations of aggregate data.

"(g) BUREAU ACTION.—

"(1) IN GENERAL.—The Bureau shall prescribe such rules and issue such guidance as may be necessary to carry out, enforce, and compile data pursuant to this section.

"(2) EXCEPTIONS.—The Bureau, by rule or order, may adopt exceptions to any requirement of this section and may, conditionally or unconditionally, exempt any financial institution or class of financial institutions from the requirements of this section, as the Bureau deems necessary or appropriate to carry out the purposes of this section.

"(3) GUIDANCE.—The Bureau shall issue guidance designed to facilitate compliance with the requirements of this section, including assisting financial institutions in working with applicants to determine whether the applicants are women-owned, minority-owned, or small businesses for purposes of this section.

"(h) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

"(1) FINANCIAL INSTITUTION.—The term 'financial institution' means any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity that engages in any financial activity.

"(2) SMALL BUSINESS.—The term 'small business' has the same meaning as the term 'small business concern' in section 3 of the Small Business Act (15 U.S.C. 632).

"(3) SMALL BUSINESS LOAN.—The term 'small business loan' means a loan made to a small business.

"(4) MINORITY.—The term 'minority' has the same meaning as in section 1204(c)(3) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

"(5) MINORITY-OWNED BUSINESS.—The term 'minority-owned business' means a business—

"(A) more than 50 percent of the ownership or control of which is held by 1 or more minority individuals; and

"(B) more than 50 percent of the net profit or loss of which accrues to 1 or more minority individuals.

"(6) WOMEN-OWNED BUSINESS.—The term 'women-owned business' means a business—

"(A) more than 50 percent of the ownership or control of which is held by 1 or more women; and

"(B) more than 50 percent of the net profit or loss of which accrues to 1 or more women.".

(b) TECHNICAL AND CONFORMING AMENDMENTS.—Section 701(b) of the Equal Credit Opportunity Act (15 U.S.C. 1691(b)) is amended—

(1) in paragraph (3), by striking "or" at the end;

(2) in paragraph (4), by striking the period at the end and inserting "; or"; and

(3) by inserting after paragraph (4), the following:

"(5) to make an inquiry under section 704B, in accordance with the requirements of that section.".

(c) CLERICAL AMENDMENT.—The table of sections for title VII of the Consumer Credit Protection Act is amended by inserting after the item relating to section 704A the following new item:

"704B. Small business loan data collection.".

(d) EFFECTIVE DATE.—This section shall become effective on the designated transfer date.

SEC. 1072. ASSISTANCE FOR ECONOMICALLY VULNERABLE INDIVIDUALS AND FAMILIES.

(a) HERA AMENDMENTS.—Section 1132 of the Housing and Economic Recovery Act of 2008 (12 U.S.C. 1701x note) is amended—

(1) in subsection (a), by inserting in each of paragraphs (1), (2), (3), and (4) "or economically vulnerable individuals and families" after "homebuyers" each place that term appears;

(2) in subsection (b)(1), by inserting "or economically vulnerable individuals and families" after "homebuyers";

(3) in subsection (c)(1)—

(A) in subparagraph (A), by striking "or" at the end;

(B) in subparagraph (B), by striking the period at the end and inserting "; or"; and

(C) by adding at the end the following:

"(C) a nonprofit corporation that—

"(i) is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986; and

"(ii) specializes or has expertise in working with economically vulnerable individuals and families, but whose primary purpose is not provision of credit counseling services."; and

(4) in subsection (d)(1), by striking "not more than 5".

(b) APPLICABILITY.—Amendments made by subsection (a) shall not apply to programs authorized by section 1132 of the Housing and Economic Recovery Act of 2008 (12 U.S.C. 1701x note) that are funded with appropriations prior to fiscal year 2011.

SEC. 1073. REMITTANCE TRANSFERS.

(a) TREATMENT OF REMITTANCE TRANSFERS.—The Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) is amended—

(1) in section 902(b) (15 U.S.C. 1693(b)), by inserting "and remittance" after "electronic fund";

(2) in section 904(c) (15 U.S.C. 1693b(c)), in the first sentence, by inserting "or remittance transfers" after "electronic fund transfers";

(3) by redesignating sections 919, 920, 921, and 922 as sections 920, 921, 922, and 923, respectively; and

(4) by inserting after section 918 the following:

"SEC. 919. REMITTANCE TRANSFERS.

"(a) DISCLOSURES REQUIRED FOR REMITTANCE TRANSFERS.—

"(1) IN GENERAL.—Each remittance transfer provider shall make disclosures as required under this section and in accordance with rules prescribed by the Board. Disclosures required under this section shall be in addition to any other disclosures applicable under this title.

"(2) DISCLOSURES.—Subject to rules prescribed by the Board, a remittance transfer provider shall provide, in writing and in a form that the sender may keep, to each sender requesting a remittance transfer, as applicable to the transaction—

"(A) at the time at which the sender requests a remittance transfer to be initiated, and prior to the sender making any payment in connection with the remittance transfer, a disclosure describing—

"(i) the amount of currency that will be received by the designated recipient, using the values of the currency into which the funds will be exchanged;

"(ii) the amount of transfer and any other fees charged by the remittance transfer provider for the remittance transfer; and

"(iii) any exchange rate to be used by the remittance transfer provider for the remittance transfer, to the nearest 1/100th of a point; and

"(B) at the time at which the sender makes payment in connection with the remittance transfer—

"(i) a receipt showing—

"(I) the information described in subparagraph (A);

"(II) the promised date of delivery to the designated recipient; and

"(III) the name and either the telephone number or the address of the designated recipient, if either the telephone number or the address of the designated recipient is provided by the sender; and

"(ii) a statement containing—

"(I) information about the rights of the sender under this section regarding the resolution of errors; and

"(II) appropriate contact information for—

"(aa) the remittance transfer provider; and

"(bb) the State agency that regulates the remittance transfer provider and the Board, including the toll-free telephone number established under section 1013 of the Consumer Financial Protection Act of 2010.

"(3) REQUIREMENTS RELATING TO DISCLOSURES.—With respect to each disclosure required to be provided under paragraph (2) a remittance transfer provider shall—

"(A) provide an initial notice and receipt, as required by subparagraphs (A) and (B) of paragraph (2), and an error resolution statement, as required by subsection (d), that clearly and conspicuously describe the information required to be disclosed therein; and

"(B) with respect to any transaction that a sender conducts electronically, comply with the Electronic Signatures in Global and National Commerce Act (15 U.S.C. 7001 et seq.).

"(4) EXCEPTION FOR DISCLOSURES OF AMOUNT RECEIVED.—

"(A) IN GENERAL.—Subject to the rules prescribed by the Board, and except as provided under subparagraph (B), the disclosures required regarding the amount of currency that will be received by the designated recipient shall be deemed to be accurate, so long as the disclosures provide a reasonably accurate estimate of the foreign currency to be received. This paragraph shall apply only to a remittance transfer provider who is an insured depository institution, as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813), or an insured credit union, as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752), and if—

"(i) a remittance transfer is conducted through a demand deposit, savings deposit, or other asset account that the sender holds with such remittance transfer provider; and

"(ii) at the time at which the sender requests the transaction, the remittance transfer provider is unable to know, for reasons beyond its control, the amount of currency that will be made available to the designated recipient.

"(B) DEADLINE.—The application of subparagraph (A) shall terminate 5 years after the date of enactment of the Consumer Financial Protection Act of 2010, unless the Board determines that termination of such provision would negatively affect the ability of remittance transfer providers described in subparagraph (A) to send remittances to locations in foreign countries, in which case, the Board may, by rule, extend the application of subparagraph (A) to not longer than 10 years after the date of enactment of the Consumer Financial Protection Act of 2010.

"(5) EXEMPTION AUTHORITY.—The Board may, by rule, permit a remittance transfer provider to satisfy the requirements of—

"(A) paragraph (2)(A) orally, if the transaction is conducted entirely by telephone;

"(B) paragraph (2)(B), in the case of a transaction conducted entirely by telephone, by mailing the disclosures required under such subparagraph to the sender, not later than 1 business day after the date on which the transaction is conducted, or by including such documents in the next periodic statement, if the telephone transaction is conducted through a demand deposit, savings deposit, or other asset account that the sender holds with the remittance transfer provider;

"(C) subparagraphs (A) and (B) of paragraph (2) together in one written disclosure, but only to the extent that the information provided in accordance with paragraph (3)(A) is accurate at the time at which payment is made in connection with the subject remittance transfer; and

"(D) paragraph (2)(A), without compliance with section 101(c) of the Electronic Signatures in Global Commerce Act, if a sender initiates the transaction electronically and the information is displayed electronically in a manner that the sender can keep.

"(6) STOREFRONT AND INTERNET NOTICES.—

"(A) IN GENERAL.—

"(i) PROMINENT POSTING.—Subject to subparagraph (B), the Board may prescribe rules to require a remittance transfer provider to prominently post, and timely update, a notice describing a model remittance transfer for one or more amounts, as the Board may determine, which notice shall show the amount of currency that will be received by the designated recipient, using the values of the currency into which the funds will be exchanged.

"(ii) ONSITE DISPLAYS.—The Board may require the notice prescribed under this subparagraph to be displayed in every physical storefront location owned or controlled by the remittance transfer provider.

"(iii) INTERNET NOTICES.—Subject to paragraph (3), the Board shall prescribe rules to require a remittance transfer provider that provides remittance transfers via the Internet to provide a notice, comparable to a storefront notice described in this subparagraph, located on the home page or landing page (with respect to such remittance transfer services) owned or controlled by the remittance transfer provider.

"(iv) RULEMAKING AUTHORITY.—In prescribing rules under this subparagraph, the Board may impose standards or requirements regarding the provision of the storefront and Internet notices required under this subparagraph and the provision of the disclosures required under paragraphs (2) and (3).

"(B) STUDY AND ANALYSIS.—Prior to proposing rules under subparagraph (A), the Board shall undertake appropriate studies and analyses, which shall be consistent with section 904(a)(2), and may include an advanced notice of proposed rulemaking, to determine whether a storefront notice or Internet notice facilitates the ability of a consumer—

"(i) to compare prices for remittance transfers; and "(ii) to understand the types and amounts of any fees or costs imposed on remittance transfers.

"(b) FOREIGN LANGUAGE DISCLOSURES.—The disclosures required under this section shall be made in English and in each of the foreign languages principally used by the remittance transfer provider, or any of its agents, to advertise, solicit, or market, either orally or in writing, at that office.

"(c) REGULATIONS REGARDING TRANSFERS TO CERTAIN NATIONS.—If the Board determines that a recipient nation does not legally allow, or the method by which transactions are made in the recipient country do not allow, a remittance transfer provider to know the amount of currency that will be received by the designated recipient, the Board may prescribe rules (not later than 18 months after the date of enactment of the Consumer Financial Protection Act of 2010) addressing the issue, which rules shall include standards for a remittance transfer provider to provide—

"(1) a receipt that is consistent with subsections (a) and (b); and

"(2) a reasonably accurate estimate of the foreign currency to be received, based on the rate provided to the sender by the remittance transfer provider at the time at which the transaction was initiated by the sender.

"(d) REMITTANCE TRANSFER ERRORS.—

"(1) ERROR RESOLUTION.—

"(A) IN GENERAL.—If a remittance transfer provider receives oral or written notice from the sender within 180 days of the promised date of delivery that an error occurred with respect to a remittance transfer, including the amount of currency designated in subsection (a)(3)(A) that was to be sent to the designated recipient of the remittance transfer, using the values of the currency into which the funds should have been exchanged, but was not made available to the designated recipient in the foreign country, the remittance transfer provider shall resolve the error pursuant to this subsection and investigate the reason for the error.

"(B) REMEDIES.—Not later than 90 days after the date of receipt of a notice from the sender pursuant to subparagraph (A), the remittance transfer provider shall, as applicable to the error and as designated by the sender—

"(i) refund to the sender the total amount of funds tendered by the sender in connection with the remittance transfer which was not properly transmitted;

"(ii) make available to the designated recipient, without additional cost to the designated recipient or to the sender, the amount appropriate to resolve the error;

"(iii) provide such other remedy, as determined appropriate by rule of the Board for the protection of senders; or

"(iv) provide written notice to the sender that there was no error with an explanation responding to the specific complaint of the sender.

"(2) RULES.—The Board shall establish, by rule issued not later than 18 months after the date of enactment of the Consumer Financial Protection Act of 2010, clear and appropriate standards for remittance transfer providers with respect to error resolution relating to remittance transfers, to protect senders from such errors. Standards prescribed under this paragraph shall include appropriate standards regarding record keeping, as required, including documentation—

"(A) of the complaint of the sender;

"(B) that the sender provides the remittance transfer provider with respect to the alleged error; and

"(C) of the findings of the remittance transfer provider regarding the investigation of the alleged error that the sender brought to their attention.

"(3) CANCELLATION AND REFUND POLICY RULES.—Not later than 18 months after the date of enactment of the Consumer Financial Protection Act of 2010, the Board shall issue final rules regarding appropriate remittance transfer cancellation and refund policies for consumers.

"(e) APPLICABILITY OF THIS TITLE.—

"(1) IN GENERAL.—A remittance transfer that is not an electronic fund transfer, as defined in section 903, shall not be subject to any of the provisions of sections 905 through 913. A remittance transfer that is an electronic fund transfer, as defined in section 903, shall be subject to all provisions of this title, except for section 908, that are otherwise applicable to electronic fund transfers under this title.

"(2) RULE OF CONSTRUCTION.—Nothing in this section shall be construed—

"(A) to affect the application to any transaction, to any remittance provider, or to any other person of any of the provisions of subchapter II of chapter 53 of title 31, United States Code, section 21 of the Federal Deposit Insurance Act (12 U.S.C. 1829b), or chapter 2 of title I of Public Law 91–508 (12 U.S.C. 1951–1959), or any regulations promulgated thereunder; or

"(B) to cause any fund transfer that would not otherwise be treated as such under paragraph (1) to be treated as an electronic fund transfer, or as otherwise subject to this title, for the purposes of any of the provisions referred to in subparagraph (A) or any regulations promulgated thereunder.

"(f) ACTS OF AGENTS.—

"(1) IN GENERAL.—A remittance transfer provider shall be liable for any violation of this section by any agent, authorized delegate, or person affiliated with such provider, when such agent, authorized delegate, or affiliate acts for that remittance transfer provider.

"(2) OBLIGATIONS OF REMITTANCE TRANSFER PROVIDERS.—The Board shall prescribe rules to implement appropriate standards or conditions of, liability of a remittance transfer provider, including a provider who acts through an agent or authorized delegate. An agency charged with enforcing the requirements of this section, or rules prescribed by the Board under this section, may consider, in any action or other proceeding against a remittance transfer provider, the extent to which the provider had established and maintained policies or procedures for compliance, including policies, procedures, or other appropriate oversight measures designed to assure compliance by an agent or authorized delegate acting for such provider.

"(g) DEFINITIONS.—As used in this section—

"(1) the term 'designated recipient' means any person located in a foreign country and identified by the sender as the authorized recipient of a remittance transfer to be made by a remittance transfer provider, except that a designated recipient shall not be deemed to be a consumer for purposes of this Act;

"(2) the term 'remittance transfer'—

"(A) means the electronic (as defined in section 106(2) of the Electronic Signatures in Global and National Commerce Act (15 U.S.C. 7006(2))) transfer of funds requested by a sender located in any State to a designated recipient that is initiated by a remittance transfer provider, whether or not the sender holds an account with the remittance transfer provider or whether or not the remittance transfer is also an electronic fund transfer, as defined in section 903; and

"(B) does not include a transfer described in subparagraph (A) in an amount that is equal to or lesser than the amount of a small-value transaction determined, by rule, to be excluded from the requirements under section 906(a);

"(3) the term 'remittance transfer provider' means any person or financial institution that provides remittance transfers for a consumer in the normal course of its business, whether or not the consumer holds an account with such person or financial institution; and

"(4) the term 'sender' means a consumer who requests a remittance provider to send a remittance transfer for the consumer to a designated recipient.".

(b) AUTOMATED CLEARINGHOUSE SYSTEM.—

(1) EXPANSION OF SYSTEM.—The Board of Governors shall work with the Federal reserve banks and the Department of the Treasury to expand the use of the automated clearinghouse system and other payment mechanisms for remittance transfers to foreign countries, with a focus on countries that receive significant remittance transfers from the United States, based on—

(A) the number, volume, and size of such transfers;

(B) the significance of the volume of such transfers relative to the external financial flows of the receiving country, including—

(i) the total amount transferred; and

(ii) the total volume of payments made by United States Government agencies to beneficiaries and retirees living abroad;

(C) the feasibility of such an expansion; and

(D) the ability of the Federal Reserve System to establish payment gateways in different geographic regions and currency zones to receive remittance transfers and route them through the payments systems in the destination countries.

(2) REPORT TO CONGRESS.—Not later than one calendar year after the date of enactment of this Act, and on April 30 biennially thereafter during the 10-year period beginning on that date of enactment, the Board of Governors shall submit a report to the Committee on Banking, Housing, and Urban

Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the status of the automated clearinghouse system and its progress in complying with the requirements of this subsection. The report shall include an analysis of adoption rates of International ACH Transactions rules and formats, the efficacy of increasing adoption rates, and potential recommendations to increase adoption.

(c) EXPANSION OF FINANCIAL INSTITUTION PROVISION OF REMITTANCE TRANSFERS.—

(1) PROVISION OF GUIDELINES TO INSTITUTIONS.—Each of the Federal banking agencies and the National Credit Union Administration shall provide guidelines to financial institutions under the jurisdiction of the agency regarding the offering of low-cost remittance transfers and no-cost or low-cost basic consumer accounts, as well as agency services to remittance transfer providers.

(2) ASSISTANCE TO FINANCIAL LITERACY COMMISSION.—As part of its duties as members of the Financial Literacy and Education Commission, the Bureau, the Federal banking agencies, and the National Credit Union Administration shall assist the Financial Literacy and Education Commission in executing the Strategy for Assuring Financial Empowerment (or the "SAFE Strategy"), as it relates to remittances.

(d) FEDERAL CREDIT UNION ACT CONFORMING AMENDMENT.— Paragraph (12) of section 107 of the Federal Credit Union Act (12 U.S.C. 1757) is amended to read as follows:

"(12) in accordance with regulations prescribed by the Board—

"(A) to sell, to persons in the field of membership, negotiable checks (including travelers checks), money orders, and other similar money transfer instruments (including international and domestic electronic fund transfers and remittance transfers, as defined in section 919 of the Electronic Fund Transfer Act); and

"(B) to cash checks and money orders for persons in the field of membership for a fee;".

(e) REPORT ON FEASIBILITY OF AND IMPEDIMENTS TO USE OF REMITTANCE HISTORY IN CALCULATION OF CREDIT SCORE.—Before the end of the 365-day period beginning on the date of enactment of this Act, the Director shall submit a report to the President, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives regarding—

(1) the manner in which the remittance history of a consumer could be used to enhance the credit score of the consumer;

(2) the current legal and business model barriers and impediments that impede the use of the remittance history of the consumer to enhance the credit score of the consumer; and

(3) recommendations on the manner in which maximum transparency and disclosure to consumers of exchange rates for remittance transfers subject to this title and the amendments made by this title may be accomplished, whether or not such exchange rates are known at the time of origination or payment by the consumer for the remittance transfer, including disclosure to the sender of the actual exchange rate

used and the amount of currency that the recipient of the remittance transfer received, using the values of the currency into which the funds were exchanged, as contained in sections 919(a)(2)(D) and 919(a)(3) of the Electronic Fund Transfer Act (as amended by this section).

SEC. 1074. DEPARTMENT OF THE TREASURY STUDY ON ENDING THE CONSERVATORSHIP OF FANNIE MAE, FREDDIE MAC, AND REFORMING THE HOUSING FINANCE SYSTEM.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—The Secretary of the Treasury shall conduct a study of and develop recommendations regarding the options for ending the conservatorship of the Federal National Mortgage Association (in this section referred to as "Fannie Mae") and the Federal Home Loan Mortgage Corporation (in this section referred to as "Freddie Mac"), while minimizing the cost to taxpayers, including such options as—

(A) the gradual wind-down and liquidation of such entities;

(B) the privatization of such entities;

(C) the incorporation of the functions of such entities into a Federal agency;

(D) the dissolution of Fannie Mae and Freddie Mac into smaller companies; or

(E) any other measures the Secretary determines appropriate.

(2) ANALYSES.—The study required under paragraph (1) shall include an analysis of—

(A) the role of the Federal Government in supporting a stable, well-functioning housing finance system, and whether and to what extent the Federal Government should bear risks in meeting Federal housing finance objectives;

(B) how the current structure of the housing finance system can be improved;

(C) how the housing finance system should support the continued availability of mortgage credit to all segments of the market;

(D) how the housing finance system should be structured to ensure that consumers continue to have access to 30-year, fixed rate, pre-payable mortgages and other mortgage products that have simple terms that can be easily understood;

(E) the role of the Federal Housing Administration and the Department of Veterans Affairs in a future housing system;

(F) the impact of reforms of the housing finance system on the financing of rental housing;

(G) the impact of reforms of the housing finance system on secondary market liquidity;

(H) the role of standardization in the housing finance system;

(I) how housing finance systems in other countries offer insights that can help inform options for reform in the United States; and

(J) the options for transition to a reformed housing finance system.

(b) REPORT AND RECOMMENDATIONS.—Not later than January 31, 2011, the Secretary of the Treasury shall submit the report and recommendations required under subsection (a) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 1075. REASONABLE FEES AND RULES FOR PAYMENT CARD TRANSACTIONS.

(a) IN GENERAL.—The Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) is amended—

(1) by redesignating sections 920 and 921 as sections 921 and 922, respectively; and

(2) by inserting after section 919 the following:

"SEC. 920. REASONABLE FEES AND RULES FOR PAYMENT CARD TRANSACTIONS.

"(a) REASONABLE INTERCHANGE TRANSACTION FEES FOR ELECTRONIC DEBIT TRANSACTIONS.—

"(1) REGULATORY AUTHORITY OVER INTERCHANGE TRANSACTION FEES.—The Board may prescribe regulations, pursuant to section 553 of title 5, United States Code, regarding any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction, to implement this subsection (including related definitions), and to prevent circumvention or evasion of this subsection.

"(2) REASONABLE INTERCHANGE TRANSACTION FEES.—The amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction.

"(3) RULEMAKING REQUIRED.—

"(A) IN GENERAL.—The Board shall prescribe regulations in final form not later than 9 months after the date of enactment of the Consumer Financial Protection Act of 2010, to establish standards for assessing whether the amount of any interchange transaction fee described in paragraph (2) is reasonable and proportional to the cost incurred by the issuer with respect to the transaction.

"(B) INFORMATION COLLECTION.—The Board may require any issuer (or agent of an issuer) or payment card network to provide the Board with such information as may be necessary to carry out the provisions of this subsection and the Board, in issuing rules under subparagraph (A) and on at least a bi-annual basis thereafter, shall disclose such aggregate or summary information concerning the costs incurred, and interchange transaction fees charged or received, by issuers or payment card networks in connection with the authorization, clearance or settlement of electronic debit transactions as the Board considers appropriate and in the public interest.

"(4) CONSIDERATIONS; CONSULTATION.—In prescribing regulations under paragraph (3)(A), the Board shall—

"(A) consider the functional similarity between—

"(i) electronic debit transactions; and

"(ii) checking transactions that are required within the Federal Reserve bank system to clear at par;

"(B) distinguish between—

"(i) the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction, which cost shall be considered under paragraph (2); and

"(ii) other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered under paragraph (2); and

"(C) consult, as appropriate, with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the Administrator of the Small Business Administration, and the Director of the Bureau of Consumer Financial Protection.

"(5) ADJUSTMENTS TO INTERCHANGE TRANSACTION FEES FOR FRAUD PREVENTION COSTS.—

"(A) ADJUSTMENTS.—The Board may allow for an adjustment to the fee amount received or charged by an issuer under paragraph (2), if—

"(i) such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions involving that issuer; and

"(ii) the issuer complies with the fraud-related standards established by the Board under subparagraph (B), which standards shall—

"(I) be designed to ensure that any fraud-related adjustment of the issuer is limited to the amount described in clause (i) and takes into account any fraud-related reimbursements (including amounts from charge-backs) received from consumers, merchants, or payment card networks in relation to electronic debit transactions involving the issuer; and

"(II) require issuers to take effective steps to reduce the occurrence of, and costs from, fraud in relation to electronic debit transactions, including through the development and implementation of cost-effective fraud prevention technology.

"(B) RULEMAKING REQUIRED.—

"(i) IN GENERAL.—The Board shall prescribe regulations in final form not later than 9 months after the date of enactment of the Consumer Financial Protection Act of 2010, to establish standards for making adjustments under this paragraph.

"(ii) FACTORS FOR CONSIDERATION.—In issuing the standards and prescribing regulations under this paragraph, the Board shall consider—

"(I) the nature, type, and occurrence of fraud in electronic debit transactions;

"(II) the extent to which the occurrence of fraud depends on whether authorization in an electronic debit transaction is based on signature, PIN, or other means;

"(III) the available and economical means by which fraud on electronic debit transactions may be reduced;

"(IV) the fraud prevention and data security costs expended by each party involved in electronic debit transactions (including consumers, persons who accept debit cards as a form of payment, financial institutions, retailers and payment card networks);

"(V) the costs of fraudulent transactions absorbed by each party involved in such transactions (including consumers, persons who accept debit cards as a form of payment, financial institutions, retailers and payment card networks);

"(VI) the extent to which interchange transaction fees have in the past reduced or increased incentives for parties involved in electronic debit transactions to reduce fraud on such transactions; and

"(VII) such other factors as the Board considers appropriate.

"(6) EXEMPTION FOR SMALL ISSUERS.—

"(A) IN GENERAL.—This subsection shall not apply to any issuer that, together with its affiliates, has assets of less than $10,000,000,000, and the Board shall exempt such issuers from regulations prescribed under paragraph (3)(A).

"(B) DEFINITION.—For purposes of this paragraph, the term "issuer" shall be limited to the person holding the asset account that is debited through an electronic debit transaction.

"(7) EXEMPTION FOR GOVERNMENT-ADMINISTERED PAYMENT PROGRAMS AND RELOADABLE PREPAID CARDS.—

"(A) IN GENERAL.—This subsection shall not apply to an interchange transaction fee charged or received with respect to an electronic debit transaction in which a person uses—

"(i) a debit card or general-use prepaid card that has been provided to a person pursuant to a Federal, State or local government-administered payment program, in which the person may only use the debit card or general-use prepaid card to transfer or debit funds, monetary value, or other assets that have been provided pursuant to such program; or

"(ii) a plastic card, payment code, or device that is—

"(I) linked to funds, monetary value, or assets which are purchased or loaded on a prepaid basis;

"(II) not issued or approved for use to access or debit any account held by or for the benefit of the card holder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis);

"(III) redeemable at multiple, unaffiliated merchants or service providers, or automated teller machines;

"(IV) used to transfer or debit funds, monetary value, or other assets; and

"(V) reloadable and not marketed or labeled as a gift card or gift certificate.

"(B) EXCEPTION.—Notwithstanding subparagraph (A), after the end of the 1-year period beginning on the effective date provided in paragraph (9), this subsection shall apply to an interchange transaction fee charged or received with respect to an electronic debit transaction described in subparagraph (A)(i) in which a person uses a general-use prepaid card, or an electronic debit transaction described in subparagraph (A)(ii), if any of the following fees may be charged to a person with respect to the card:

"(i) A fee for an overdraft, including a shortage of funds or a transaction processed for an amount exceeding the account balance.

"(ii) A fee imposed by the issuer for the first withdrawal per month from an automated teller machine that is part of the issuer's designated automated teller machine network.

"(C) DEFINITION.—For purposes of subparagraph (B), the term 'designated automated teller machine network' means either—

"(i) all automated teller machines identified in the name of the issuer; or

"(ii) any network of automated teller machines identified by the issuer that provides reasonable and convenient access to the issuer's customers.

"(D) REPORTING.—Beginning 12 months after the date of enactment of the Consumer Financial Protection Act of 2010, the Board shall annually provide a report to the Congress regarding —

"(i) the prevalence of the use of general-use prepaid cards in Federal, State or local government-administered payment programs; and

"(ii) the interchange transaction fees and cardholder fees charged with respect to the use of such general-use prepaid cards.

"(8) REGULATORY AUTHORITY OVER NETWORK FEES.—

"(A) IN GENERAL.—The Board may prescribe regulations, pursuant to section 553 of title 5, United States Code, regarding any network fee.

"(B) LIMITATION.—The authority under subparagraph (A) to prescribe regulations shall be limited to regulations to ensure that—

"(i) a network fee is not used to directly or indirectly compensate an issuer with respect to an electronic debit transaction; and

"(ii) a network fee is not used to circumvent or evade the restrictions of this subsection and regulations prescribed under such subsection.

"(C) RULEMAKING REQUIRED.—The Board shall prescribe regulations in final form before the end of the 9-month period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010, to carry out the authorities provided under subparagraph (A).

"(9) EFFECTIVE DATE.—This subsection shall take effect at the end of the 12-month period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010.

"(b) LIMITATION ON PAYMENT CARD NETWORK RESTRICTIONS.—

"(1) PROHIBITIONS AGAINST EXCLUSIVITY ARRANGEMENTS.—

"(A) NO EXCLUSIVE NETWORK.—The Board shall, before the end of the 1-year period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010, prescribe regulations providing that an issuer or payment card network shall not directly or through any agent, processor, or licensed member of a payment card network, by contract, requirement, condition, penalty, or otherwise, restrict the number of payment card networks on which an electronic debit transaction may be processed to—

"(i) 1 such network; or

"(ii) 2 or more such networks which are owned, controlled, or otherwise operated by —

"(I) affiliated persons; or

"(II) networks affiliated with such issuer.

"(B) NO ROUTING RESTRICTIONS.—The Board shall, before the end of the 1-year period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010, prescribe regulations providing that an issuer or payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person who accepts debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions.

"(2) LIMITATION ON RESTRICTIONS ON OFFERING DISCOUNTS FOR USE OF A FORM OF PAYMENT.—

"(A) IN GENERAL.—A payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person to provide a discount or in-kind incentive for payment by the use of cash, checks, debit cards, or credit cards to the extent that—

"(i) in the case of a discount or in-kind incentive for payment by the use of debit cards, the discount or in-kind incentive does not differentiate on the basis of the issuer or the payment card network;

"(ii) in the case of a discount or in-kind incentive for payment by the use of credit cards, the discount or in-kind incentive does not differentiate on the basis of the issuer or the payment card network; and

"(iii) to the extent required by Federal law and applicable State law, such discount or in-kind incentive is offered to all prospective buyers and disclosed clearly and conspicuously.

"(B) LAWFUL DISCOUNTS.—For purposes of this paragraph, the network may not penalize any person for the providing of a discount that is in compliance with Federal law and applicable State law.

"(3) LIMITATION ON RESTRICTIONS ON SETTING TRANSACTION MINIMUMS OR MAXIMUMS.—

"(A) IN GENERAL.—A payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability—

"(i) of any person to set a minimum dollar value for the acceptance by that person of credit cards, to the extent that —

"(I) such minimum dollar value does not differentiate between issuers or between payment card networks; and

"(II) such minimum dollar value does not exceed $10.00; or

"(ii) of any Federal agency or institution of higher education to set a maximum dollar value for the acceptance by that Federal agency or institution of higher education of credit cards, to the extent that such maximum dollar value does not differentiate between issuers or between payment card networks.

"(B) INCREASE IN MINIMUM DOLLAR AMOUNT.—The Board may, by regulation prescribed pursuant to section 553 of title 5, United States Code, increase the amount of the dollar value listed in subparagraph (A)(i)(II).

"(4) RULE OF CONSTRUCTION:.—No provision of this subsection shall be construed to authorize any person—

"(A) to discriminate between debit cards within a payment card network on the basis of the issuer that issued the debit card; or

"(B) to discriminate between credit cards within a payment card network on the basis of the issuer that issued the credit card.

"(c) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

"(1) AFFILIATE.—The term 'affiliate' means any company that controls, is controlled by, or is under common control with another company.

"(2) DEBIT CARD.—The term 'debit card'—

"(A) means any card, or other payment code or device, issued or approved for use through a payment card network to debit an asset account (regardless of the purpose for which the account is established), whether authorization is based on signature, PIN, or other means;

"(B) includes a general-use prepaid card, as that term is defined in section 915(a)(2)(A); and

"(C) does not include paper checks.

"(3) CREDIT CARD.—The term 'credit card' has the same meaning as in section 103 of the Truth in Lending Act.

"(4) DISCOUNT.—The term 'discount'—

"(A) means a reduction made from the price that customers are informed is the regular price; and

"(B) does not include any means of increasing the price that customers are informed is the regular price.

"(5) ELECTRONIC DEBIT TRANSACTION.—The term 'electronic debit transaction' means a transaction in which a person uses a debit card.

"(6) FEDERAL AGENCY.—The term 'Federal agency' means—

"(A) an agency (as defined in section 101 of title 31, United States Code); and

"(B) a Government corporation (as defined in section 103 of title 5, United States Code).

"(7) INSTITUTION OF HIGHER EDUCATION.—The term 'institution of higher education' has the same meaning as in 101 and 102 of the Higher Education Act of 1965 (20 U.S.C. 1001, 1002).

"(8) INTERCHANGE TRANSACTION FEE.—The term 'interchange transaction fee' means any fee established, charged or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction.

"(9) ISSUER.—The term 'issuer' means any person who issues a debit card, or credit card, or the agent of such person with respect to such card.

"(10) NETWORK FEE.—The term 'network fee' means any fee charged and received by a payment card network with respect to an electronic debit transaction, other than an interchange transaction fee.

"(11) PAYMENT CARD NETWORK.—The term 'payment card network' means an entity that directly, or through licensed members, processors, or agents, provides the proprietary services, infrastructure, and software that route information and data to conduct debit card or credit card transaction authorization, clearance, and settlement, and that a person uses in order to accept as a form of payment a brand of debit card, credit card or other device that may be used to carry out debit or credit transactions.

"(d) ENFORCEMENT.—

"(1) IN GENERAL.—Compliance with the requirements imposed under this section shall be enforced under section 918.

"(2) EXCEPTION.—Sections 916 and 917 shall not apply with respect to this section or the requirements imposed pursuant to this section.".

(b) AMENDMENT TO THE FOOD AND NUTRITION ACT OF 2008.—Section 7(h)(10) of the Food and Nutrition Act of 2008 (7 U.S.C. 2016(h)(10)) is amended to read as follows:

"(10) FEDERAL LAW NOT APPLICABLE.—Section 920 of the Electronic Fund Transfer Act shall not apply to electronic benefit transfer or reimbursement systems under this Act.".

(c) AMENDMENT TO THE FARM SECURITY AND RURAL INVESTMENT ACT OF 2002.—Section 4402 of the Farm Security and Rural Investment Act of 2002 (7 U.S.C. 3007) is amended by adding at the end the following new subsection:

"(f) FEDERAL LAW NOT APPLICABLE.—Section 920 of the Electronic Fund Transfer Act shall not apply to electronic benefit transfer systems established under this section.".

(d) AMENDMENT TO THE CHILD NUTRITION ACT OF 1966.—Section 11 of the Child Nutrition Act of 1966 (42 U.S.C. 1780) is amended by adding at the end the following:

"(c) FEDERAL LAW NOT APPLICABLE.—Section 920 of the Electronic Fund Transfer Act shall not apply to electronic benefit transfer systems established under this Act or the Richard B. Russell National School Lunch Act (42 U.S.C. 1751 et seq.).".

SEC. 1076. REVERSE MORTGAGE STUDY AND REGULATIONS.

(a) STUDY.—Not later than 1 year after the designated transfer date, the Bureau shall conduct a study on reverse mortgage transactions.

(b) REGULATIONS.—

(1) IN GENERAL.—If the Bureau determines through the study required under subsection (a) that conditions or limitations on reverse mortgage transactions are necessary or appropriate for accomplishing the purposes and objectives of this title, including protecting borrowers with respect to the obtaining of reverse mortgage loans for the purpose of funding investments, annuities, and other investment products and the suitability of a borrower in obtaining a reverse mortgage for such purpose.

(2) IDENTIFIED PRACTICES AND INTEGRATED DISCLOSURES.—The regulations prescribed under paragraph (1) may, as the Bureau may so determine—

(A) identify any practice as unfair, deceptive, or abusive in connection with a reverse mortgage transaction; and

(B) provide for an integrated disclosure standard and model disclosures for reverse mortgage transactions, consistent with section 4302(d), that combines the relevant disclosures required under the Truth in Lending Act (15 U.S.C. 1601 et seq.) and the Real Estate Settlement Procedures Act, with the disclosures required to be provided to consumers for Home Equity Conversion Mortgages under section 255 of the National Housing Act.

(c) RULE OF CONSTRUCTION.—This section shall not be construed as limiting the authority of the Bureau to issue regulations, orders, or guidance that apply to reverse mortgages prior to the completion of the study required under subsection (a).

SEC. 1077. REPORT ON PRIVATE EDUCATION LOANS AND PRIVATE EDUCATIONAL LENDERS.

(a) REPORT.—Not later than 2 years after the date of enactment of this Act, the Director and the Secretary of Education, in consultation with the Commissioners of the Federal Trade Commission, and the Attorney General of the United States, shall submit a report to the Committee on Banking, Housing, and Urban Affairs and the Committee on Health, Education, Labor, and Pensions of the Senate and the Committee on Financial Services and the Committee on Education and Labor of the House of Representatives, on private education loans (as that term is defined in section 140 of the Truth in Lending Act (15 U.S.C. 1650)) and private educational lenders (as that term is defined in such section).

(b) CONTENT.—The report required by this section shall examine, at a minimum—

(1) the growth and changes of the private education loan market in the United States;

(2) factors influencing such growth and changes;

(3) the extent to which students and parents of students rely on private education loans to finance postsecondary education and the private education loan indebtedness of borrowers;

(4) the characteristics of private education loan borrowers, including—

(A) the types of institutions of higher education that they attend;

(B) socioeconomic characteristics (including income and education levels, racial characteristics, geographical background, age, and gender);

(C) what other forms of financing borrowers use to pay for education;

(D) whether they exhaust their Federal loan options before taking out a private loan;

(E) whether such borrowers are dependent or independent students (as determined under part F of title IV of the Higher Education Act of 1965) or parents of such students;

(F) whether such borrowers are students enrolled in a program leading to a certificate, license, or credential other than a degree, an associates degree, a baccalaureate degree, or a graduate or professional degree; and

(G) if practicable, employment and repayment behaviors;

(5) the characteristics of private educational lenders, including whether such creditors are for-profit, non-profit, or institutions of higher education;

(6) the underwriting criteria used by private educational lenders, including the use of cohort default rate (as such term is defined in section 435(m) of the Higher Education Act of 1965);

(7) the terms, conditions, and pricing of private education loans;

(8) the consumer protections available to private education loan borrowers, including the effectiveness of existing disclosures and requirements and borrowers' awareness and understanding about terms and conditions of various financial products;

(9) whether Federal regulators and the public have access to information sufficient to provide them with assurances that private education loans are provided in accord with the Nation's fair lending laws and that allows public officials to determine lender compliance with fair lending laws; and

(10) any statutory or legislative recommendations necessary to improve consumer protections for private education loan borrowers and to better enable Federal regulators and the public to ascertain private educational lender compliance with fair lending laws.

SEC. 1078. STUDY AND REPORT ON CREDIT SCORES.

(a) STUDY.—The Bureau shall conduct a study on the nature, range, and size of variations between the credit scores sold to creditors and those sold to consumers by consumer reporting agencies that compile and maintain files on consumers on a nationwide basis (as defined in section 603(p) of the Fair Credit Reporting Act; 15 U.S.C. 1681a(p)), and whether such variations disadvantage consumers.

(b) REPORT TO CONGRESS.—The Bureau shall submit a report to Congress on the results of the study conducted under subsection (a) not later than 1 year after the date of enactment of this Act.

SEC. 1079. REVIEW, REPORT, AND PROGRAM WITH RESPECT TO EXCHANGE FACILITATORS.

(a) REVIEW.—The Director shall review all Federal laws and regulations relating to the protection of consumers who use exchange facilitators for transactions primarily for personal, family, or household purposes.

(b) REPORT.—Not later than 1 year after the designated transfer date, the Director shall submit to Congress a report describing—

(1) recommendations for legislation to ensure the appropriate protection of consumers who use exchange facilitators for transactions primarily for personal, family, or household purposes;

(2) recommendations for updating the regulations of Federal departments and agencies to ensure the appropriate protection of such consumers; and

(3) recommendations for regulations to ensure the appropriate protection of such consumers.

(c) PROGRAM.—Not later than 2 years after the date of the submission of the report under subsection (b), the Bureau shall, consistent with subtitle B, propose regulations or otherwise establish a program to protect consumers who use exchange facilitators.

(d) EXCHANGE FACILITATOR DEFINED.—In this section, the term "exchange facilitator" means a person that—

(1) facilitates, for a fee, an exchange of like kind property by entering into an agreement with a taxpayer by which the exchange facilitator acquires from the taxpayer the contractual rights to sell the taxpayer's relinquished property and transfers a replacement property to the taxpayer as a qualified intermediary (within the meaning of Treasury Regulations section 1.1031(k)–1(g)(4)) or enters into an agreement with the taxpayer to take title to a property as an exchange accommodation titleholder (within the meaning of Revenue Procedure 2000–37) or enters into an agreement with a taxpayer to act as a qualified trustee or qualified escrow holder (within the meaning of Treasury Regulations section 1.1031(k)–1(g)(3));

(2) maintains an office for the purpose of soliciting business to perform the services described in paragraph (1); or

(3) advertises any of the services described in paragraph (1) or solicits clients in printed publications, direct mail, television or radio advertisements, telephone calls, facsimile transmissions, or other electronic communications directed to the general public for purposes of providing any such services.

SEC. 1079A. FINANCIAL FRAUD PROVISIONS.

(a) SENTENCING GUIDELINES.—

(1) SECURITIES FRAUD.—

(A) DIRECTIVE.—Pursuant to its authority under section 994 of title 28, United States Code, and in accordance with this paragraph, the United States Sentencing Commission shall review and, if appropriate, amend the Federal Sentencing Guidelines and policy statements applicable to persons convicted of offenses relating to securities fraud or any other similar provision of law, in order to reflect the intent of Congress that penalties for the offenses under the guidelines and policy statements appropriately account for the potential and actual harm to the public and the financial markets from the offenses.

(B) REQUIREMENTS.—In making any amendments to the Federal Sentencing Guidelines and policy statements under subparagraph (A), the United States Sentencing Commission shall—

(i) ensure that the guidelines and policy statements, particularly section 2B1.1(b)(14) and section 2B1.1(b)(17) (and any successors thereto), reflect—

(I) the serious nature of the offenses described in subparagraph (A);

(II) the need for an effective deterrent and appropriate punishment to prevent the offenses; and

(III) the effectiveness of incarceration in furthering the objectives described in subclauses (I) and (II);

(ii) consider the extent to which the guidelines appropriately account for the potential and actual harm to the public and the financial markets resulting from the offenses;

(iii) ensure reasonable consistency with other relevant directives and guidelines and Federal statutes;

(iv) make any necessary conforming changes to guidelines; and

(v) ensure that the guidelines adequately meet the purposes of sentencing, as set forth in section 3553(a)(2) of title 18, United States Code.

(2) FINANCIAL INSTITUTION FRAUD.—

(A) DIRECTIVE.—Pursuant to its authority under section 994 of title 28, United States Code, and in accordance with this paragraph, the United States Sentencing Commission shall review and, if appropriate, amend the Federal Sentencing Guidelines and policy statements applicable to persons convicted of fraud offenses relating to financial institutions or federally related mortgage loans and any other similar provisions of law, to reflect the intent of Congress that the penalties for the offenses under the guidelines and policy statements ensure appropriate terms of imprisonment for offenders involved in substantial bank frauds or other frauds relating to financial institutions.

(B) REQUIREMENTS.—In making any amendments to the Federal Sentencing Guidelines and policy statements under subparagraph (A), the United States Sentencing Commission shall—

(i) ensure that the guidelines and policy statements reflect—

(I) the serious nature of the offenses described in subparagraph (A);

(II) the need for an effective deterrent and appropriate punishment to prevent the offenses; and

(III) the effectiveness of incarceration in furthering the objectives described in subclauses (I) and (II);

(ii) consider the extent to which the guidelines appropriately account for the potential and actual harm to the public and the financial markets resulting from the offenses;

(iii) ensure reasonable consistency with other relevant directives and guidelines and Federal statutes;

(iv) make any necessary conforming changes to guidelines; and

(v) ensure that the guidelines adequately meet the purposes of sentencing, as set forth in section 3553(a)(2) of title 18, United States Code.

(b) EXTENSION OF STATUTE OF LIMITATIONS FOR SECURITIES FRAUD VIOLATIONS.—

(1) IN GENERAL.—Chapter 213 of title 18, United States Code, is amended by adding at the end the following:

''§ 3301. Securities fraud offenses

''(a) DEFINITION.—In this section, the term 'securities fraud offense' means a violation of, or a conspiracy or an attempt to violate—

''(1) section 1348;

''(2) section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(a));

''(3) section 24 of the Securities Act of 1933 (15 U.S.C. 77x);

''(4) section 217 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–17);

''(5) section 49 of the Investment Company Act of 1940 (15 U.S.C. 80a–48); or

''(6) section 325 of the Trust Indenture Act of 1939 (15 U.S.C. 77yyy).

''(b) LIMITATION.—No person shall be prosecuted, tried, or punished for a securities fraud offense, unless the indictment is found or the information is instituted within 6 years after the commission of the offense.''.

(2) TECHNICAL AND CONFORMING AMENDMENT.—The table of sections for chapter 213 of title 18, United States Code, is amended by adding at the end the following:

''3301. Securities fraud offenses.''.

(c) AMENDMENTS TO THE FALSE CLAIMS ACT RELATING TO LIMITATIONS ON ACTIONS.—Section 3730(h) of title 31, United States Code, is amended—

(1) in paragraph (1), by striking ''or agent on behalf of the employee, contractor, or agent or associated others in furtherance of other efforts to stop 1 or more violations of this subchapter'' and inserting ''agent or associated others in furtherance of an action under this section or other efforts to stop 1 or more violations of this subchapter''; and

(2) by adding at the end the following:

''(3) LIMITATION ON BRINGING CIVIL ACTION.—A civil action under this subsection may not be brought more than 3 years after the date when the retaliation occurred.''.

Subtitle H—Conforming Amendments

SEC. 1081. AMENDMENTS TO THE INSPECTOR GENERAL ACT.

Effective on the date of enactment of this Act, the Inspector General Act of 1978 (5 U.S.C. App. 3) is amended—

(1) in section 8G(a)(2), by inserting "and the Bureau of Consumer Financial Protection" after "Board of Governors of the Federal Reserve System";

(2) in section 8G(c), by adding at the end the following: "For purposes of implementing this section, the Chairman of the Board of Governors of the Federal Reserve System shall appoint the Inspector General of the Board of Governors of the Federal Reserve System and the Bureau of Consumer Financial Protection. The Inspector General of the Board of Governors of the Federal Reserve System and the Bureau of Consumer Financial Protection shall have all of the authorities and responsibilities provided by this Act with respect to the Bureau of Consumer Financial Protection, as if the Bureau were part of the Board of Governors of the Federal Reserve System."; and

(3) in section 8G(g)(3), by inserting "and the Bureau of Consumer Financial Protection" after "Board of Governors of the Federal Reserve System" the first place that term appears.

SEC. 1082. AMENDMENTS TO THE PRIVACY ACT OF 1974.

Effective on the date of enactment of this Act, section 552a of title 5, United States Code, is amended by adding at the end the following:

"(w) APPLICABILITY TO BUREAU OF CONSUMER FINANCIAL PROTECTION.—Except as provided in the Consumer Financial Protection Act of 2010, this section shall apply with respect to the Bureau of Consumer Financial Protection.".

SEC. 1083. AMENDMENTS TO THE ALTERNATIVE MORTGAGE TRANSACTION PARITY ACT OF 1982.

(a) IN GENERAL.—The Alternative Mortgage Transaction Parity Act of 1982 (12 U.S.C. 3801 et seq.) is amended—

(1) in section 803 (12 U.S.C. 3802(1)), by striking "1974" and all that follows through "described and defined" and inserting the following: "1974), in which the interest rate or finance charge may be adjusted or renegotiated, described and defined"; and

(2) in section 804 (12 U.S.C. 3803)—

(A) in subsection (a)—

(i) in each of paragraphs (1), (2), and (3), by inserting after "transactions made" each place that term appears "on or before the designated transfer date, as determined under section 1062 of the Consumer Financial Protection Act of 2010,";

(ii) in paragraph (2), by striking "and" at the end;

(iii) in paragraph (3), by striking the period at the end and inserting "; and"; and

(iv) by adding at the end the following new paragraph:

"(4) with respect to transactions made after the designated transfer date, only in accordance with regulations governing alternative mortgage transactions, as issued by the Bureau of Consumer Financial Protection for federally chartered housing creditors, in accordance with the rulemaking authority granted to the Bureau of Consumer Financial Protection with regard to federally chartered housing creditors under provisions of law other than this section.'';

(B) by striking subsection (c) and inserting the following:

''(c) PREEMPTION OF STATE LAW.—An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation that prohibits an alternative mortgage transaction. For purposes of this subsection, a State constitution, law, or regulation that prohibits an alternative mortgage transaction does not include any State constitution, law, or regulation that regulates mortgage transactions generally, including any restriction on prepayment penalties or late charges.''; and

(C) by adding at the end the following:

''(d) BUREAU ACTIONS.—The Bureau of Consumer Financial Protection shall—

''(1) review the regulations identified by the Comptroller of the Currency and the National Credit Union Administration, (as those rules exist on the designated transfer date), as applicable under paragraphs (1) through (3) of subsection (a);

''(2) determine whether such regulations are fair and not deceptive and otherwise meet the objectives of the Consumer Financial Protection Act of 2010; and

''(3) promulgate regulations under subsection (a)(4) after the designated transfer date.

''(e) DESIGNATED TRANSFER DATE.—As used in this section, the term 'designated transfer date' means the date determined under section 1062 of the Consumer Financial Protection Act of 2010.''.

(b) EFFECTIVE DATE.—This section and the amendments made by this section shall become effective on the designated transfer date.

(c) RULE OF CONSTRUCTION.—The amendments made by subsection (a) shall not affect any transaction covered by the Alternative Mortgage Transaction Parity Act of l982 (12 U.S.C. 3801 et seq.) and entered into on or before the designated transfer date.

SEC. 1084. AMENDMENTS TO THE ELECTRONIC FUND TRANSFER ACT.

The Electronic Fund Transfer Act (15 U.S.C. 1693 et seq.) is amended—

(1) by striking ''Board'' each place that term appears and inserting ''Bureau'', except in subsections (a) and (e) of section 904 (as amended in paragraph (3) of this section) and in 918 (15 U.S.C. 1693o) (as so designated by the Credit Card Act of 2009) and section 920 (as added by section 1076);

(2) in section 903 (15 U.S.C. 1693a)—

(A) by redesignating paragraphs (3) through (11) as paragraphs (4) through (12), respectively; and

(B) by inserting after paragraph (3) the following:

''(4) the term 'Bureau' means the Bureau of Consumer Financial Protection;'';

(3) in section 904 (15 U.S.C. 1693b)—

(A) in subsection (a), by striking "(a) PRESCRIPTION BY BOARD.—The Board shall prescribe regulations to carry out the purposes of this title." and inserting the following:

"(a) PRESCRIPTION BY THE BUREAU AND THE BOARD.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the Bureau shall prescribe rules to carry out the purposes of this title.

"(2) AUTHORITY OF THE BOARD.—The Board shall have sole authority to prescribe rules—

"(A) to carry out the purposes of this title with respect to a person described in section 1029(a) of the Consumer Financial Protection Act of 2010; and

"(B) to carry out the purposes of section 920."; and

(B) by adding at the end the following new subsection:

"(e) DEFERENCE.—No provision of this title may be construed as altering, limiting, or otherwise affecting the deference that a court affords to—

"(1) the Bureau in making determinations regarding the meaning or interpretation of any provision of this title for which the Bureau has authority to prescribe regulations; or

"(2) the Board in making determinations regarding the meaning or interpretation of section 920.".

(4) in section 916(d) (15 U.S.C. 1693m) (as so designated by the Credit CARD Act of 2009)—

(A) in the subsection heading, by striking "OF BOARD OR APPROVAL OF DULY AUTHORIZED OFFICIAL OR EMPLOYEE OF FEDERAL RESERVE SYSTEM";

(B) by inserting "Bureau or the" before "Board" each place that term appears; and

(C) by inserting "Bureau of Consumer Financial Protection or the" before "Federal Reserve System"; and

(5) in section 918 (15 U.S.C. 1693o) (as so designated by the Credit CARD Act of 2009)—

(A) in subsection (a)—

(i) by striking "Compliance" and inserting "Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance";

(ii) by striking paragraphs (1) and (2), and inserting the following:

"(1) section 8 of the Federal Deposit Insurance Act, by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

"(A) national banks, Federal savings associations, and Federal branches and Federal agencies of foreign banks;

"(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act; and

"(C) banks and State savings associations insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), and insured State branches of foreign banks;";

(iii) by redesignating paragraphs (3) through (5) as paragraphs (2) through (4), respectively;

(iv) in paragraph (2) (as so redesignated), by striking the period at the end and inserting a semicolon;

(v) in paragraph (3) (as so redesignated), by striking "and" at the end;

(vi) in paragraph (4) (as so redesignated), by striking the period at the end and inserting "and"; and

(vii) by adding at the end the following:

"(5) subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this title, except that the Bureau shall not have authority to enforce the requirements of section 920 or any regulations prescribed by the Board under section 920.";

(B) in subsection (b), by inserting "any of paragraphs (1) through (4) of" before "subsection (a)" each place that term appears; and

(C) by striking subsection (c) and inserting the following:

"(c) OVERALL ENFORCEMENT AUTHORITY OF THE FEDERAL TRADE COMMISSION.—Except to the extent that enforcement of the requirements imposed under this title is specifically committed to some other Government agency under any of paragraphs (1) through (4) of subsection (a), and subject to subtitle B of the Consumer Financial Protection Act of 2010, the Federal Trade Commission shall be authorized to enforce such requirements. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act, a violation of any requirement imposed under this title shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Federal Trade Commission to enforce compliance by any person subject to the jurisdiction of the Federal Trade Commission with the requirements imposed under this title, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests under the Federal Trade Commission Act.".

SEC. 1085. AMENDMENTS TO THE EQUAL CREDIT OPPORTUNITY ACT.

The Equal Credit Opportunity Act (15 U.S.C. 1691 et seq.) is amended—

(1) by striking "Board" each place that term appears, other than in section 703(f) (as added by this section) and section 704(a)(4) (15 U.S.C. 1691c(a)(4)), and inserting "Bureau";

(2) in section 702 (15 U.S.C. 1691a), by striking subsection (c) and inserting the following:

"(c) The term 'Bureau' means the Bureau of Consumer Financial Protection.";

(3) in section 703 (15 U.S.C. 1691b)—

(A) by striking the section heading and inserting the following:

"SEC. 703. PROMULGATION OF REGULATIONS BY THE BUREAU.";

(B) by striking "(a) REGULATIONS.—";

(C) by striking subsection (b);

(D) by redesignating paragraphs (1) through (5) as subsections (a) through (e), respectively;

(E) in subsection (c), as so redesignated, by striking "paragraph (2)" and inserting "subsection (b)"; and

(F) by adding at the end the following:

"(f) BOARD AUTHORITY.—Notwithstanding subsection (a), the Board shall prescribe regulations to carry out the purposes of this title with respect to a person described in section 1029(a) of the Consumer Financial Protection Act of 2010. These regulations may contain but are not limited to such classifications, differentiation, or other provision, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate or substantiate compliance therewith.

"(g) DEFERENCE.—Notwithstanding any power granted to any Federal agency under this title, the deference that a court affords to a Federal agency with respect to a determination made by such agency relating to the meaning or interpretation of any provision of this title that is subject to the jurisdiction of such agency shall be applied as if that agency were the only agency authorized to apply, enforce, interpret, or administer the provisions of this title";

(4) in section 704 (15 U.S.C. 1691c)—

(A) in subsection (a)—

(i) by striking "Compliance" and inserting "Subject to subtitle B of the Consumer Protection Financial Protection Act of 2010";

(ii) by striking paragraphs (1) and (2) and inserting the following:

"(1) section 8 of the Federal Deposit Insurance Act, by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

"(A) national banks, Federal savings associations, and Federal branches and Federal agencies of foreign banks;

"(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act; and

"(C) banks and State savings associations insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), and insured State branches of foreign banks;";

(iii) by redesignating paragraphs (3) through (9) as paragraphs (2) through (8), respectively;

(iv) in paragraph (7) (as so redesignated), by striking "and" at the end;

(v) in paragraph (8) (as so redesignated), by striking the period at the end, and inserting "; and"; and

(vi) by adding at the end the following:

"(9) Subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this title.";

(B) by striking subsection (c) and inserting the following:

"(c) OVERALL ENFORCEMENT AUTHORITY OF FEDERAL TRADE COMMISSION.—Except to the extent that enforcement of the requirements imposed under this title is specifically committed to some other Government agency under any of paragraphs (1) through (8) of subsection (a), and subject to subtitle B of the Consumer Financial Protection Act of 2010, the Federal Trade Commission shall be authorized to enforce such requirements. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act (15 U.S.C. 41 et seq.), a violation of any requirement imposed under this subchapter shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Federal Trade Commission to enforce compliance by any person with the requirements imposed under this title, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests under the Federal Trade Commission Act, including the power to enforce any rule prescribed by the Bureau under this title in the same manner as if the violation had been a violation of a Federal Trade Commission trade regulation rule."; and

(C) in subsection (d), by striking "Board" and inserting "Bureau";

(5) in section 706(e) (15 U.S.C. 1691e(e))—

(A) in the subsection heading—

(i) by striking "BOARD" each place that term appears and inserting "BUREAU"; and

(ii) by striking "FEDERAL RESERVE SYSTEM" and inserting "BUREAU OF CONSUMER FINANCIAL PROTECTION"; and

(B) by striking "Federal Reserve System" and inserting "Bureau of Consumer Financial Protection";

(6) in section 706(g) (15 U.S.C. 1691e(g)), by striking "(3)" and inserting "(9)"; and

(7) in section 706(f) (15 U.S.C. 1691e(f)), by striking "two years from" each place that term appears and inserting "5 years after".

SEC. 1086. AMENDMENTS TO THE EXPEDITED FUNDS AVAILABILITY ACT.

(a) AMENDMENT TO SECTION 603.—Section 603(d)(1) of the Expedited Funds Availability Act (12 U.S.C. 4002) is amended by inserting after "Board" the following ", jointly with the Director of the Bureau of Consumer Financial Protection,".

(b) AMENDMENTS TO SECTION 604.—Section 604 of the Expedited Funds Availability Act (12 U.S.C. 4003) is amended—

(1) by inserting after "Board" each place that term appears, other than in subsection (f), the following: ", jointly with the Director of the Bureau of Consumer Financial Protection,"; and

(2) in subsection (f), by striking "Board." each place that term appears and inserting the following: "Board, jointly with the Director of the Bureau of Consumer Financial Protection.".

(c) AMENDMENTS TO SECTION 605.—Section 605 of the Expedited Funds Availability Act (12 U.S.C. 4004) is amended—

(1) by inserting after "Board" each place that term appears, other than in the heading for section 605(f)(1), the following: ", jointly with the Director of the Bureau of Consumer Financial Protection,"; and

(2) in subsection (f)(1), in the paragraph heading, by inserting "AND BUREAU" after "BOARD".

(d) AMENDMENTS TO SECTION 609.—Section 609 of the Expedited Funds Availability Act (12 U.S.C. 4008) is amended:

(1) in subsection (a), by inserting after "Board" the following ", jointly with the Director of the Bureau of Consumer Financial Protection,"; and

(2) by striking subsection (e) and inserting the following:

"(e) CONSULTATIONS.—In prescribing regulations under subsections (a) and (b), the Board and the Director of the Bureau of Consumer Financial Protection, in the case of subsection (a), and the Board, in the case of subsection (b), shall consult with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, and the National Credit Union Administration Board.".

(e) EXPEDITED FUNDS AVAILABILITY IMPROVEMENTS.—Section 603 of the Expedited Funds Availability Act (12 U.S.C. 4002) is amended—

(1) in subsection (a)(2)(D), by striking "$100" and inserting "$200"; and

(2) in subsection (b)(3)(C), in the subparagraph heading, by striking "$100" and inserting "$200"; and

(3) in subsection (c)(1)(B)(iii), in the clause heading, by striking "$100" and inserting "$200".

(f) REGULAR ADJUSTMENTS FOR INFLATION.—Section 607 of the Expedited Funds Availability Act (12 U.S.C. 4006) is amended by adding at the end the following:

"(f) ADJUSTMENTS TO DOLLAR AMOUNTS FOR INFLATION.—The dollar amounts under this title shall be adjusted every 5 years after December 31, 2011, by the annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers, as published by the Bureau of Labor Statistics, rounded to the nearest multiple of $25.".

SEC. 1087. AMENDMENTS TO THE FAIR CREDIT BILLING ACT.

The Fair Credit Billing Act (15 U.S.C. 1666–1666j) is amended by striking "Board" each place that term appears, other than in section 105(i) (as added by this subtitle) and inserting "Bureau".

SEC. 1088. AMENDMENTS TO THE FAIR CREDIT REPORTING ACT AND THE FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003.

(a) FAIR CREDIT REPORTING ACT.—The Fair Credit Reporting Act (15 U.S.C. 1681 et seq.) is amended—

(1) in section 603 (15 U.S.C. 1681a)—

(A) by redesignating subsections (w) and (x) as subsections (x) and (y), respectively; and

(B) by inserting after subsection (v) the following:

"(w) The term 'Bureau' means the Bureau of Consumer Financial Protection."; and

(2) except as otherwise specifically provided in this subsection—

(A) by striking "Federal Trade Commission" each place that term appears and inserting "Bureau";

(B) by striking "FTC" each place that term appears and inserting "Bureau";

(C) by striking "the Commission" each place that term appears, other than sections 615(e) (15 U.S.C. 1681m(e)) and 628(a)(1) (15 U.S.C. 1681w(a)(1)), and inserting "the Bureau"; and

(D) by striking "The Federal banking agencies, the National Credit Union Administration, and the Commission shall jointly" each place that term appears, other than section 615(e)(1) (15 U.S.C. 1681m(e)) and section 628(a)(1) (15 U.S.C. 1681w(a)(1)), and inserting "The Bureau shall";

(3) in section 603(k)(2) (15 U.S.C. 1681a(k)(2)), by striking "Board of Governors of the Federal Reserve System" and inserting "Bureau";

(4) in section 604(g) (15 U.S.C. 1681b(g))—

(A) in paragraph (3), by striking subparagraph (C) and inserting the following:

"(C) as otherwise determined to be necessary and appropriate, by regulation or order, by the Bureau or the applicable State insurance authority (with respect to any person engaged in providing insurance or annuities)."; and

(B) by striking paragraph (5) and inserting the following:

"(5) REGULATIONS AND EFFECTIVE DATE FOR PARAGRAPH (2).—

"(A) REGULATIONS REQUIRED.—The Bureau may, after notice and opportunity for comment, prescribe regulations that permit transactions under paragraph (2) that are determined to be necessary and appropriate to protect legitimate operational, transactional, risk, consumer, and other needs (and which shall include permitting actions necessary for administrative verification purposes), consistent with the intent of paragraph (2) to restrict the use of medical information for inappropriate purposes.";

(5) in section 605(h)(2)(A) (15 U.S.C. 1681c(h)(2)(A)), by striking "with respect to the entities that are subject to their respective enforcement authority under section 621" and inserting ", in consultation with the Federal banking agencies, the National Credit Union Administration, and the Federal Trade Commission,".

(6) in section 611(e)(2) (15 U.S.C. 1681i(e)), by striking paragraph (2) and inserting the following:

"(2) EXCLUSION.—Complaints received or obtained by the Bureau pursuant to its investigative authority under the Consumer Financial Protection Act of 2010 shall not be subject to paragraph (1).";

(7) in section 615(d)(2)(B) (15 U.S.C. 1681m(d)(2)(B)), by striking "the Federal banking agencies" and inserting "the Federal Trade Commission, the Federal banking agencies,";

(8) in section 615(e)(1) (15 U.S.C. 1681m(e)(1)), by striking "and the Commission" and inserting "the Federal Trade

Commission, the Commodity Futures Trading Commission, and the Securities and Exchange Commission";

(9) in section 615(h)(6) (15 U.S.C. 1681m(h)(6)), by striking subparagraph (A) and inserting the following:

"(A) RULES REQUIRED.—The Bureau shall prescribe rules to carry out this subsection.";

(10) in section 621 (15 U.S.C. 1681s)—

(A) by striking subsection (a) and inserting the following:

"(a) ENFORCEMENT BY FEDERAL TRADE COMMISSION.—

"(1) IN GENERAL.—The Federal Trade Commission shall be authorized to enforce compliance with the requirements imposed by this title under the Federal Trade Commission Act (15 U.S.C. 41 et seq.), with respect to consumer reporting agencies and all other persons subject thereto, except to the extent that enforcement of the requirements imposed under this title is specifically committed to some other Government agency under any of subparagraphs (A) through (G) of subsection (b)(1), and subject to subtitle B of the Consumer Financial Protection Act of 2010, subsection (b). For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act, a violation of any requirement or prohibition imposed under this title shall constitute an unfair or deceptive act or practice in commerce, in violation of section 5(a) of the Federal Trade Commission Act (15 U.S.C. 45(a)), and shall be subject to enforcement by the Federal Trade Commission under section 5(b) of that Act with respect to any consumer reporting agency or person that is subject to enforcement by the Federal Trade Commission pursuant to this subsection, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests under the Federal Trade Commission Act. The Federal Trade Commission shall have such procedural, investigative, and enforcement powers, including the power to issue procedural rules in enforcing compliance with the requirements imposed under this title and to require the filing of reports, the production of documents, and the appearance of witnesses, as though the applicable terms and conditions of the Federal Trade Commission Act were part of this title. Any person violating any of the provisions of this title shall be subject to the penalties and entitled to the privileges and immunities provided in the Federal Trade Commission Act as though the applicable terms and provisions of such Act are part of this title.

"(2) PENALTIES.—

"(A) KNOWING VIOLATIONS.—Except as otherwise provided by subtitle B of the Consumer Financial Protection Act of 2010, in the event of a knowing violation, which constitutes a pattern or practice of violations of this title, the Federal Trade Commission may commence a civil action to recover a civil penalty in a district court of the United States against any person that violates this title. In such action, such person shall be liable for a civil penalty of not more than $2,500 per violation.

"(B) DETERMINING PENALTY AMOUNT.—In determining the amount of a civil penalty under subparagraph (A), the court shall take into account the degree of culpability, any history of such prior conduct, ability to pay, effect on ability to continue to do business, and such other matters as justice may require.

"(C) LIMITATION.—Notwithstanding paragraph (2), a court may not impose any civil penalty on a person for a violation of section 623(a)(1), unless the person has been enjoined from committing the violation, or ordered not to commit the violation, in an action or proceeding brought by or on behalf of the Federal Trade Commission, and has violated the injunction or order, and the court may not impose any civil penalty for any violation occurring before the date of the violation of the injunction or order.";

(B) by striking subsection (b) and inserting the following:

"(b) ENFORCEMENT BY OTHER AGENCIES.—

"(1) IN GENERAL.—Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance with the requirements imposed under this title with respect to consumer reporting agencies, persons who use consumer reports from such agencies, persons who furnish information to such agencies, and users of information that are subject to section 615(d) shall be enforced under—

"(A) section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818), by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

"(i) any national bank or State savings association, and any Federal branch or Federal agency of a foreign bank;

"(ii) any member bank of the Federal Reserve System (other than a national bank), a branch or agency of a foreign bank (other than a Federal branch, Federal agency, or insured State branch of a foreign bank), a commercial lending company owned or controlled by a foreign bank, and any organization operating under section 25 or 25A of the Federal Reserve Act; and

"(iii) any bank or Federal savings association insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System) and any insured State branch of a foreign bank;

"(B) the Federal Credit Union Act (12 U.S.C. 1751 et seq.), by the Administrator of the National Credit Union Administration with respect to any Federal credit union;

"(C) subtitle IV of title 49, United States Code, by the Secretary of Transportation, with respect to all carriers subject to the jurisdiction of the Surface Transportation Board;

"(D) the Federal Aviation Act of 1958 (49 U.S.C. App. 1301 et seq.), by the Secretary of Transportation, with respect to any air carrier or foreign air carrier subject to that Act;

"(E) the Packers and Stockyards Act, 1921 (7 U.S.C. 181 et seq.) (except as provided in section 406 of that Act), by the Secretary of Agriculture, with respect to any activities subject to that Act;

"(F) the Commodity Exchange Act, with respect to a person subject to the jurisdiction of the Commodity Futures Trading Commission;

"(G) the Federal securities laws, and any other laws that are subject to the jurisdiction of the Securities and Exchange Commission, with respect to a person that is subject to the jurisdiction of the Securities and Exchange Commission; and

"(H) subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this title.

"(2) INCORPORATED DEFINITIONS.—The terms used in paragraph (1) that are not defined in this title or otherwise defined in section 3(s) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) have the same meanings as in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).";

(C) in subsection (c)(2)—

(i) by inserting "and the Federal Trade Commission" before "or the appropriate"; and

(ii) by inserting "and the Federal Trade Commission" before "or appropriate" each place that term appears;

(D) in subsection (c)(4), by inserting before "or the appropriate" each place that term appears the following: ", the Federal Trade Commission,";

(E) by striking subsection (e) and inserting the following:

"(e) REGULATORY AUTHORITY.—

"(1) IN GENERAL.—The Bureau shall prescribe such regulations as are necessary to carry out the purposes of this title, except with respect to sections 615(e) and 628. The Bureau may prescribe regulations as may be necessary or appropriate to administer and carry out the purposes and objectives of this title, and to prevent evasions thereof or to facilitate compliance therewith. Except as provided in section 1029(a) of the Consumer Financial Protection Act of 2010, the regulations prescribed by the Bureau under this title shall apply to any person that is subject to this title, notwithstanding the enforcement authorities granted to other agencies under this section.

"(2) DEFERENCE.—Notwithstanding any power granted to any Federal agency under this title, the deference that a court affords to a Federal agency with respect to a determination made by such agency relating to the meaning or interpretation of any provision of this title that is subject to the jurisdiction of such agency shall be applied as if that agency were the only agency authorized to apply, enforce, interpret, or administer the provisions of this title The regulations prescribed by the Bureau under this title shall apply to any person that is subject to this title, notwithstanding the enforcement authorities granted to other agencies under this section."; and

(F) in subsection (f)(2), by striking "the Federal banking agencies" and insert "the Federal Trade Commission, the Federal banking agencies,";

(11) in section 623 (15 U.S.C. 1681s–2)—

(A) in subsection (a)(7), by striking subparagraph (D) and inserting the following:

"(D) MODEL DISCLOSURE.—

"(i) DUTY OF BUREAU.—The Bureau shall prescribe a brief model disclosure that a financial institution may use to comply with subparagraph (A), which shall not exceed 30 words.

"(ii) USE OF MODEL NOT REQUIRED.—No provision of this paragraph may be construed to require a financial institution to use any such model form prescribed by the Bureau.

"(iii) COMPLIANCE USING MODEL.—A financial institution shall be deemed to be in compliance with subparagraph (A) if the financial institution uses any model form prescribed by the Bureau under this subparagraph, or the financial institution uses any such model form and rearranges its format.";

(B) in subsection (a)(8), by inserting ", in consultation with the Federal Trade Commission, the Federal banking agencies, and the National Credit Union Administration," before "shall jointly"; and

(C) by striking subsection (e) and inserting the following:

"(e) ACCURACY GUIDELINES AND REGULATIONS REQUIRED.—

"(1) GUIDELINES.—The Bureau shall, with respect to persons or entities that are subject to the enforcement authority of the Bureau under section 621—

"(A) establish and maintain guidelines for use by each person that furnishes information to a consumer reporting agency regarding the accuracy and integrity of the information relating to consumers that such entities furnish to consumer reporting agencies, and update such guidelines as often as necessary; and

"(B) prescribe regulations requiring each person that furnishes information to a consumer reporting agency to establish reasonable policies and procedures for implementing the guidelines established pursuant to subparagraph (A).

"(2) CRITERIA.—In developing the guidelines required by paragraph (1)(A), the Bureau shall—

"(A) identify patterns, practices, and specific forms of activity that can compromise the accuracy and integrity of information furnished to consumer reporting agencies;

"(B) review the methods (including technological means) used to furnish information relating to consumers to consumer reporting agencies;

"(C) determine whether persons that furnish information to consumer reporting agencies maintain and enforce policies to ensure the accuracy and integrity of information furnished to consumer reporting agencies; and

"(D) examine the policies and processes that persons that furnish information to consumer reporting agencies employ to conduct reinvestigations and correct inaccurate information relating to consumers that has been furnished to consumer reporting agencies.";

(12) in section 628(a)(1) (15 U.S.C. 1681w(a)(1)), by striking "Not later than" and all that follows through "Exchange Commission," and inserting "The Federal Trade Commission, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Federal banking agencies,

and the National Credit Union Administration, with respect to the entities that are subject to their respective enforcement authority under section 621,''; and

(13) in section 628(a)(3) (15 U.S.C. 1681w(a)(3)), by striking ''the Federal banking agencies, the National Credit Union Administration, the Commission, and the Securities and Exchange Commission'' and inserting ''the agencies identified in paragraph (1)''.

(b) FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003.—The Fair and Accurate Credit Transactions Act of 2003 (Public Law 108–159) is amended—

(1) in section 112(b) (15 U.S.C. 1681c–1 note), by striking ''Commission'' and inserting ''Bureau'';

(2) in section 211(d) (15 U.S.C. 1681j note), by striking ''Commission'' each place that term appears and inserting ''Bureau'';

(3) in section 214(b) (15 U.S.C. 1681s–3 note), by striking paragraph (1) and inserting the following:

''(1) IN GENERAL.—Regulations to carry out section 624 of the Fair Credit Reporting Act (15 U.S.C. 1681s–3), shall be prescribed, as described in paragraph (2), by—

''(A) the Commodity Futures Trading Commission, with respect to entities subject to its enforcement authorities;

''(B) the Securities and Exchange Commission, with respect to entities subject to its enforcement authorities; and

''(C) the Bureau, with respect to other entities subject to this Act.''; and

(4) in section 214(e)(1) (15 U.S.C. 1681s–3 note), by striking ''Commission'' and inserting ''Bureau''.

SEC. 1089. AMENDMENTS TO THE FAIR DEBT COLLECTION PRACTICES ACT.

The Fair Debt Collection Practices Act (15 U.S.C. 1692 et seq.) is amended—

(1) by striking ''Commission'' each place that term appears and inserting ''Bureau'';

(2) in section 803 (15 U.S.C. 1692a)—

(A) by striking paragraph (1) and inserting the following:

''(1) The term 'Bureau' means the Bureau of Consumer Financial Protection.'';

(3) in section 814 (15 U.S.C. 1692l)—

(A) by striking subsection (a) and inserting the following:

''(a) FEDERAL TRADE COMMISSION.—The Federal Trade Commission shall be authorized to enforce compliance with this title, except to the extent that enforcement of the requirements imposed under this title is specifically committed to another Government agency under any of paragraphs (1) through (5) of subsection (b), subject to subtitle B of the Consumer Financial Protection Act of 2010. For purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act (15 U.S.C. 41 et seq.), a violation of this title shall be deemed an unfair or deceptive act or practice in violation of that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Federal Trade Commission to enforce compliance by any person with this title, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests under the Federal Trade Commission Act, including the power to enforce the provisions of this title, in the same manner as if the violation had been a violation of a Federal Trade Commission trade regulation rule."; and

(B) in subsection (b)—

(i) by striking "Compliance" and inserting "Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance";

(ii) by striking paragraphs (1) and (2) and inserting the following:

"(1) section 8 of the Federal Deposit Insurance Act, by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

"(A) national banks, Federal savings associations, and Federal branches and Federal agencies of foreign banks;

"(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act; and

"(C) banks and State savings associations insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), and insured State branches of foreign banks;";

(iii) by redesignating paragraphs (3) through (6), as paragraphs (2) through (5), respectively;

(iv) in paragraph (4) (as so redesignated), by striking "and" at the end;

(v) in paragraph (5) (as so redesignated), by striking the period at the end and inserting "; and"; and

(vi) by inserting before the undesignated matter at the end the following:

"(6) subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this title.".

(4) in subsection (d), by striking "Neither the Commission" and all that follows through the end of the subsection and inserting the following: "Except as provided in section 1029(a) of the Consumer Financial Protection Act of 2010, the Bureau may prescribe rules with respect to the collection of debts by debt collectors, as defined in this title.".

SEC. 1090. AMENDMENTS TO THE FEDERAL DEPOSIT INSURANCE ACT.

The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended—

(1) in section 8(t) (12 U.S.C. 1818(t)), by adding at the end the following:

"(6) REFERRAL TO BUREAU OF CONSUMER FINANCIAL PROTECTION.—Subject to subtitle B of the Consumer Financial Protection Act of 2010, each appropriate Federal banking agency shall make a referral to the Bureau of Consumer Financial Protection when the Federal banking agency has a reasonable belief that a violation of an enumerated consumer law, as defined in the Consumer Financial Protection Act of 2010, has been committed by any insured depository institution or institution-affiliated party within the jurisdiction of that appropriate Federal banking agency."; and

(2) in section 43 (12 U.S.C. 1831t)—

(A) in subsection (c), by striking "Federal Trade Commission" and inserting "Bureau";

(B) in subsection (d), by striking "Federal Trade Commission" and inserting "Bureau";

(C) in subsection (e)—

(i) in paragraph (2), by striking "Federal Trade Commission" and inserting "Bureau"; and

(ii) by adding at the end the following new paragraph:

"(5) BUREAU.—The term 'Bureau' means the Bureau of Consumer Financial Protection."; and

(D) in subsection (f)—

(i) by striking paragraph (1) and inserting the following:

"(1) LIMITED ENFORCEMENT AUTHORITY.—Compliance with the requirements of subsections (b), (c), and (e), and any regulation prescribed or order issued under such subsection, shall be enforced under the Consumer Financial Protection Act of 2010, by the Bureau, subject to subtitle B of the Consumer Financial Protection Act of 2010, and under the Federal Trade Commission Act (15 U.S.C. 41 et seq.) by the Federal Trade Commission."; and

(ii) in paragraph (2), by striking subparagraph (C) and inserting the following:

"(C) LIMITATION ON STATE ACTION WHILE FEDERAL ACTION PENDING.—If the Bureau or Federal Trade Commission has instituted an enforcement action for a violation of this section, no appropriate State supervisory agency may, during the pendency of such action, bring an action under this section against any defendant named in the complaint of the Bureau or Federal Trade Commission for any violation of this section that is alleged in that complaint.".

SEC. 1091. AMENDMENT TO FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL ACT OF 1978.

Section 1004(a)(4) of the Federal Financial Institutions Examination Council Act of 1978 (12 U.S.C. 3303(a)(4)) is amended by striking "Director, Office of Thrift Supervision" and inserting "Director of the Consumer Financial Protection Bureau".

SEC. 1092. AMENDMENTS TO THE FEDERAL TRADE COMMISSION ACT.

Section 18(f) of the Federal Trade Commission Act (15 U.S.C. 57a(f)) is amended—

(1) by striking the subsection heading and inserting the following:

"(f) DEFINITIONS OF BANKS, SAVINGS AND LOAN INSTITUTIONS, AND FEDERAL CREDIT UNIONS.—".

(2) by striking paragraph (1) and inserting the following: "(1) [Repealed.]";

(3) by striking paragraphs (5) through (7);

(4) in paragraph (2)—

(A) by striking "(2) ENFORCEMENT" and all that follows through "in the case of" and inserting the following:

"(2) DEFINITION.—For purposes of this Act, the term 'bank' means";

(B) in subparagraph (A), by striking ", by the division" and all that follows through "Currency";

(C) in subparagraph (B)—

(i) by striking ", by the division" and all that follows through "System"; and

(ii) by striking "25(a)" and inserting "25A"; and

(D) in subparagraph (C)—

(i) by striking "(other" and inserting "(other than"; and

(ii) by striking ", by the division" and all that follows through "Corporation";

(5) in paragraph (3), by striking "Compliance" and all that follows through "as defined in" and inserting the following: "For purposes of this Act, the term "savings and loan institution" has the same meaning as in"; and

(6) in paragraph (4), by striking "Compliance" and all that follows through "credit unions under" and inserting the following: "For purposes of this Act, the term "Federal credit union" has the same meaning as in".

SEC. 1093. AMENDMENTS TO THE GRAMM-LEACH-BLILEY ACT.

Title V of the Gramm-Leach-Bliley Act (15 U.S.C. 6801 et seq.) is amended—

(1) in section 501(b) (15 U.S.C. 6801(b)), by inserting ", other than the Bureau of Consumer Financial Protection," after "505(a)";

(2) in section 502(e)(5) (15 U.S.C. 6802(e)(5)), by inserting "the Bureau of Consumer Financial Protection" after "(including";

(3) in section 504(a) (15 U.S.C. 6804(a))—

(A) by striking paragraphs (1) and (2) and inserting the following:

"(1) RULEMAKING.—

"(A) IN GENERAL.—Except as provided in subparagraph (C), the Bureau of Consumer Financial Protection and the Securities and Exchange Commission shall have authority to prescribe such regulations as may be necessary to carry out the purposes of this subtitle with respect to financial institutions and other persons subject to their respective jurisdiction under section 505 (and notwithstanding subtitle B of the Consumer Financial Protection Act of 2010), except that the Bureau of Consumer Financial Protection shall not have authority to prescribe regulations with respect to the standards under section 501.

"(B) CFTC.—The Commodity Futures Trading Commission shall have authority to prescribe such regulations as may be necessary to carry out the purposes of this subtitle with respect to financial institutions and other persons subject to the jurisdiction of the Commodity Futures Trading Commission under section 5g of the Commodity Exchange Act.

"(C) FEDERAL TRADE COMMISSION AUTHORITY.—Notwithstanding the authority of the Bureau of Consumer Financial Protection under subparagraph (A), the Federal Trade Commission shall have authority to prescribe such regulations as may be necessary to carry out the purposes of this subtitle with respect to any financial institution that is a person described in section 1029(a) of the Consumer Financial Protection Act of 2010.

"(D) RULE OF CONSTRUCTION.—Nothing in this paragraph shall be construed to alter, affect, or otherwise limit the authority of a State insurance authority to adopt regulations to carry out this subtitle.

"(2) COORDINATION, CONSISTENCY, AND COMPARABILITY.—Each of the agencies authorized under paragraph (1) to prescribe regulations shall consult and coordinate with the other such agencies and, as appropriate, and with representatives of State insurance authorities designated by the National Association of Insurance Commissioners, for the purpose of assuring, to the extent possible, that the regulations prescribed by each such agency are consistent and comparable with the regulations prescribed by the other such agencies."; and

(B) in paragraph (3), by striking ", and shall be issued in final form not later than 6 months after the date of enactment of this Act";

(4) in section 505(a) (15 U.S.C. 6805(a))—

(A) by striking "This subtitle" and all that follows through "as follows:" and inserting "Subject to subtitle B of the Consumer Financial Protection Act of 2010, this subtitle and the regulations prescribed thereunder shall be enforced by the Bureau of Consumer Financial Protection, the Federal functional regulators, the State insurance authorities, and the Federal Trade Commission with respect to financial institutions and other persons subject to their jurisdiction under applicable law, as follows:";

(B) in paragraph (1)—

(i) in the matter preceding subparagraph (A), by inserting "by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act," after "Act,";

(ii) in subparagraph (A), by striking ", by the Office of the Comptroller of the Currency";

(iii) in subparagraph (B), by striking ", by the Board of Governors of the Federal Reserve System";

(iv) in subparagraph (C), by striking ", by the Board of Directors of the Federal Deposit Insurance Corporation"; and

(v) in subparagraph (D), by striking ", by the Director of the Office of Thrift Supervision"; and

(C) by adding at the end the following:

"(8) Under subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau of Consumer Financial Protection, in the case of any financial institution and other covered person or service provider that is subject to the jurisdiction of the

Bureau and any person subject to this subtitle, but not with respect to the standards under section 501.";

(5) in section 505(b)(1) (15 U.S.C. 6805(b)(1)), by inserting ", other than the Bureau of Consumer Financial Protection," after "subsection (a)"; and

(6) in section 507(b) (15 U.S.C. 6807), by striking "Federal Trade Commission" and inserting "Bureau of Consumer Financial Protection".

SEC. 1094. AMENDMENTS TO THE HOME MORTGAGE DISCLOSURE ACT OF 1975.

The Home Mortgage Disclosure Act of 1975 (12 U.S.C. 2801 et seq.) is amended—

(1) by striking "Board" each place that term appears, other than in sections 303, 304(h), 305(b) (as amended by this section), and 307(a) (as amended by this section) and inserting "Bureau".

(2) in section 303 (12 U.S.C. 2802)—

(A) by redesignating paragraphs (1) through (6) as paragraphs (2) through (7), respectively; and

(B) by inserting before paragraph (2) the following:

"(1) the term 'Bureau' means the Bureau of Consumer Financial Protection;";

(3) in section 304 (12 U.S.C. 2803)—

(A) in subsection (b)—

(i) in paragraph (4), by inserting "age," before "and gender";

(ii) in paragraph (3), by striking "and" at the end;

(iii) in paragraph (4), by striking the period at the end and inserting a semicolon; and

(iv) by adding at the end the following:

"(5) the number and dollar amount of mortgage loans grouped according to measurements of—

"(A) the total points and fees payable at origination in connection with the mortgage as determined by the Bureau, taking into account 15 U.S.C. 1602(aa)(4);

"(B) the difference between the annual percentage rate associated with the loan and a benchmark rate or rates for all loans;

"(C) the term in months of any prepayment penalty or other fee or charge payable on repayment of some portion of principal or the entire principal in advance of scheduled payments; and

"(D) such other information as the Bureau may require; and

"(6) the number and dollar amount of mortgage loans and completed applications grouped according to measurements of—

"(A) the value of the real property pledged or proposed to be pledged as collateral;

"(B) the actual or proposed term in months of any introductory period after which the rate of interest may change;

"(C) the presence of contractual terms or proposed contractual terms that would allow the mortgagor or applicant to make payments other than fully amortizing payments during any portion of the loan term;

"(D) the actual or proposed term in months of the mortgage loan;

"(E) the channel through which application was made, including retail, broker, and other relevant categories;

"(F) as the Bureau may determine to be appropriate, a unique identifier that identifies the loan originator as set forth in section 1503 of the S.A.F.E. Mortgage Licensing Act of 2008;

"(G) as the Bureau may determine to be appropriate, a universal loan identifier;

"(H) as the Bureau may determine to be appropriate, the parcel number that corresponds to the real property pledged or proposed to be pledged as collateral;

"(I) the credit score of mortgage applicants and mortgagors, in such form as the Bureau may prescribe; and

"(J) such other information as the Bureau may require.";

(B) by striking subsection (h) and inserting the following:

"(h) SUBMISSION TO AGENCIES.—

"(1) IN GENERAL.—The data required to be disclosed under subsection (b) shall be submitted to the Bureau or to the appropriate agency for the institution reporting under this title, in accordance with rules prescribed by the Bureau. Notwithstanding the requirement of subsection (a)(2)(A) for disclosure by census tract, the Bureau, in consultation with other appropriate agencies described in paragraph (2) and, after notice and comment, shall develop regulations that—

"(A) prescribe the format for such disclosures, the method for submission of the data to the appropriate agency, and the procedures for disclosing the information to the public;

"(B) require the collection of data required to be disclosed under subsection (b) with respect to loans sold by each institution reporting under this title;

"(C) require disclosure of the class of the purchaser of such loans;

"(D) permit any reporting institution to submit in writing to the Bureau or to the appropriate agency such additional data or explanations as it deems relevant to the decision to originate or purchase mortgage loans; and

"(E) modify or require modification of itemized information, for the purpose of protecting the privacy interests of the mortgage applicants or mortgagors, that is or will be available to the public.

"(2) OTHER APPROPRIATE AGENCIES.—The appropriate agencies described in this paragraph are—

"(A) the appropriate Federal banking agencies, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to the entities that are subject to the jurisdiction of each such agency, respectively;

"(B) the Federal Deposit Insurance Corporation for banks insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), mutual savings banks, insured State branches of foreign banks, and any other depository institution described in section 303(2)(A) which is not otherwise referred to in this paragraph;

"(C) the National Credit Union Administration Board with respect to credit unions; and

"(D) the Secretary of Housing and Urban Development with respect to other lending institutions not regulated by the agencies referred to in subparagraph (A) or (B).

"(3) RULES FOR MODIFICATIONS UNDER PARAGRAPH (1).—

"(A) APPLICATION.—A modification under paragraph (1)(E) shall apply to information concerning—

"(i) credit score data described in subsection (b)(6)(I), in a manner that is consistent with the purpose described in paragraph (1)(E); and

"(ii) age or any other category of data described in paragraph (5) or (6) of subsection (b), as the Bureau determines to be necessary to satisfy the purpose described in paragraph (1)(E), and in a manner consistent with that purpose.

"(B) STANDARDS.—The Bureau shall prescribe standards for any modification under paragraph (1)(E) to effectuate the purposes of this title, in light of the privacy interests of mortgage applicants or mortgagors. Where necessary to protect the privacy interests of mortgage applicants or mortgagors, the Bureau shall provide for the disclosure of information described in subparagraph (A) in aggregate or other reasonably modified form, in order to effectuate the purposes of this title.";

(C) in subsection (i), by striking "subsection (b)(4)" and inserting "subsections (b)(4), (b)(5), and (b)(6)";

(D) in subsection (j)—

(i) by striking paragraph (3) and inserting the following:

"(3) CHANGE OF FORM NOT REQUIRED.—A depository institution meets the disclosure requirement of paragraph (1) if the institution provides the information required under such paragraph in such formats as the Bureau may require"; and

(ii) in paragraph (2)(A), by striking "in the format in which such information is maintained by the institution" and inserting "in such formats as the Bureau may require";

(E) in subsection (m), by striking paragraph (2) and inserting the following:

"(2) FORM OF INFORMATION.—In complying with paragraph (1), a depository institution shall provide the person requesting the information with a copy of the information requested in such formats as the Bureau may require."; and

(F) by adding at the end the following:

"(n) TIMING OF CERTAIN DISCLOSURES.—The data required to be disclosed under subsection (b) shall be submitted to the Bureau or to the appropriate agency for any institution reporting under this title, in accordance with regulations prescribed by the Bureau. Institutions shall not be required to report new data under paragraph (5) or (6) of subsection (b) before the first January 1 that occurs after the end of the 9-month period beginning on the date on which regulations are issued by the Bureau in final form with respect to such disclosures.";

(4) in section 305 (12 U.S.C. 2804)—

(A) by striking subsection (b) and inserting the following:

"(b) POWERS OF CERTAIN OTHER AGENCIES.—

"(1) IN GENERAL.—Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance with the requirements of this title shall be enforced—

"(A) under section 8 of the Federal Deposit Insurance Act, the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

"(i) any national bank or Federal savings association, and any Federal branch or Federal agency of a foreign bank;

"(ii) any member bank of the Federal Reserve System (other than a national bank), branch or agency of a foreign bank (other than a Federal branch, Federal agency, and insured State branch of a foreign bank), commercial lending company owned or controlled by a foreign bank, and any organization operating under section 25 or 25A of the Federal Reserve Act; and

"(iii) any bank or State savings association insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System), any mutual savings bank as, defined in section 3(f) of the Federal Deposit Insurance Act (12 U.S.C. 1813(f)), any insured State branch of a foreign bank, and any other depository institution not referred to in this paragraph or subparagraph (B) or (C);

"(B) under subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this subtitle;

"(C) under the Federal Credit Union Act, by the Administrator of the National Credit Union Administration with respect to any insured credit union; and

"(D) with respect to other lending institutions, by the Secretary of Housing and Urban Development.

"(2) INCORPORATED DEFINITIONS.—The terms used in paragraph (1) that are not defined in this title or otherwise defined in section 3(s) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the same meanings as in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101)."; and

(B) by adding at the end the following:

"(d) OVERALL ENFORCEMENT AUTHORITY OF THE BUREAU OF CONSUMER FINANCIAL PROTECTION.—Subject to subtitle B of the Consumer Financial Protection Act of 2010, enforcement of the requirements imposed under this title is committed to each of the agencies under subsection (b). To facilitate research, examinations, and enforcement, all data collected pursuant to section 304 shall be available to the entities listed under subsection (b). The Bureau may exercise its authorities under the Consumer Financial Protection Act of 2010 to exercise principal authority to examine and enforce compliance by any person with the requirements of this title.";

(5) in section 306 (12 U.S.C. 2805(b)), by striking subsection (b) and inserting the following:

"(b) EXEMPTION AUTHORITY.—The Bureau may, by regulation, exempt from the requirements of this title any State-chartered depository institution within any State or subdivision thereof, if the agency determines that, under the law of such State or subdivision, that institution is subject to requirements that are substantially similar to those imposed under this title, and that such law contains adequate provisions for enforcement. Notwithstanding any other provision of this subsection, compliance with the requirements imposed under this subsection shall be enforced by the Office of the Comptroller of the Currency under section 8 of the Federal Deposit Insurance Act, in the case of national banks and Federal savings associations, the deposits of which are insured by the Federal Deposit Insurance Corporation.''; and

(6) by striking section 307 (12 U.S.C. 2806) and inserting the following:

''SEC. 307. COMPLIANCE IMPROVEMENT METHODS.

''(a) IN GENERAL.—

''(1) CONSULTATION REQUIRED.—The Director of the Bureau of Consumer Financial Protection, with the assistance of the Secretary, the Director of the Bureau of the Census, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and such other persons as the Bureau deems appropriate, shall develop or assist in the improvement of, methods of matching addresses and census tracts to facilitate compliance by depository institutions in as economical a manner as possible with the requirements of this title.

''(2) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated, such sums as may be necessary to carry out this subsection.

''(3) CONTRACTING AUTHORITY.—The Director of the Bureau of Consumer Financial Protection is authorized to utilize, contract with, act through, or compensate any person or agency in order to carry out this subsection.

''(b) RECOMMENDATIONS TO CONGRESS.—The Director of the Bureau of Consumer Financial Protection shall recommend to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, such additional legislation as the Director of the Bureau of Consumer Financial Protection deems appropriate to carry out the purpose of this title.''.

SEC. 1095. AMENDMENTS TO THE HOMEOWNERS PROTECTION ACT OF 1998.

Section 10 of the Homeowners Protection Act of 1998 (12 U.S.C. 4909) is amended—

(1) in subsection (a)—

(A) by striking ''Compliance'' and all that follows through the end of paragraph (1) and inserting the following: ''Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance with the requirements imposed under this Act shall be enforced under—

''(1) section 8 of the Federal Deposit Insurance Act, by the appropriate Federal banking agency (as defined in section 3(q) of that Act), with respect to—

''(A) insured depository institutions (as defined in section 3(c)(2) of that Act);

''(B) depository institutions described in clause (i), (ii), or (iii) of section 19(b)(1)(A) of the Federal Reserve Act which are not insured depository institutions (as defined in section 3(c)(2) of the Federal Deposit Insurance Act); and

"(C) depository institutions described in clause (v) or (vi) of section 19(b)(1)(A) of the Federal Reserve Act which are not insured depository institutions (as defined in section 3(c)(2) of the Federal Deposit Insurance Act);";

(B) in paragraph (2), by striking "and" at the end;

(C) in paragraph (3), by striking the period at the end and inserting "; and"; and

(D) by adding at the end the following:

"(4) subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau of Consumer Financial Protection, with respect to any person subject to this Act."; and

(2) in subsection (b)(2), by inserting before the period at the end the following: ", subject to subtitle B of the Consumer Financial Protection Act of 2010".

SEC. 1096. AMENDMENTS TO THE HOME OWNERSHIP AND EQUITY PROTECTION ACT OF 1994.

The Home Ownership and Equity Protection Act of 1994 (15 U.S.C. 1601 note) is amended—

(1) in section 158(a), by striking "Board of Governors of the Federal Reserve System, in consultation with the Consumer Advisory Council of the Board" and inserting "Bureau, in consultation with the Advisory Board to the Bureau"; and

(2) in section 158(b), by striking "Board of Governors of the Federal Reserve System" and inserting "Bureau".

SEC. 1097. AMENDMENTS TO THE OMNIBUS APPROPRIATIONS ACT, 2009.

Section 626 of the Omnibus Appropriations Act, 2009 (15 U.S.C. 1638 note) is amended—

(1) by striking subsection (a) and inserting the following:

"(a)(1) The Bureau of Consumer Financial Protection shall have authority to prescribe rules with respect to mortgage loans in accordance with section 553 of title 5, United States Code. Such rulemaking shall relate to unfair or deceptive acts or practices regarding mortgage loans, which may include unfair or deceptive acts or practices involving loan modification and foreclosure rescue services. Any violation of a rule prescribed under this paragraph shall be treated as a violation of a rule prohibiting unfair, deceptive, or abusive acts or practices under the Consumer Financial Protection Act of 2010 and a violation of a rule under section 18 of the Federal Trade Commission Act (15 U.S.C. 57a) regarding unfair or deceptive acts or practices.

"(2) The Bureau of Consumer Financial Protection shall enforce the rules issued under paragraph (1) in the same manner, by the same means, and with the same jurisdiction, powers, and duties, as though all applicable terms and provisions of the Consumer Financial Protection Act of 2010 were incorporated into and made part of this subsection.

"(3) Subject to subtitle B of the Consumer Financial Protection Act of 2010, the Federal Trade Commission shall enforce the rules issued under paragraph (1), in the same manner, by the same means, and with the same jurisdiction, as though all applicable terms and provisions of the Federal Trade Commission Act were incorporated into and made part of this section."; and

(2) in subsection (b)—

(A) by striking paragraph (1) and inserting the following:

"(1) Except as provided in paragraph (6), in any case in which the attorney general of a State has reason to believe that an interest of the residents of the State has been or is threatened or adversely affected by the engagement of any person subject to a rule prescribed under subsection (a) in practices that violate such rule, the State, as parens patriae, may bring a civil action on behalf of its residents in an appropriate district court of the United States or other court of competent jurisdiction—

"(A) to enjoin that practice;

"(B) to enforce compliance with the rule;

"(C) to obtain damages, restitution, or other compensation on behalf of the residents of the State; or

"(D) to obtain penalties and relief provided under the Consumer Financial Protection Act of 2010, the Federal Trade Commission Act, and such other relief as the court deems appropriate.";

(B) in paragraphs (2) and (3), by striking "the primary Federal regulator" each time the term appears and inserting "the Bureau of Consumer Financial Protection or the Commission, as appropriate";

(C) in paragraph (3), by inserting "and subject to subtitle B of the Consumer Financial Protection Act of 2010," after "paragraph (2),"; and

(D) in paragraph (6), by striking "the primary Federal regulator" each place that term appears and inserting "the Bureau of Consumer Financial Protection or the Commission".

SEC. 1098. AMENDMENTS TO THE REAL ESTATE SETTLEMENT PROCEDURES ACT OF 1974.

The Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 et seq.) is amended—

(1) in section 3 (12 U.S.C. 2602)—

(A) in paragraph (7), by striking "and" at the end;

(B) in paragraph (8), by striking the period at the end and inserting "; and"; and

(C) by adding at the end the following:

"(9) the term 'Bureau' means the Bureau of Consumer Financial Protection.";

(2) in section 4 (12 U.S.C. 2603)—

(A) in subsection (a), by striking the first sentence and inserting the following: "The Bureau shall publish a single, integrated disclosure for mortgage loan transactions (including real estate settlement cost statements) which includes the disclosure requirements of this section and section 5, in conjunction with the disclosure requirements of the Truth in Lending Act that, taken together, may apply to a transaction that is subject to both or either provisions of law. The purpose of such model disclosure shall be to facilitate compliance with the disclosure requirements of this title and the Truth in Lending Act, and to aid the borrower or lessee in understanding the transaction by utilizing readily understandable language to simplify the technical nature of the disclosures.";

(B) by striking "Secretary" each place that term appears and inserting "Bureau"; and

(C) by striking "form" each place that term appears and inserting "forms";

(3) in section 5 (12 U.S.C. 2604)—

(A) by striking "Secretary" each place that term appears and inserting "Bureau"; and

(B) in subsection (a), by striking the first sentence and inserting the following: "The Bureau shall prepare and distribute booklets jointly addressing compliance with the requirements of the Truth in Lending Act and the provisions of this title, in order to help persons borrowing money to finance the purchase of residential real estate better to understand the nature and costs of real estate settlement services.";

(4) in section 6(j)(3) (12 U.S.C. 2605(j)(3))—

(A) by striking "Secretary" and inserting "Bureau"; and

(B) by striking ", by regulations that shall take effect not later than April 20, 1991,";

(5) in section 7(b) (12 U.S.C. 2606(b)) by striking "Secretary" and inserting "Bureau";

(6) in section 8(c)(5) (12 U.S.C. 2607(c)(5)), by striking "Secretary" and inserting "Bureau";

(7) in section 8(d) (12 U.S.C. 2607(d))—

(A) in the subsection heading, by inserting "BUREAU AND" before "SECRETARY"; and

(B) by striking paragraph (4), and inserting the following:

"(4) The Bureau, the Secretary, or the attorney general or the insurance commissioner of any State may bring an action to enjoin violations of this section. Except, to the extent that a person is subject to the jurisdiction of the Bureau, the Secretary, or the attorney general or the insurance commissioner of any State, the Bureau shall have primary authority to enforce or administer this section, subject to subtitle B of the Consumer Financial Protection Act of 2010.";

(8) in section 10(c) (12 U.S.C. 2609(c) and (d)), by striking "Secretary" and inserting "Bureau";

(9) in section 16 (12 U.S.C. 2614), by inserting "the Bureau," before "the Secretary";

(10) in section 18 (12 U.S.C. 2616), by striking "Secretary" each place that term appears and inserting "Bureau"; and

(11) in section 19 (12 U.S.C. 2617)—

(A) in the section heading by striking "**SECRETARY**" and inserting "**BUREAU**";

(B) in subsection (a), by striking "Secretary" each place that term appears and inserting "Bureau"; and

(C) in subsections (b) and (c), by striking "the Secretary" each place that term appears and inserting "the Bureau".

SEC. 1098A. AMENDMENTS TO THE INTERSTATE LAND SALES FULL DISCLOSURE ACT.

The Interstate Land Sales Full Disclosure Act (15 U.S.C. 1701 et seq.) is amended—

(1) by striking "Secretary" each place that term appears and inserting "Director";

(2) by striking "Department of Housing and Urban Development" each place that term appears and inserting "Bureau of Consumer Financial Protection";

(3) by striking "Department" each place that term appears and inserting "Bureau";

(4) in section 1402 (15 U.S.C. 1701)—

(A) by striking paragraph (1) and inserting the following:

"(1) 'Director' means the Director of the Bureau of Consumer Financial Protection;";

(B) in paragraph (10), by striking "and" at the end;

(C) in paragraph (11), by striking the period at the end and inserting "; and"; and

(D) by adding at the end the following:

"(12) 'Bureau' means the Bureau of Consumer Financial Protection."; and

(5) in section 1416(a) (15 U.S.C. 1715(a)), by striking "Secretary of Housing and Urban Development" and inserting "Director of the Bureau of Consumer Financial Protection".

SEC. 1099. AMENDMENTS TO THE RIGHT TO FINANCIAL PRIVACY ACT OF 1978.

The Right to Financial Privacy Act of 1978 (12 U.S.C. 3401 et seq.) is amended—

(1) in section 1101—

(A) in paragraph (6)—

(i) in subparagraph (A), by inserting "and" after the semicolon;

(ii) in subparagraph (B), by striking "and" at the end; and

(iii) by striking subparagraph (C); and

(B) in paragraph (7), by striking subparagraph (B), and inserting the following:

"(B) the Bureau of Consumer Financial Protection;";

(2) in section 1112(e) (12 U.S.C. 3412(e)), by striking "and the Commodity Futures Trading Commission is permitted" and inserting "the Commodity Futures Trading Commission, and the Bureau of Consumer Financial Protection is permitted"; and

(3) in section 1113 (12 U.S.C. 3413), by adding at the end the following new subsection:

"(r) DISCLOSURE TO THE BUREAU OF CONSUMER FINANCIAL PROTECTION.—Nothing in this title shall apply to the examination by or disclosure to the Bureau of Consumer Financial Protection of financial records or information in the exercise of its authority with respect to a financial institution.".

SEC. 1100. AMENDMENTS TO THE SECURE AND FAIR ENFORCEMENT FOR MORTGAGE LICENSING ACT OF 2008.

The S.A.F.E. Mortgage Licensing Act of 2008 (12 U.S.C. 5101 et seq.) is amended—

(1) by striking "a Federal banking agency" each place that term appears, other than in paragraphs (7) and (11) of section 1503 and section 1507(a)(1), and inserting "the Bureau";

(2) by striking "Federal banking agencies" each place that term appears and inserting "Bureau"; and

(3) by striking "Secretary" each place that term appears and inserting "Director";

(4) in section 1503 (12 U.S.C. 5102)—

(A) by redesignating paragraphs (2) through (12) as (3) through (13), respectively;

(B) by striking paragraph (1) and inserting the following:

"(1) BUREAU.—The term 'Bureau' means the Bureau of Consumer Financial Protection.

"(2) FEDERAL BANKING AGENCY.—The term 'Federal banking agency' means the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the National Credit Union Administration, and the Federal Deposit Insurance Corporation."; and

(C) by striking paragraph (10), as so designated by this section, and inserting the following:

"(10) DIRECTOR.—The term 'Director' means the Director of the Bureau of Consumer Financial Protection."; and

(5) in section 1507 (12 U.S.C. 5106)—

(A) in subsection (a)—

(i) by striking paragraph (1) and inserting the following:

"(1) IN GENERAL.—The Bureau shall develop and maintain a system for registering employees of a depository institution, employees of a subsidiary that is owned and controlled by a depository institution and regulated by a Federal banking agency, or employees of an institution regulated by the Farm Credit Administration, as registered loan originators with the Nationwide Mortgage Licensing System and Registry. The system shall be implemented before the end of the 1-year period beginning on the date of enactment of the Consumer Financial Protection Act of 2010."; and

(ii) in paragraph (2)—

(I) by striking "appropriate Federal banking agency and the Farm Credit Administration" and inserting "Bureau"; and

(II) by striking "employees's identity" and inserting "identity of the employee"; and

(B) in subsection (b), by striking "through the Financial Institutions Examination Council, and the Farm Credit Administration", and inserting "and the Bureau of Consumer Financial Protection";

(6) in section 1508 (12 U.S.C. 5107)—

(A) by striking the section heading and inserting the following: "**SEC. 1508. BUREAU OF CONSUMER FINANCIAL PROTECTION BACKUP AUTHORITY TO ESTABLISH LOAN ORIGINATOR LICENSING SYSTEM.**"; and

(B) by adding at the end the following:

"(f) REGULATION AUTHORITY.—

"(1) IN GENERAL.—The Bureau is authorized to promulgate regulations setting minimum net worth or surety bond requirements for residential mortgage loan originators and minimum requirements for recovery funds paid into by loan originators.

"(2) CONSIDERATIONS.—In issuing regulations under paragraph (1), the Bureau shall take into account the need to provide originators adequate incentives to originate affordable and sustainable mortgage loans, as well as the need to ensure a competitive origination market that maximizes consumer access to affordable and sustainable mortgage loans.";

(7) by striking section 1510 (12 U.S.C. 5109) and inserting the following:

"SEC. 1510. FEES.

"The Bureau, the Farm Credit Administration, and the Nationwide Mortgage Licensing System and Registry may charge reasonable fees to cover the costs of maintaining and providing access to information from the Nationwide Mortgage Licensing System and Registry, to the extent that such fees are not charged to consumers for access to such system and registry.";

(8) by striking section 1513 (12 U.S.C. 5112) and inserting the following:

"SEC. 1513. LIABILITY PROVISIONS.

"The Bureau, any State official or agency, or any organization serving as the administrator of the Nationwide Mortgage Licensing System and Registry or a system established by the Director under section 1509, or any officer or employee of any such entity, shall not be subject to any civil action or proceeding for monetary damages by reason of the good faith action or omission of any officer or employee of any such entity, while acting within the scope of office or employment, relating to the collection, furnishing, or dissemination of information concerning persons who are loan originators or are applying for licensing or registration as loan originators."; and

(9) in section 1514 (12 U.S.C. 5113) in the section heading, by striking "**UNDER HUD BACKUP LICENSING SYSTEM**" and inserting "**BY THE BUREAU**".

SEC. 1100A. AMENDMENTS TO THE TRUTH IN LENDING ACT.

The Truth in Lending Act (15 U.S.C. 1601 et seq.) is amended—

(1) in section 103 (15 U.S.C. 1602)—

(A) by redesignating subsections (b) through (bb) as subsections (c) through (cc), respectively; and

(B) by inserting after subsection (a) the following:

"(b) BUREAU.—The term 'Bureau' means the Bureau of Consumer Financial Protection.";

(2) by striking "Board" each place that term appears, other than in section 140(d) and sections 105(i) and 108(a), as amended by this section, and inserting "Bureau";

(3) by striking "Federal Trade Commission" each place that term appears, other than in section 108(c) and section 129(m), as amended by this Act, and other than in the context of a reference to the Federal Trade Commission Act, and inserting "Bureau";

(4) in section 105(a) (15 U.S.C. 1604(a)), in the second sentence—

(A) by striking "Except in the case of a mortgage referred to in section 103(aa), these regulations may contain such" and inserting "Except with respect to the provisions of section 129 that apply to a mortgage referred to in section 103(aa), such regulations may contain such additional requirements,"; and

(B) by inserting "all or" after "exceptions for";

(5) in section 105(b) (15 U.S.C. 1604(b)), by striking the first sentence and inserting the following: "The Bureau shall publish a single, integrated disclosure for mortgage loan transactions (including real estate settlement cost statements) which includes the disclosure requirements of this title in conjunction with the disclosure requirements of the Real Estate Settlement Procedures Act of 1974 that, taken together, may apply to a transaction that is subject to both or either provisions of law. The purpose of such model disclosure shall be to facilitate compliance with the disclosure requirements of this title and the Real Estate Settlement Procedures Act of 1974, and to aid the borrower or lessee in understanding the transaction by utilizing readily understandable language to simplify the technical nature of the disclosures.";

(6) in section 105(f)(1) (15 U.S.C. 1604(f)(1)), by inserting "all or" after "from all or part of this title";

(7) in section 105 (15 U.S.C. 1604), by adding at the end the following:

"(i) AUTHORITY OF THE BOARD TO PRESCRIBE RULES.—Notwithstanding subsection (a), the Board shall have authority to prescribe rules under this title with respect to a person described in section 1029(a) of the Consumer Financial Protection Act of 2010. Regulations prescribed under this subsection may contain such classifications, differentiations, or other provisions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.";

(8) in section 108 (15 U.S.C. 1604), by adding at the end the following:

(A) by striking subsection (a) and inserting the following:

"(a) ENFORCING AGENCIES.—Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance with the requirements imposed under this title shall be enforced under—

"(1) section 8 of the Federal Deposit Insurance Act, by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

"(A) national banks, Federal savings associations, and Federal branches and Federal agencies of foreign banks;

"(B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act; and

"(C) banks and State savings associations insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), and insured State branches of foreign banks;

"(2) the Federal Credit Union Act, by the Director of the National Credit Union Administration, with respect to any Federal credit union;

"(3) the Federal Aviation Act of 1958, by the Secretary of Transportation, with respect to any air carrier or foreign air carrier subject to that Act;

"(4) the Packers and Stockyards Act, 1921 (except as provided in section 406 of that Act), by the Secretary of Agriculture, with respect to any activities subject to that Act;

"(5) the Farm Credit Act of 1971, by the Farm Credit Administration with respect to any Federal land bank, Federal land bank association, Federal intermediate credit bank, or production credit association; and

"(6) subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this title."; and

(B) by striking subsection (c) and inserting the following:

"(c) OVERALL ENFORCEMENT AUTHORITY OF THE FEDERAL TRADE COMMISSION.—Except to the extent that enforcement of the requirements imposed under this title is specifically committed to some other Government agency under any of paragraphs (1) through (5) of subsection (a), and subject to subtitle B of the Consumer Financial Protection Act of 2010, the Federal Trade Commission shall be authorized to enforce such requirements. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act, a violation of any requirement imposed under this title shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Federal Trade Commission to enforce compliance by any person with the requirements under this title, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests under the Federal Trade Commission Act."; and

(9) in section 129 (15 U.S.C. 1639), by striking subsection (m) and inserting the following:

"(m) CIVIL PENALTIES IN FEDERAL TRADE COMMISSION ENFORCEMENT ACTIONS.—For purposes of enforcement by the Federal Trade Commission, any violation of a regulation issued by the Bureau pursuant to subsection (l)(2) shall be treated as a violation of a rule promulgated under section 18 of the Federal Trade Commission Act (15 U.S.C. 57a) regarding unfair or deceptive acts or practices."; and

(10) in chapter 5 (15 U.S.C. 1667 et seq.)—

(A) by striking "the Board" each place that term appears and inserting "the Bureau"; and

(B) by striking "The Board" each place that term appears and inserting "The Bureau".

SEC. 1100B. AMENDMENTS TO THE TRUTH IN SAVINGS ACT.

The Truth in Savings Act (12 U.S.C. 4301 et seq.) is amended—

(1) by striking "Board" each place that term appears, other than in section 272(b) (12 U.S.C. 4311), and inserting "Bureau";

(2) in section 270(a) (12 U.S.C. 4309)—

(A) by striking "Compliance" and all that follows through the end of paragraph (1) and inserting: "Subject to subtitle B of the Consumer Financial Protection Act of 2010, compliance with the requirements imposed under this subtitle shall be enforced under—

"(1) section 8 of the Federal Deposit Insurance Act by the appropriate Federal banking agency (as defined in section 3(q) of that Act), with respect to—

"(A) insured depository institutions (as defined in section 3(c)(2) of that Act);

"(B) depository institutions described in clause (i), (ii), or (iii) of section 19(b)(1)(A) of the Federal Reserve Act which are not insured depository institutions (as defined in section 3(c)(2) of the Federal Deposit Insurance Act); and

"(C) depository institutions described in clause (v) or (vi) of section 19(b)(1)(A) of the Federal Reserve Act which are not insured depository institutions (as defined in section 3(c)(2) of the Federal Deposit Insurance Act);";

(B) in paragraph (2), by striking the period at the end and inserting "; and"; and

(C) by adding at the end the following:

"(3) subtitle E of the Consumer Financial Protection Act of 2010, by the Bureau, with respect to any person subject to this subtitle.";

(3) in section 272(b) (12 U.S.C. 4311(b)), by striking "regulation prescribed by the Board" each place that term appears and inserting "regulation prescribed by the Bureau"; and

(4) in section 274 (12 U.S.C. 4313), by striking paragraph (4) and inserting the following:

"(4) BUREAU.—The term 'Bureau' means the Bureau of Consumer Financial Protection.".

SEC. 1100C. AMENDMENTS TO THE TELEMARKETING AND CONSUMER FRAUD AND ABUSE PREVENTION ACT.

(a) AMENDMENTS TO SECTION 3.—Section 3 of the Telemarketing and Consumer Fraud and Abuse Prevention Act (15 U.S.C. 6102) is amended by striking subsections (b) and (c) and inserting the following:

"(b) RULEMAKING AUTHORITY.—The Commission shall have authority to prescribe rules under subsection (a), in accordance with section 553 of title 5, United States Code. In prescribing a rule under this section that relates to the provision of a consumer financial product or service that is subject to the Consumer Financial Protection Act of 2010, including any enumerated consumer law thereunder, the Commission shall consult with the Bureau of Consumer Financial Protection regarding the consistency of a proposed rule with standards, purposes, or objectives administered by the Bureau of Consumer Financial Protection.

"(c) VIOLATIONS.—Any violation of any rule prescribed under subsection (a)—

"(1) shall be treated as a violation of a rule under section 18 of the Federal Trade Commission Act regarding unfair or deceptive acts or practices; and

"(2) that is committed by a person subject to the Consumer Financial Protection Act of 2010 shall be treated as a violation of a rule under section 1031 of that Act regarding unfair, deceptive, or abusive acts or practices.".

(b) AMENDMENTS TO SECTION 4.—Section 4(d) of the Telemarketing and Consumer Fraud and Abuse Prevention Act (15 U.S.C. 6103(d)) is amended by inserting after "Commission" each place that term appears the following: "or the Bureau of Consumer Financial Protection".

(c) AMENDMENTS TO SECTION 5.—Section 5(c) of the Telemarketing and Consumer Fraud and Abuse Prevention Act (15 U.S.C. 6104(c)) is amended by inserting after "Commission" each place that term appears the following: "or the Bureau of Consumer Financial Protection".

(d) AMENDMENT TO SECTION 6.—Section 6 of the Telemarketing and Consumer Fraud and Abuse Prevention Act (15 U.S.C. 6105) is amended by adding at the end the following:

"(d) ENFORCEMENT BY BUREAU OF CONSUMER FINANCIAL PROTECTION.—Except as otherwise provided in sections 3(d), 3(e), 4, and 5, and subject to subtitle B of the Consumer Financial Protection Act of 2010, this Act shall be enforced by the Bureau of Consumer Financial Protection under subtitle E of the Consumer Financial Protection Act of 2010, with respect to the offering or provision of a consumer financial product or service subject to that Act.".

SEC. 1100D. AMENDMENTS TO THE PAPERWORK REDUCTION ACT.

(a) DESIGNATION AS AN INDEPENDENT AGENCY.—Section 2(5) of the Paperwork Reduction Act (44 U.S.C. 3502(5)) is amended by inserting "the Bureau of Consumer Financial Protection, the Office of Financial Research," after "the Securities and Exchange Commission,".

(b) COMPARABLE TREATMENT.—Section 3513 of title 44, United States Code, is amended by adding at the end the following:

"(c) COMPARABLE TREATMENT.—Notwithstanding any other provision of law, the Director shall treat or review a rule or order prescribed or proposed by the Director of the Bureau of Consumer Financial Protection on the same terms and conditions as apply to any rule or order prescribed or proposed by the Board of Governors of the Federal Reserve System.".

SEC. 1100E. ADJUSTMENTS FOR INFLATION IN THE TRUTH IN LENDING ACT.

(a) CAPS.—

(1) CREDIT TRANSACTIONS.—Section 104(3) of the Truth in Lending Act (15 U.S.C. 1603(3)) is amended by striking "$25,000" and inserting "$50,000".

(2) CONSUMER LEASES.—Section 181(1) of the Truth in Lending Act (15 U.S.C. 1667(1)) is amended by striking "$25,000" and inserting "$50,000".

(b) ADJUSTMENTS FOR INFLATION.—On and after December 31, 2011, the Bureau shall adjust annually the dollar amounts described in sections 104(3) and 181(1) of the Truth in Lending Act (as amended by this section), by the annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers, as published by the Bureau of Labor Statistics, rounded to the nearest multiple of $100, or $1,000, as applicable.

SEC. 1100F. USE OF CONSUMER REPORTS.

Section 615 of the Fair Credit Reporting Act (15 U.S.C. 1681m) is amended—

(1) in subsection (a)—

(A) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively;

(B) by inserting after paragraph (1) the following:

"(2) provide to the consumer written or electronic disclosure—

"(A) of a numerical credit score as defined in section 609(f)(2)(A) used by such person in taking any adverse action based in whole or in part on any information in a consumer report; and

"(B) of the information set forth in subparagraphs (B) through (E) of section 609(f)(1);"; and

(C) in paragraph (4) (as so redesignated), by striking "paragraph (2)" and inserting "paragraph (3)"; and

(2) in subsection (h)(5)—

(A) in subparagraph (C), by striking "; and" and inserting a semicolon;

(B) in subparagraph (D), by striking the period and inserting "; and"; and

(C) by inserting at the end the following:

"(E) include a statement informing the consumer of—

"(i) a numerical credit score as defined in section 609(f)(2)(A), used by such person in making the credit decision described in paragraph (1) based in whole or in part on any information in a consumer report; and

"(ii) the information set forth in subparagraphs (B) through (E) of section 609(f)(1).".

SEC. 1100G. SMALL BUSINESS FAIRNESS AND REGULATORY TRANSPARENCY.

(a) PANEL REQUIREMENT.—Section 609(d) of title 5, United States Code, is amended by striking "means the" and all that follows and inserting the following: "means—

"(1) the Environmental Protection Agency;

"(2) the Consumer Financial Protection Bureau of the Federal Reserve System; and

"(3) the Occupational Safety and Health Administration of the Department of Labor.".

(b) INITIAL REGULATORY FLEXIBILITY ANALYSIS.—Section 603 of title 5, United States Code, is amended by adding at the end the following:

"(d)(1) For a covered agency, as defined in section 609(d)(2), each initial regulatory flexibility analysis shall include a description of—

"(A) any projected increase in the cost of credit for small entities;

"(B) any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any increase in the cost of credit for small entities; and

"(C) advice and recommendations of representatives of small entities relating to issues described in subparagraphs (A) and (B) and subsection (b).

"(2) A covered agency, as defined in section 609(d)(2), shall, for purposes of complying with paragraph (1)(C)—

"(A) identify representatives of small entities in consultation with the Chief Counsel for Advocacy of the Small Business Administration; and

"(B) collect advice and recommendations from the representatives identified under subparagraph (A) relating to issues described in subparagraphs (A) and (B) of paragraph (1) and subsection (b).".

(c) FINAL REGULATORY FLEXIBILITY ANALYSIS.—Section 604(a) of title 5, United States Code, is amended—

(1) in paragraph (4), by striking "and" at the end;

(2) in paragraph (5), by striking the period at the end and inserting "; and"; and

(3) by adding at the end the following:

"(6) for a covered agency, as defined in section 609(d)(2), a description of the steps the agency has taken to minimize any additional cost of credit for small entities.".

SEC. 1100H. EFFECTIVE DATE.

Except as otherwise provided in this subtitle and the amendments made by this subtitle, this subtitle and the amendments made by this subtitle, other than sections 1081 and 1082, shall become effective on the designated transfer date.

TITLE XI—FEDERAL RESERVE SYSTEM PROVISIONS

SEC. 1101. FEDERAL RESERVE ACT AMENDMENTS ON EMERGENCY LENDING AUTHORITY.

(a) FEDERAL RESERVE ACT.—The third undesignated paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 343) (relating to emergency lending authority) is amended—

(1) by inserting "(3)(A)" before "In unusual";

(2) by striking "individual, partnership, or corporation" the first place that term appears and inserting the following: "participant in any program or facility with broad-based eligibility";

(3) by striking "exchange for an individual or a partnership or corporation" and inserting "exchange,";

(4) by striking "such individual, partnership, or corporation" and inserting the following: "such participant in any program or facility with broad-based eligibility";

(5) by striking "for individuals, partnerships, corporations" and inserting "for any participant in any program or facility with broad-based eligibility"; and

(6) by striking "may prescribe." and inserting the following: "may prescribe.

"(B)(i) As soon as is practicable after the date of enactment of this subparagraph, the Board shall establish, by regulation, in consultation with the Secretary of the Treasury, the policies and procedures governing emergency lending under this paragraph. Such policies and procedures shall be designed to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system, and not to aid a failing financial company, and that the security for emergency loans is sufficient to protect taxpayers from losses and that any such program is terminated in a timely and orderly fashion. The policies and procedures established by the Board shall require that a Federal reserve bank assign, consistent with sound risk management practices and to ensure protection for the taxpayer, a lendable value to all collateral for a loan executed by a Federal reserve bank under this paragraph in determining whether the loan is secured satisfactorily for purposes of this paragraph.

"(ii) The Board shall establish procedures to prohibit borrowing from programs and facilities by borrowers that are insolvent. Such procedures may include a certification from the chief executive officer (or other authorized officer) of the borrower, at the time the borrower initially borrows under the program or facility (with a duty by the borrower to update the certification if the information in the certification materially changes), that the borrower is not insolvent. A borrower shall be considered insolvent for purposes of this subparagraph, if the borrower is in bankruptcy, resolution under title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or any other Federal or State insolvency proceeding.

"(iii) A program or facility that is structured to remove assets from the balance sheet of a single and specific company, or that is established for the purpose of assisting a single and specific company avoid bankruptcy, resolution under title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or any other Federal or State insolvency proceeding, shall not be considered a program or facility with broad-based eligibility.

"(iv) The Board may not establish any program or facility under this paragraph without the prior approval of the Secretary of the Treasury.

"(C) The Board shall provide to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives—

"(i) not later than 7 days after the Board authorizes any loan or other financial assistance under this paragraph, a report that includes—

"(I) the justification for the exercise of authority to provide such assistance;

"(II) the identity of the recipients of such assistance;

"(III) the date and amount of the assistance, and form in which the assistance was provided; and

"(IV) the material terms of the assistance, including—

"(aa) duration;

"(bb) collateral pledged and the value thereof;

"(cc) all interest, fees, and other revenue or items of value to be received in exchange for the assistance;

"(dd) any requirements imposed on the recipient with respect to employee compensation, distribution of dividends, or any other corporate decision in exchange for the assistance; and

"(ee) the expected costs to the taxpayers of such assistance; and

"(ii) once every 30 days, with respect to any outstanding loan or other financial assistance under this paragraph, written updates on—

"(I) the value of collateral;

"(II) the amount of interest, fees, and other revenue or items of value received in exchange for the assistance; and

"(III) the expected or final cost to the taxpayers of such assistance.

"(D) The information required to be submitted to Congress under subparagraph (C) related to—

"(i) the identity of the participants in an emergency lending program or facility commenced under this paragraph;

"(ii) the amounts borrowed by each participant in any such program or facility;

"(iii) identifying details concerning the assets or collateral held by, under, or in connection with such a program or facility,

shall be kept confidential, upon the written request of the Chairman of the Board, in which case such information shall be made available only to the Chairpersons or Ranking Members of the Committees described in subparagraph (C).

"(E) If an entity to which a Federal reserve bank has provided a loan under this paragraph becomes a covered financial company, as defined in section 201 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, at any time while such loan is outstanding, and the Federal reserve bank incurs a realized net loss on the loan, then the Federal reserve bank shall have a claim equal to the amount of the net realized loss against the covered entity, with the same priority as an obligation to the Secretary of the Treasury under section 210(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.".

(b) CONFORMING AMENDMENT.—Section 507(a)(2) of title 11, United States Code, is amended by inserting "unsecured claims of any Federal reserve bank related to loans made through programs or facilities authorized under section 13(3) of the Federal Reserve Act (12 U.S.C. 343)," after "this title,".

(c) REFERENCES.—On and after the date of enactment of this Act, any reference in any provision of Federal law to the third undesignated paragraph of section 13 of the Federal Reserve Act (12 U.S.C. 343) shall be deemed to be a reference to section 13(3) of the Federal Reserve Act, as so designated by this section.

SEC. 1102. AUDITS OF SPECIAL FEDERAL RESERVE CREDIT FACILITIES.

(a) AUDITS.—Section 714 of title 31, United States Code, is amended by adding at the end the following:

"(f) AUDITS OF CREDIT FACILITIES OF THE FEDERAL RESERVE SYSTEM.—

"(1) DEFINITIONS.—In this subsection, the following definitions shall apply:

"(A) CREDIT FACILITY.—The term 'credit facility' means a program or facility, including any special purpose vehicle or other entity established by or on behalf of the Board of Governors of the Federal Reserve System or a Federal reserve bank, authorized by the Board of Governors under section 13(3) of the Federal Reserve Act (12 U.S.C. 343), that is not subject to audit under subsection (e).

"(B) COVERED TRANSACTION.—The term 'covered transaction' means any open market transaction or discount window advance that meets the definition of 'covered transaction' in section 11(s) of the Federal Reserve Act.

"(2) AUTHORITY FOR AUDITS AND EXAMINATIONS.—Subject to paragraph (3), and notwithstanding any limitation in subsection (b) on the auditing and oversight of certain functions of the Board of Governors of the Federal Reserve System or any Federal reserve bank, the Comptroller General of the United States may conduct audits, including onsite examinations, of the Board of Governors, a Federal reserve bank, or a credit facility, if the Comptroller General determines that such audits are appropriate, solely for the purposes of assessing, with respect to a credit facility or a covered transaction—

"(A) the operational integrity, accounting, financial reporting, and internal controls governing the credit facility or covered transaction;

"(B) the effectiveness of the security and collateral policies established for the facility or covered transaction in mitigating risk to the relevant Federal reserve bank and taxpayers;

"(C) whether the credit facility or the conduct of a covered transaction inappropriately favors one or more specific participants over other institutions eligible to utilize the facility; and

"(D) the policies governing the use, selection, or payment of third-party contractors by or for any credit facility or to conduct any covered transaction.

"(3) REPORTS AND DELAYED DISCLOSURE.—

"(A) REPORTS REQUIRED.—A report on each audit conducted under paragraph (2) shall be submitted by the Comptroller General to the Congress before the end of the 90-day period beginning on the date on which such audit is completed.

"(B) CONTENTS.—The report under subparagraph (A) shall include a detailed description of the findings and conclusions of the Comptroller General with respect to the matters described in paragraph (2) that were audited and are the subject of the report, together with such recommendations for legislative or administrative action relating to such matters as the Comptroller General may determine to be appropriate.

"(C) DELAYED RELEASE OF CERTAIN INFORMATION.—

"(i) IN GENERAL.—The Comptroller General shall not disclose to any person or entity, including to Congress, the names or identifying details of specific participants in any credit facility or covered transaction, the amounts borrowed by or transferred by or to specific participants in any credit facility or covered transaction, or identifying details regarding assets or collateral held or transferred by, under, or in connection with any credit facility or covered transaction, and any report provided under subparagraph (A) shall be redacted to ensure that such names and details are not disclosed.

"(ii) DELAYED RELEASE.—The nondisclosure obligation under clause (i) shall expire with respect to any participant on the date on which the Board of Governors, directly or through a Federal reserve bank, publicly discloses the identity of the subject participant or the identifying details of the subject assets, collateral, or transaction.

"(iii) GENERAL RELEASE.—The Comptroller General shall release a nonredacted version of any report on a credit facility 1 year after the effective date of the termination by the Board of Governors of the authorization for the credit facility. For purposes of this clause, a credit facility shall be deemed to have terminated 24 months after the date on which the credit facility ceases to make extensions of credit and loans, unless the credit facility is otherwise terminated by the Board of Governors.

"(iv) EXCEPTIONS.—The nondisclosure obligation under clause (i) shall not apply to the credit facilities Maiden Lane, Maiden Lane II, and Maiden Lane III.

"(v) RELEASE OF COVERED TRANSACTION INFORMATION.—The Comptroller General shall release a nonredacted version of any report regarding covered transactions upon the release of the information regarding such covered transactions by the Board of Governors of the Federal Reserve System, as provided in section 11(s) of the Federal Reserve Act.".

(b) ACCESS TO RECORDS.—Section 714(d) of title 31, United States Code, is amended—

(1) in paragraph (2), by inserting "or any person or entity described in paragraph (3)(A)" after "used by an agency";

(2) in paragraph (3), by inserting "or (f)" after "subsection (e)" each place that term appears;

(3) in clauses (i) and (ii) of paragraph (3)(A), by inserting "or the Federal Reserve banks" after "by the Board" each place that term appears;

(4) in paragraph (3)(A)(ii), by inserting "participating in or" after "any entity"; and

(5) in paragraph (3)(B), by adding at the end the following: "The Comptroller General may make and retain copies of books, accounts, and other records provided under subparagraph (A) as the Comptroller General deems appropriate. The Comptroller General shall provide to any person or entity described in subparagraph (A) a current list of officers and employees to whom, with proper identification, records and property may be made available, and who may make notes or copies necessary to carry out a audit or examination under this subsection.".

SEC. 1103. PUBLIC ACCESS TO INFORMATION.

(a) IN GENERAL.—Section 2B of the Federal Reserve Act (12 U.S.C. 225b) is amended by adding at the end the following:

"(c) PUBLIC ACCESS TO INFORMATION.—The Board shall place on its home Internet website, a link entitled 'Audit', which shall link to a webpage that shall serve as a repository of information made available to the public for a reasonable period of time, not less than 6 months following the date of release of the relevant information, including—

"(1) the reports prepared by the Comptroller General under section 714 of title 31, United States Code;

"(2) the annual financial statements prepared by an independent auditor for the Board in accordance with section 11B;

"(3) the reports to the Committee on Banking, Housing, and Urban Affairs of the Senate required under section 13(3) (relating to emergency lending authority); and

"(4) such other information as the Board reasonably believes is necessary or helpful to the public in understanding the accounting, financial reporting, and internal controls of the Board and the Federal reserve banks.".

(b) FEDERAL RESERVE TRANSPARENCY AND RELEASE OF INFORMATION.—Section 11 of the Federal Reserve Act (12 U.S.C. 248) is amended by adding at the end the following new subsection:

"(s) FEDERAL RESERVE TRANSPARENCY AND RELEASE OF INFORMATION.—

"(1) IN GENERAL.—In order to ensure the disclosure in a timely manner consistent with the purposes of this Act of information concerning the borrowers and counterparties participating in emergency credit facilities, discount window lending programs, and open market operations authorized or conducted by the Board or a Federal reserve bank, the Board of Governors shall disclose, as provided in paragraph (2)—

"(A) the names and identifying details of each borrower, participant, or counterparty in any credit facility or covered transaction;

"(B) the amount borrowed by or transferred by or to a specific borrower, participant, or counterparty in any credit facility or covered transaction;

"(C) the interest rate or discount paid by each borrower, participant, or counterparty in any credit facility or covered transaction; and

"(D) information identifying the types and amounts of collateral pledged or assets transferred in connection with participation in any credit facility or covered transaction.

"(2) MANDATORY RELEASE DATE.—In the case of—

"(A) a credit facility, the Board shall disclose the information described in paragraph (1) on the date that is 1 year after the effective date of the termination by the Board of the authorization of the credit facility; and

"(B) a covered transaction, the Board shall disclose the information described in paragraph (1) on the last day of the eighth calendar quarter following the calendar quarter in which the covered transaction was conducted.

"(3) EARLIER RELEASE DATE AUTHORIZED.—The Chairman of the Board may publicly release the information described in paragraph (1) before the relevant date specified in paragraph

(2), if the Chairman determines that such disclosure would be in the public interest and would not harm the effectiveness of the relevant credit facility or the purpose or conduct of covered transactions.

"(4) DEFINITIONS.—For purposes of this subsection, the following definitions shall apply:

"(A) CREDIT FACILITY.—The term 'credit facility' has the same meaning as in section 714(f)(1)(A) of title 31, United States Code.

"(B) COVERED TRANSACTION.—The term 'covered transaction' means—

"(i) any open market transaction with a nongovernmental third party conducted under the first undesignated paragraph of section 14 or subparagraph (a), (b), or (c) of the 2nd undesignated paragraph of such section, after the date of enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and

"(ii) any advance made under section 10B after the date of enactment of that Act.

"(5) TERMINATION OF CREDIT FACILITY BY OPERATION OF LAW.—A credit facility shall be deemed to have terminated as of the end of the 24-month period beginning on the date on which the credit facility ceases to make extensions of credit and loans, unless the credit facility is otherwise terminated by the Board before such date.

"(6) CONSISTENT TREATMENT OF INFORMATION.—Except as provided in this subsection or section 13(3)(D), or in section 714(f)(3)(C) of title 31, United States Code, the information described in paragraph (1) and information concerning the transactions described in section 714(f) of such title, shall be confidential, including for purposes of section 552(b)(3) of title 5 of such Code, until the relevant mandatory release date described in paragraph (2), unless the Chairman of the Board determines that earlier disclosure of such information would be in the public interest and would not harm the effectiveness of the relevant credit facility or the purpose of conduct of the relevant transactions.

"(7) PROTECTION OF PERSONAL PRIVACY.—This subsection and section 13(3)(C), section 714(f)(3)(C) of title 31, United States Code, and subsection (a) or (c) of section 1109 of the Dodd-Frank Wall Street Reform and Consumer Protection Act shall not be construed as requiring any disclosure of nonpublic personal information (as defined for purposes of section 502 of the Gramm-Leach-Bliley Act (12 U.S.C. 6802)) concerning any individual who is referenced in collateral pledged or assets transferred in connection with a credit facility or covered transaction, unless the person is a borrower, participant, or counterparty under the credit facility or covered transaction.

"(8) STUDY OF FOIA EXEMPTION IMPACT.—

"(A) STUDY.—The Inspector General of the Board of Governors of the Federal Reserve System shall—

"(i) conduct a study on the impact that the exemption from section 552(b)(3) of title 5 (known as the Freedom of Information Act) established under paragraph (6) has had on the ability of the public to access information about the administration by the Board of Governors of emergency credit facilities, discount window lending programs, and open market operations; and

"(ii) make any recommendations on whether the exemption described in clause (i) should remain in effect.

"(B) REPORT.—Not later than 30 months after the date of enactment of this section, the Inspector General of the Board of Governors of the Federal Reserve System shall submit a report on the findings of the study required under subparagraph (A) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, and publish the report on the website of the Board.

"(9) RULE OF CONSTRUCTION.—Nothing in this section is meant to affect any pending litigation or lawsuit filed under section 552 of title 5, United States Code (popularly known as the Freedom of Information Act), on or before the date of enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act.".

SEC. 1104. LIQUIDITY EVENT DETERMINATION.

(a) DETERMINATION AND WRITTEN RECOMMENDATION.—

(1) DETERMINATION REQUEST.—The Secretary may request the Corporation and the Board of Governors to determine whether a liquidity event exists that warrants use of the guarantee program authorized under section 1105.

(2) REQUIREMENTS OF DETERMINATION.—Any determination pursuant to paragraph (1) shall—

(A) be written; and

(B) contain an evaluation of the evidence that—

(i) a liquidity event exists;

(ii) failure to take action would have serious adverse effects on financial stability or economic conditions in the United States; and

(iii) actions authorized under section 1105 are needed to avoid or mitigate potential adverse effects on the United States financial system or economic conditions.

(b) PROCEDURES.—Notwithstanding any other provision of Federal or State law, upon the determination of both the Corporation (upon a vote of not fewer than ⅔ of the members of the Corporation then serving) and the Board of Governors (upon a vote of not fewer than ⅔ of the members of the Board of Governors then serving) under subsection (a) that a liquidity event exists that warrants use of the guarantee program authorized under section 1105, and with the written consent of the Secretary—

(1) the Corporation shall take action in accordance with section 1105(a); and

(2) the Secretary (in consultation with the President) shall take action in accordance with section 1105(c).

(c) DOCUMENTATION AND REVIEW.—

(1) DOCUMENTATION.—The Secretary shall—

(A) maintain the written documentation of each determination of the Corporation and the Board of Governors under this section; and

(B) provide the documentation for review under paragraph (2).

(2) GAO REVIEW.—The Comptroller General of the United States shall review and report to Congress on any determination of the Corporation and the Board of Governors under subsection (a), including—

(A) the basis for the determination; and

(B) the likely effect of the actions taken.

(d) REPORT TO CONGRESS.—On the earlier of the date of a submission made to Congress under section 1105(c), or within 30 days of the date of a determination under subsection (a), the Secretary shall provide written notice of the determination of the Corporation and the Board of Governors to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives, including a description of the basis for the determination.

SEC. 1105. EMERGENCY FINANCIAL STABILIZATION.

(a) IN GENERAL.—Upon the written determination of the Corporation and the Board of Governors under section 1104, the Corporation shall create a widely available program to guarantee obligations of solvent insured depository institutions or solvent depository institution holding companies (including any affiliates thereof) during times of severe economic distress, except that a guarantee of obligations under this section may not include the provision of equity in any form.

(b) RULEMAKING AND TERMS AND CONDITIONS.—

(1) POLICIES AND PROCEDURES.—As soon as is practicable after the date of enactment of this Act, the Corporation shall establish, by regulation, and in consultation with the Secretary, policies and procedures governing the issuance of guarantees authorized by this section. Such policies and procedures may include a requirement of collateral as a condition of any such guarantee.

(2) TERMS AND CONDITIONS.—The terms and conditions of any guarantee program shall be established by the Corporation, with the concurrence of the Secretary.

(c) DETERMINATION OF GUARANTEED AMOUNT.—

(1) IN GENERAL.—In connection with any program established pursuant to subsection (a) and subject to paragraph (2) of this subsection, the Secretary (in consultation with the President) shall determine the maximum amount of debt outstanding that the Corporation may guarantee under this section, and the President may transmit to Congress a written report on the plan of the Corporation to exercise the authority under this section to issue guarantees up to that maximum amount and a request for approval of such plan. The Corporation shall exercise the authority under this section to issue guarantees up to that specified maximum amount upon passage of the joint resolution of approval, as provided in subsection (d). Absent such approval, the Corporation shall issue no such guarantees.

(2) ADDITIONAL DEBT GUARANTEE AUTHORITY.—If the Secretary (in consultation with the President) determines, after a submission to Congress under paragraph (1), that the maximum guarantee amount should be raised, and the Council concurs with that determination, the President may transmit to Congress a written report on the plan of the Corporation to exercise the authority under this section to issue guarantees

up to the increased maximum debt guarantee amount. The Corporation shall exercise the authority under this section to issue guarantees up to that specified maximum amount upon passage of the joint resolution of approval, as provided in subsection (d). Absent such approval, the Corporation shall issue no such guarantees.

(d) RESOLUTION OF APPROVAL.—

(1) ADDITIONAL DEBT GUARANTEE AUTHORITY.—A request by the President under this section shall be considered granted by Congress upon adoption of a joint resolution approving such request. Such joint resolution shall be considered in the Senate under expedited procedures.

(2) FAST TRACK CONSIDERATION IN SENATE.—

(A) RECONVENING.—Upon receipt of a request under subsection (c), if the Senate has adjourned or recessed for more than 2 days, the majority leader of the Senate, after consultation with the minority leader of the Senate, shall notify the Members of the Senate that, pursuant to this section, the Senate shall convene not later than the second calendar day after receipt of such message.

(B) PLACEMENT ON CALENDAR.—Upon introduction in the Senate, the joint resolution shall be placed immediately on the calendar.

(C) FLOOR CONSIDERATION.—

(i) IN GENERAL.—Notwithstanding Rule XXII of the Standing Rules of the Senate, it is in order at any time during the period beginning on the 4th day after the date on which Congress receives a request under subsection (c), and ending on the 7th day after that date (even though a previous motion to the same effect has been disagreed to) to move to proceed to the consideration of the joint resolution, and all points of order against the joint resolution (and against consideration of the joint resolution) are waived. The motion to proceed is not debatable. The motion is not subject to a motion to postpone. A motion to reconsider the vote by which the motion is agreed to or disagreed to shall not be in order. If a motion to proceed to the consideration of the resolution is agreed to, the joint resolution shall remain the unfinished business until disposed of.

(ii) DEBATE.—Debate on the joint resolution, and on all debatable motions and appeals in connection therewith, shall be limited to not more than 10 hours, which shall be divided equally between the majority and minority leaders or their designees. A motion further to limit debate is in order and not debatable. An amendment to, or a motion to postpone, or a motion to proceed to the consideration of other business, or a motion to recommit the joint resolution is not in order.

(iii) VOTE ON PASSAGE.—The vote on passage shall occur immediately following the conclusion of the debate on the joint resolution, and a single quorum call at the conclusion of the debate if requested in accordance with the rules of the Senate.

(iv) RULINGS OF THE CHAIR ON PROCEDURE.—Appeals from the decisions of the Chair relating to the application of the rules of the Senate, as the case may be, to the procedure relating to a joint resolution shall be decided without debate.

(3) RULES.—

(A) COORDINATION WITH ACTION BY HOUSE OF REPRESENTATIVES.—If, before the passage by the Senate of a joint resolution of the Senate, the Senate receives a joint resolution, from the House of Representatives, then the following procedures shall apply:

(i) The joint resolution of the House of Representatives shall not be referred to a committee.

(ii) With respect to a joint resolution of the Senate—

(I) the procedure in the Senate shall be the same as if no joint resolution had been received from the other House; but

(II) the vote on passage shall be on the joint resolution of the House of Representatives.

(B) TREATMENT OF JOINT RESOLUTION OF HOUSE OF REPRESENTATIVES.—If the Senate fails to introduce or consider a joint resolution under this section, the joint resolution of the House of Representatives shall be entitled to expedited floor procedures under this subsection.

(C) TREATMENT OF COMPANION MEASURES.—If, following passage of the joint resolution in the Senate, the Senate then receives the companion measure from the House of Representatives, the companion measure shall not be debatable.

(D) RULES OF THE SENATE.—This subsection is enacted by Congress—

(i) as an exercise of the rulemaking power of the Senate, and as such it is deemed a part of the rules of the Senate, but applicable only with respect to the procedure to be followed in the Senate in the case of a joint resolution, and it supersedes other rules, only to the extent that it is inconsistent with such rules; and

(ii) with full recognition of the constitutional right of the Senate to change the rules (so far as relating to the procedure of the Senate) at any time, in the same manner, and to the same extent as in the case of any other rule of the Senate.

(4) DEFINITION.—As used in this subsection, the term "joint resolution" means only a joint resolution—

(A) that is introduced not later than 3 calendar days after the date on which the request referred to in subsection (c) is received by Congress;

(B) that does not have a preamble;

(C) the title of which is as follows: "Joint resolution relating to the approval of a plan to guarantee obligations under section 1105 of the Dodd-Frank Wall Street Reform and Consumer Protection Act"; and

(D) the matter after the resolving clause of which is as follows: "That Congress approves the obligation of any amount described in section 1105(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.".

(e) FUNDING.—

(1) FEES AND OTHER CHARGES.—The Corporation shall charge fees and other assessments to all participants in the program established pursuant to this section, in such amounts as are necessary to offset projected losses and administrative expenses, including amounts borrowed pursuant to paragraph (3), and such amounts shall be available to the Corporation.

(2) EXCESS FUNDS.—If, at the conclusion of the program established under this section, there are any excess funds collected from the fees associated with such program, the funds shall be deposited in the General Fund of the Treasury.

(3) AUTHORITY OF CORPORATION.—The Corporation—

(A) may borrow funds from the Secretary of the Treasury and issue obligations of the Corporation to the Secretary for amounts borrowed, and the amounts borrowed shall be available to the Corporation for purposes of carrying out a program established pursuant to this section, including the payment of reasonable costs of administering the program, and the obligations issued shall be repaid in full with interest through fees and charges paid by participants in accordance with paragraphs (1) and (4), as applicable; and

(B) may not borrow funds from the Deposit Insurance Fund established pursuant to section 11(a)(4) of the Federal Deposit Insurance Act.

(4) BACKUP SPECIAL ASSESSMENTS.—To the extent that the funds collected pursuant to paragraph (1) are insufficient to cover any losses or expenses, including amounts borrowed pursuant to paragraph (3), arising from a program established pursuant to this section, the Corporation shall impose a special assessment solely on participants in the program, in amounts necessary to address such insufficiency, and which shall be available to the Corporation to cover such losses or expenses.

(5) AUTHORITY OF THE SECRETARY.—The Secretary may purchase any obligations issued under paragraph (3)(A). For such purpose, the Secretary may use the proceeds of the sale of any securities issued under chapter 31 of title 31, United States Code, and the purposes for which securities may be issued under that chapter 31 are extended to include such purchases, and the amount of any securities issued under that chapter 31 for such purpose shall be treated in the same manner as securities issued under section 208(n)(5)(E).

(f) RULE OF CONSTRUCTION.—For purposes of this section, a guarantee of deposits held by insured depository institutions shall not be treated as a debt guarantee program.

(g) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

(1) COMPANY.—The term "company" means any entity other than a natural person that is incorporated or organized under Federal law or the laws of any State.

(2) DEPOSITORY INSTITUTION HOLDING COMPANY.—The term "depository institution holding company" has the same meaning as in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813).

(3) LIQUIDITY EVENT.—The term "liquidity event" means—

(A) an exceptional and broad reduction in the general ability of financial market participants—

(i) to sell financial assets without an unusual and significant discount; or

(ii) to borrow using financial assets as collateral without an unusual and significant increase in margin; or

(B) an unusual and significant reduction in the ability of financial market participants to obtain unsecured credit.

(4) SOLVENT.—The term "solvent" means that the value of the assets of an entity exceed its obligations to creditors.

SEC. 1106. ADDITIONAL RELATED AMENDMENTS.

(a) SUSPENSION OF PARALLEL FEDERAL DEPOSIT INSURANCE ACT AUTHORITY.—Effective upon the date of enactment of this section, the Corporation may not exercise its authority under section 13(c)(4)(G)(i) of the Federal Deposit Insurance Act (12 U.S.C. 1823(c)(4)(G)(i)) to establish any widely available debt guarantee program for which section 1105 would provide authority.

(b) FEDERAL DEPOSIT INSURANCE ACT.—Section 13(c)(4)(G) of the Federal Deposit Insurance Act (12 U.S.C. 1823(c)(4)(G)) is amended—

(1) in clause (i)—

(A) in subclause (I), by inserting "for which the Corporation has been appointed receiver" before "would have serious"; and

(B) in the undesignated matter following subclause (II), by inserting "for the purpose of winding up the insured depository institution for which the Corporation has been appointed receiver" after "provide assistance under this section"; and

(2) in clause (v)(I), by striking "The" and inserting "Not later than 3 days after making a determination under clause (i), the".

(c) EFFECT OF DEFAULT ON AN FDIC GUARANTEE.—If an insured depository institution or depository institution holding company (as those terms are defined in section 3 of the Federal Deposit Insurance Act) participating in a program under section 1105, or any participant in a debt guarantee program established pursuant to section 13(c)(4)(G)(i) of the Federal Deposit Insurance Act defaults on any obligation guaranteed by the Corporation after the date of enactment of this Act, the Corporation shall—

(1) appoint itself as receiver for the insured depository institution that defaults; and

(2) with respect to any other participating company that is not an insured depository institution that defaults—

(A) require—

(i) consideration of whether a determination shall be made, as provided in section 203 to resolve the company under section 202; and

(ii) the company to file a petition for bankruptcy under section 301 of title 11, United States Code, if the Corporation is not appointed receiver pursuant to section 202 within 30 days of the date of default; or

(B) file a petition for involuntary bankruptcy on behalf of the company under section 303 of title 11, United States Code.

SEC. 1107. FEDERAL RESERVE ACT AMENDMENTS ON FEDERAL RESERVE BANK GOVERNANCE.

The 5th subparagraph of the 4th undesignated paragraph of section 4 of the Federal Reserve Act (12 U.S.C. 341) is amended by striking the 2nd sentence and inserting the following: "The president shall be the chief executive officer of the bank and shall be appointed by the Class B and Class C directors of the bank, with the approval of the Board of Governors of the Federal Reserve System, for a term of 5 years; and all other executive officers and all employees of the bank shall be directly responsible to the president.".

SEC. 1108. FEDERAL RESERVE ACT AMENDMENTS ON SUPERVISION AND REGULATION POLICY.

(a) ESTABLISHMENT OF THE POSITION OF VICE CHAIRMAN FOR SUPERVISION.—

(1) POSITION ESTABLISHED.—The second undesignated paragraph of section 10 of the Federal Reserve Act (12 U.S.C. 242) (relating to the Chairman and Vice Chairman of the Board) is amended by striking the third sentence and inserting the following: "Of the persons thus appointed, 1 shall be designated by the President, by and with the advice and consent of the Senate, to serve as Chairman of the Board for a term of 4 years, and 2 shall be designated by the President, by and with the advice and consent of the Senate, to serve as Vice Chairmen of the Board, each for a term of 4 years, 1 of whom shall serve in the absence of the Chairman, as provided in the fourth undesignated paragraph of this section, and 1 of whom shall be designated Vice Chairman for Supervision. The Vice Chairman for Supervision shall develop policy recommendations for the Board regarding supervision and regulation of depository institution holding companies and other financial firms supervised by the Board, and shall oversee the supervision and regulation of such firms.".

(2) EFFECTIVE DATE.—The amendment made by subsection (a) takes effect on the date of enactment of this title and applies to individuals who are designated by the President on or after that date to serve as Vice Chairman of Supervision.

(b) APPEARANCES BEFORE CONGRESS.—Section 10 of the Federal Reserve Act (12 U.S.C. 241 et seq.) is amended by adding at the end the following:

"(12) APPEARANCES BEFORE CONGRESS.—The Vice Chairman for Supervision shall appear before the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives and at semi-annual hearings regarding the efforts, activities, objectives, and plans of the Board with respect to the conduct of supervision and regulation of depository institution holding companies and other financial firms supervised by the Board.".

(c) BOARD RESPONSIBILITY TO SET SUPERVISION AND REGULATORY POLICY.—Section 11 of the Federal Reserve Act (12 U.S.C. 248) (relating to enumerated powers of the Board) is amended by adding at the end of subsection (k) (relating to delegation) the following: "The Board of Governors may not delegate to a Federal reserve bank its functions for the establishment of policies for the supervision and regulation of depository institution holding companies and other financial firms supervised by the Board of Governors.".

(d) EXERCISE OF FEDERAL RESERVE AUTHORITY.—

(1) NO DECISIONS BY FEDERAL RESERVE BANK PRESIDENTS.— No provision of title I relating to the authority of the Board of Governors shall be construed as conferring any decision-making authority on presidents of Federal reserve banks.

(2) VOTING DECISIONS BY BOARD.—The Board of Governors shall not delegate the authority to make any voting decision that the Board of Governors is authorized or required to make under title I of this Act in contravention of section 11(k) of the Federal Reserve Act.

SEC. 1109. GAO AUDIT OF THE FEDERAL RESERVE FACILITIES; PUBLICATION OF BOARD ACTIONS.

(a) GAO AUDIT.—

(1) IN GENERAL.—Notwithstanding section 714(b) of title 31, United States Code, or any other provision of law, the Comptroller General of the United States (in this subsection referred to as the "Comptroller General") shall conduct a one-time audit of all loans and other financial assistance provided during the period beginning on December 1, 2007 and ending on the date of enactment of this Act by the Board of Governors or a Federal reserve bank under the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Term Asset-Backed Securities Loan Facility, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, the Term Securities Lending Facility, the Term Auction Facility, Maiden Lane, Maiden Lane II, Maiden Lane III, the agency Mortgage-Backed Securities program, foreign currency liquidity swap lines, and any other program created as a result of section 13(3) of the Federal Reserve Act (as so designated by this title).

(2) ASSESSMENTS.—In conducting the audit under paragraph (1), the Comptroller General shall assess—

(A) the operational integrity, accounting, financial reporting, and internal controls of the credit facility;

(B) the effectiveness of the security and collateral policies established for the facility in mitigating risk to the relevant Federal reserve bank and taxpayers;

(C) whether the credit facility inappropriately favors one or more specific participants over other institutions eligible to utilize the facility;

(D) the policies governing the use, selection, or payment of third-party contractors by or for any credit facility; and

(E) whether there were conflicts of interest with respect to the manner in which such facility was established or operated.

(3) TIMING.—The audit required by this subsection shall be commenced not later than 30 days after the date of enactment of this Act, and shall be completed not later than 12 months after that date of enactment.

(4) REPORT REQUIRED.—The Comptroller General shall submit a report on the audit conducted under paragraph (1) to the Congress not later than 12 months after the date of enactment of this Act, and such report shall be made available to—

(A) the Speaker of the House of Representatives;

(B) the majority and minority leaders of the House of Representatives;

(C) the majority and minority leaders of the Senate;

(D) the Chairman and Ranking Member of the Committee on Banking, Housing, and Urban Affairs of the Senate and of the Committee on Financial Services of the House of Representatives; and

(E) any member of Congress who requests it.

(b) AUDIT OF FEDERAL RESERVE BANK GOVERNANCE.—

(1) AUDIT.—

(A) IN GENERAL.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall complete an audit of the governance of the Federal reserve bank system.

(B) REQUIRED EXAMINATIONS.—The audit required under subparagraph (A) shall—

(i) examine the extent to which the current system of appointing Federal reserve bank directors effectively represents "the public, without discrimination on the basis of race, creed, color, sex or national origin, and with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers" in the selection of bank directors, as such requirement is set forth under section 4 of the Federal Reserve Act;

(ii) examine whether there are actual or potential conflicts of interest created when the directors of Federal reserve banks, which execute the supervisory functions of the Board of Governors of the Federal Reserve System, are elected by member banks;

(iii) examine the establishment and operations of each facility described in subsection (a)(1) and each Federal reserve bank involved in the establishment and operations thereof; and

(iv) identify changes to selection procedures for Federal reserve bank directors, or to other aspects of Federal reserve bank governance, that would—

(I) improve how the public is represented;

(II) eliminate actual or potential conflicts of interest in bank supervision;

(III) increase the availability of information useful for the formation and execution of monetary policy; or

(IV) in other ways increase the effectiveness or efficiency of reserve banks.

(2) REPORT REQUIRED.—A report on the audit conducted under paragraph (1) shall be submitted by the Comptroller General to the Congress before the end of the 90-day period beginning on the date on which such audit is completed, and such report shall be made available to—

(A) the Speaker of the House of Representatives;

(B) the majority and minority leaders of the House of Representatives;

(C) the majority and minority leaders of the Senate;

(D) the Chairman and Ranking Member of the Committee on Banking, Housing, and Urban Affairs of the Senate and of the Committee on Financial Services of the House of Representatives; and

(E) any member of Congress who requests it.

(c) PUBLICATION OF BOARD ACTIONS.—Notwithstanding any other provision of law, the Board of Governors shall publish on its website, not later than December 1, 2010, with respect to all loans and other financial assistance provided during the period beginning on December 1, 2007 and ending on the date of enactment of this Act under the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Term Asset-Backed Securities Loan Facility, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, the Term Securities Lending Facility, the Term Auction Facility, Maiden Lane, Maiden Lane II, Maiden Lane III, the agency Mortgage-Backed Securities program, foreign currency liquidity swap lines, and any other program created as a result of section 13(3) of the Federal Reserve Act (as so designated by this title)—

(1) the identity of each business, individual, entity, or foreign central bank to which the Board of Governors or a Federal reserve bank has provided such assistance;

(2) the type of financial assistance provided to that business, individual, entity, or foreign central bank;

(3) the value or amount of that financial assistance;

(4) the date on which the financial assistance was provided;

(5) the specific terms of any repayment expected, including the repayment time period, interest charges, collateral, limitations on executive compensation or dividends, and other material terms; and

(6) the specific rationale for each such facility or program.

TITLE XII—IMPROVING ACCESS TO MAINSTREAM FINANCIAL INSTITUTIONS

SEC. 1201. SHORT TITLE.

This title may be cited as the "Improving Access to Mainstream Financial Institutions Act of 2010".

SEC. 1202. PURPOSE.

The purpose of this title is to encourage initiatives for financial products and services that are appropriate and accessible for millions of Americans who are not fully incorporated into the financial mainstream.

SEC. 1203. DEFINITIONS.

In this title, the following definitions shall apply:

(1) ACCOUNT.—The term "account" means an agreement between an individual and an eligible entity under which the individual obtains from or through the entity 1 or more banking products and services, and includes a deposit account, a savings

account (including a money market savings account), an account for a closed-end loan, and other products or services, as the Secretary deems appropriate.

(2) COMMUNITY DEVELOPMENT FINANCIAL INSTITUTION.—The term "community development financial institution" has the same meaning as in section 103(5) of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702(5)).

(3) ELIGIBLE ENTITY.—The term "eligible entity" means—

(A) an organization described in section 501(c)(3) of the Internal Revenue Code of 1986, and exempt from tax under section 501(a) of such Code;

(B) a federally insured depository institution;

(C) a community development financial institution;

(D) a State, local, or tribal government entity; or

(E) a partnership or other joint venture comprised of 1 or more of the entities described in subparagraphs (A) through (D), in accordance with regulations prescribed by the Secretary under this title.

(4) FEDERALLY INSURED DEPOSITORY INSTITUTION.—The term "federally insured depository institution" means any insured depository institution (as that term is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)) and any insured credit union (as that term is defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752)).

SEC. 1204. EXPANDED ACCESS TO MAINSTREAM FINANCIAL INSTITUTIONS.

(a) IN GENERAL.—The Secretary is authorized to establish a multiyear program of grants, cooperative agreements, financial agency agreements, and similar contracts or undertakings to promote initiatives designed—

(1) to enable low- and moderate-income individuals to establish one or more accounts in a federally insured depository institution that are appropriate to meet the financial needs of such individuals; and

(2) to improve access to the provision of accounts, on reasonable terms, for low- and moderate-income individuals.

(b) PROGRAM ELIGIBILITY AND ACTIVITIES.—

(1) IN GENERAL.—The Secretary shall restrict participation in any program established under subsection (a) to an eligible entity. Subject to regulations prescribed by the Secretary under this title, 1 or more eligible entities may participate in 1 or several programs established under subsection (a).

(2) ACCOUNT ACTIVITIES.—Subject to regulations prescribed by the Secretary, an eligible entity may, in participating in a program established under subsection (a), offer or provide to low- and moderate-income individuals products and services relating to accounts, including—

(A) small-dollar value loans; and

(B) financial education and counseling relating to conducting transactions in and managing accounts.

SEC. 1205. LOW-COST ALTERNATIVES TO SMALL DOLLAR LOANS.

(a) GRANTS AUTHORIZED.—The Secretary is authorized to establish multiyear demonstration programs by means of grants, cooperative agreements, financial agency agreements, and similar contracts or undertakings, with eligible entities to provide low-cost, small loans to consumers that will provide alternatives to more costly small dollar loans.

(b) TERMS AND CONDITIONS.—

(1) IN GENERAL.—Loans under this section shall be made on terms and conditions, and pursuant to lending practices, that are reasonable for consumers.

(2) FINANCIAL LITERACY AND EDUCATION OPPORTUNITIES.—

(A) IN GENERAL.—Each eligible entity awarded a grant under this section shall promote and take appropriate steps to ensure the provision of financial literacy and education opportunities, such as relevant counseling services, educational courses, or wealth building programs, to each consumer provided with a loan pursuant to this section.

(B) AUTHORITY TO EXPAND ACCESS.—As part of the grants, agreements, and undertakings established under this section, the Secretary may implement reasonable measures or programs designed to expand access to financial literacy and education opportunities, including relevant counseling services, educational courses, or wealth building programs to be provided to individuals who obtain loans from eligible entities under this section.

SEC. 1206. GRANTS TO ESTABLISH LOAN-LOSS RESERVE FUNDS.

The Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4701 et seq.) is amended by adding at the end the following:

"SEC. 122. GRANTS TO ESTABLISH LOAN-LOSS RESERVE FUNDS.

"(a) PURPOSES.—The purposes of this section are—

"(1) to make financial assistance available from the Fund in order to help community development financial institutions defray the costs of operating small dollar loan programs, by providing the amounts necessary for such institutions to establish their own loan loss reserve funds to mitigate some of the losses on such small dollar loan programs; and

"(2) to encourage community development financial institutions to establish and maintain small dollar loan programs that would help give consumers access to mainstream financial institutions and combat high cost small dollar lending.

"(b) GRANTS.—

"(1) LOAN-LOSS RESERVE FUND GRANTS.—The Fund shall make grants to community development financial institutions or to any partnership between such community development financial institutions and any other federally insured depository institution with a primary mission to serve targeted investment areas, as such areas are defined under section 103(16), to enable such institutions or any partnership of such institutions to establish a loan-loss reserve fund in order to defray the costs of a small dollar loan program established or maintained by such institution.

"(2) MATCHING REQUIREMENT.—A community development financial institution or any partnership of institutions established pursuant to paragraph (1) shall provide non-Federal matching funds in an amount equal to 50 percent of the amount of any grant received under this section.

"(3) USE OF FUNDS.—Any grant amounts received by a community development financial institution or any partnership between or among such institutions under paragraph (1)—

"(A) may not be used by such institution to provide direct loans to consumers;

"(B) may be used by such institution to help recapture a portion or all of a defaulted loan made under the small dollar loan program of such institution; and

"(C) may be used to designate and utilize a fiscal agent for services normally provided by such an agent.

"(4) TECHNICAL ASSISTANCE GRANTS.—The Fund shall make technical assistance grants to community development financial institutions or any partnership between or among such institutions to support and maintain a small dollar loan program. Any grant amounts received under this paragraph may be used for technology, staff support, and other costs associated with establishing a small dollar loan program.

"(c) DEFINITIONS.—For purposes of this section—

"(1) the term 'consumer reporting agency that compiles and maintains files on consumers on a nationwide basis' has the same meaning given such term in section 603(p) of the Fair Credit Reporting Act (15 U.S.C. 1681a(p)); and

"(2) the term 'small dollar loan program' means a loan program wherein a community development financial institution or any partnership between or among such institutions offers loans to consumers that—

"(A) are made in amounts not exceeding $2,500;

"(B) must be repaid in installments;

"(C) have no pre-payment penalty;

"(D) the institution has to report payments regarding the loan to at least 1 of the consumer reporting agencies that compiles and maintains files on consumers on a nationwide basis; and

"(E) meet any other affordability requirements as may be established by the Administrator.".

SEC. 1207. PROCEDURAL PROVISIONS.

An eligible entity desiring to participate in a program or obtain a grant under this title shall submit an application to the Secretary, in such form and containing such information as the Secretary may require.

SEC. 1208. AUTHORIZATION OF APPROPRIATIONS.

(a) AUTHORIZATION TO THE SECRETARY.—There are authorized to be appropriated to the Secretary, such sums as are necessary to both administer and fund the programs and projects authorized by this title, to remain available until expended.

(b) AUTHORIZATION TO THE FUND.—There is authorized to be appropriated to the Fund for each fiscal year beginning in fiscal year 2010, an amount equal to the amount of the administrative costs of the Fund for the operation of the grant program established under this title.

SEC. 1209. REGULATIONS.

(a) IN GENERAL.—The Secretary is authorized to promulgate regulations to implement and administer the grant programs and undertakings authorized by this title.

(b) REGULATORY AUTHORITY.—Regulations prescribed under this section may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of grant programs, undertakings, or eligible entities, as, in the judgment of the Secretary, are necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion of this title, or to facilitate compliance with this title.

SEC. 1210. EVALUATION AND REPORTS TO CONGRESS.

For each fiscal year in which a program or project is carried out under this title, the Secretary shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives containing a description of the activities funded, amounts distributed, and measurable results, as appropriate and available.

TITLE XIII—PAY IT BACK ACT

SEC. 1301. SHORT TITLE.

This title may be cited as the "Pay It Back Act".

SEC. 1302. AMENDMENT TO REDUCE TARP AUTHORIZATION.

Section 115(a) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5225(a)) is amended—

(1) in paragraph (3)—

(A) by striking ", $700,000,000,000, as such amount is reduced by $1,259,000,000, as such amount is reduced by $1,244,000,000" and inserting "$475,000,000,000"; and

(B) by striking "outstanding at any one time"; and

(2) by adding at the end the following:

"(4) For purposes of this subsection, the amount of authority considered to be exercised by the Secretary shall not be reduced by—

"(A) any amounts received by the Secretary before, on, or after the date of enactment of the Pay It Back Act from repayment of the principal of financial assistance by an entity that has received financial assistance under the TARP or any other program enacted by the Secretary under the authorities granted to the Secretary under this Act;

"(B) any amounts committed for any guarantees pursuant to the TARP that became or become uncommitted; or

"(C) any losses realized by the Secretary.

"(5) No authority under this Act may be used to incur any obligation for a program or initiative that was not initiated prior to June 25, 2010.".

SEC. 1303. REPORT.

Section 106 of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5216) is amended by inserting at the end the following:

"(f) REPORT.—The Secretary of the Treasury shall report to Congress every 6 months on amounts received and transferred to the general fund under subsection (d).".

SEC. 1304. AMENDMENTS TO HOUSING AND ECONOMIC RECOVERY ACT OF 2008.

(a) SALE OF FANNIE MAE OBLIGATIONS AND SECURITIES BY THE TREASURY; DEFICIT REDUCTION.—Section 304(g)(2) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1719(g)(2)) is amended—

(1) by redesignating subparagraph (C) as subparagraph (D); and

(2) by inserting after subparagraph (B) the following:

"(C) DEFICIT REDUCTION.—The Secretary of the Treasury shall deposit in the General Fund of the Treasury any amounts received by the Secretary from the sale of any obligation acquired by the Secretary under this subsection, where such amounts shall be—

"(i) dedicated for the sole purpose of deficit reduction; and

"(ii) prohibited from use as an offset for other spending increases or revenue reductions.".

(b) SALE OF FREDDIE MAC OBLIGATIONS AND SECURITIES BY THE TREASURY; DEFICIT REDUCTION.—Section 306(l)(2) of the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1455(l)(2)) is amended—

(1) by redesignating subparagraph (C) as subparagraph (D); and

(2) by inserting after subparagraph (B) the following:

"(C) DEFICIT REDUCTION.—The Secretary of the Treasury shall deposit in the General Fund of the Treasury any amounts received by the Secretary from the sale of any obligation acquired by the Secretary under this subsection, where such amounts shall be—

"(i) dedicated for the sole purpose of deficit reduction; and

"(ii) prohibited from use as an offset for other spending increases or revenue reductions.".

(c) SALE OF FEDERAL HOME LOAN BANKS OBLIGATIONS BY THE TREASURY; DEFICIT REDUCTION.—Section 11(l)(2) of the Federal Home Loan Bank Act (12 U.S.C. 1431(l)(2)) is amended—

(1) by redesignating subparagraph (C) as subparagraph (D); and

(2) by inserting after subparagraph (B) the following:

"(C) DEFICIT REDUCTION.—The Secretary of the Treasury shall deposit in the General Fund of the Treasury any amounts received by the Secretary from the sale of any obligation acquired by the Secretary under this subsection, where such amounts shall be—

"(i) dedicated for the sole purpose of deficit reduction; and

"(ii) prohibited from use as an offset for other spending increases or revenue reductions.".

(d) REPAYMENT OF FEES.—Any periodic commitment fee or any other fee or assessment paid by the Federal National Mortgage Association or Federal Home Loan Mortgage Corporation to the Secretary of the Treasury as a result of any preferred stock purchase agreement, mortgage-backed security purchase program, or any other program or activity authorized or carried out pursuant to the authorities granted to the Secretary of the Treasury under section 1117 of the Housing and Economic Recovery Act of 2008

(Public Law 110–289; 122 Stat. 2683), including any fee agreed to by contract between the Secretary and the Association or Corporation, shall be deposited in the General Fund of the Treasury where such amounts shall be—

(1) dedicated for the sole purpose of deficit reduction; and

(2) prohibited from use as an offset for other spending increases or revenue reductions.

SEC. 1305. FEDERAL HOUSING FINANCE AGENCY REPORT.

The Director of the Federal Housing Finance Agency shall submit to Congress a report on the plans of the Agency to continue to support and maintain the Nation's vital housing industry, while at the same time guaranteeing that the American taxpayer will not suffer unnecessary losses.

SEC. 1306. REPAYMENT OF UNOBLIGATED ARRA FUNDS.

(a) REJECTION OF ARRA FUNDS BY STATE.—Section 1607 of the American Recovery and Reinvestment Act of 2009 (Public Law 111–5; 123 Stat. 305) is amended by adding at the end the following:

"(d) STATEWIDE REJECTION OF FUNDS.—If funds provided to any State in any division of this Act are not accepted for use by the Governor of the State pursuant to subsection (a) or by the State legislature pursuant to subsection (b), then all such funds shall be—

"(1) rescinded; and

"(2) deposited in the General Fund of the Treasury where such amounts shall be—

"(A) dedicated for the sole purpose of deficit reduction; and

"(B) prohibited from use as an offset for other spending increases or revenue reductions.".

(b) WITHDRAWAL OR RECAPTURE OF UNOBLIGATED FUNDS.—Title XVI of the American Recovery and Reinvestment Act of 2009 (Public Law 111–5; 123 Stat. 302) is amended by adding at the end the following:

"SEC. 1613. WITHDRAWAL OR RECAPTURE OF UNOBLIGATED FUNDS.

"Notwithstanding any other provision of this Act, if the head of any executive agency withdraws or recaptures for any reason funds appropriated or otherwise made available under this division, and such funds have not been obligated by a State to a local government or for a specific project, such recaptured funds shall be—

"(1) rescinded; and

"(2) deposited in the General Fund of the Treasury where such amounts shall be—

"(A) dedicated for the sole purpose of deficit reduction; and

"(B) prohibited from use as an offset for other spending increases or revenue reductions.".

(c) RETURN OF UNOBLIGATED FUNDS BY END OF 2012.—Section 1603 of the American Recovery and Reinvestment Act of 2009 (Public Law 111–5; 123 Stat. 302) is amended by—

(1) striking "All funds" and inserting "(a) IN GENERAL.—All funds"; and

(2) adding at the end the following:

"(b) REPAYMENT OF UNOBLIGATED FUNDS.—Any discretionary appropriations made available in this division that have not been obligated as of December 31, 2012, are hereby rescinded, and such amounts shall be deposited in the General Fund of the Treasury where such amounts shall be—

"(1) dedicated for the sole purpose of deficit reduction; and

"(2) prohibited from use as an offset for other spending increases or revenue reductions.

"(c) PRESIDENTIAL WAIVER AUTHORITY.—

"(1) IN GENERAL.—The President may waive the requirements under subsection (b), if the President determines that it is not in the best interest of the Nation to rescind a specific unobligated amount after December 31, 2012.

"(2) REQUESTS.—The head of an executive agency may also apply to the President for a waiver from the requirements under subsection (b).".

TITLE XIV—MORTGAGE REFORM AND ANTI-PREDATORY LENDING ACT

SEC. 1400. SHORT TITLE; DESIGNATION AS ENUMERATED CONSUMER LAW.

(a) SHORT TITLE.—This title may be cited as the "Mortgage Reform and Anti-Predatory Lending Act".

(b) DESIGNATION AS ENUMERATED CONSUMER LAW UNDER THE PURVIEW OF THE BUREAU OF CONSUMER FINANCIAL PROTECTION.—Subtitles A, B, C, and E and sections 1471, 1472, 1475, and 1476, and the amendments made by such subtitles and sections, shall be enumerated consumer laws, as defined in section 1002, and come under the purview of the Bureau of Consumer Financial Protection for purposes of title X, including the transfer of functions and personnel under subtitle F of title X and the savings provisions of such subtitle.

(c) REGULATIONS; EFFECTIVE DATE.—

(1) REGULATIONS.—The regulations required to be prescribed under this title or the amendments made by this title shall—

(A) be prescribed in final form before the end of the 18-month period beginning on the designated transfer date; and

(B) take effect not later than 12 months after the date of issuance of the regulations in final form.

(2) EFFECTIVE DATE ESTABLISHED BY RULE.—Except as provided in paragraph (3), a section, or provision thereof, of this title shall take effect on the date on which the final regulations implementing such section, or provision, take effect.

(3) EFFECTIVE DATE.—A section of this title for which regulations have not been issued on the date that is 18 months after the designated transfer date shall take effect on such date.

Subtitle A—Residential Mortgage Loan Origination Standards

SEC. 1401. DEFINITIONS.

Section 103 of the Truth in Lending Act (15 U.S.C. 1602) is amended by adding at the end the following new subsection:

"(cc) DEFINITIONS RELATING TO MORTGAGE ORIGINATION AND RESIDENTIAL MORTGAGE LOANS.—

"(1) COMMISSION.—Unless otherwise specified, the term 'Commission' means the Federal Trade Commission.

"(2) MORTGAGE ORIGINATOR.—The term 'mortgage originator'—

"(A) means any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain—

"(i) takes a residential mortgage loan application;

"(ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or

"(iii) offers or negotiates terms of a residential mortgage loan;

"(B) includes any person who represents to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items), that such person can or will provide any of the services or perform any of the activities described in subparagraph (A);

"(C) does not include any person who is (i) not otherwise described in subparagraph (A) or (B) and who performs purely administrative or clerical tasks on behalf of a person who is described in any such subparagraph, or (ii) an employee of a retailer of manufactured homes who is not described in clause (i) or (iii) of subparagraph (A) and who does not advise a consumer on loan terms (including rates, fees, and other costs);

"(D) does not include a person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with applicable State law, unless such person or entity is compensated by a lender, a mortgage broker, or other mortgage originator or by any agent of such lender, mortgage broker, or other mortgage originator;

"(E) does not include, with respect to a residential mortgage loan, a person, estate, or trust that provides mortgage financing for the sale of 3 properties in any 12-month period to purchasers of such properties, each of which is owned by such person, estate, or trust and serves as security for the loan, provided that such loan—

"(i) is not made by a person, estate, or trust that has constructed, or acted as a contractor for the construction of, a residence on the property in the ordinary course of business of such person, estate, or trust;

"(ii) is fully amortizing;

"(iii) is with respect to a sale for which the seller determines in good faith and documents that the buyer has a reasonable ability to repay the loan;

"(iv) has a fixed rate or an adjustable rate that is adjustable after 5 or more years, subject to reasonable annual and lifetime limitations on interest rate increases; and

"(v) meets any other criteria the Board may prescribe;

"(F) does not include the creditor (except the creditor in a table-funded transaction) under paragraph (1), (2), or (4) of section 129B(c); and

"(G) does not include a servicer or servicer employees, agents and contractors, including but not limited to those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying, replacing and subordinating principal of existing mortgages where borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind.

"(3) NATIONWIDE MORTGAGE LICENSING SYSTEM AND REGISTRY.—The term 'Nationwide Mortgage Licensing System and Registry' has the same meaning as in the Secure and Fair Enforcement for Mortgage Licensing Act of 2008.

"(4) OTHER DEFINITIONS RELATING TO MORTGAGE ORIGINATOR.—For purposes of this subsection, a person 'assists a consumer in obtaining or applying to obtain a residential mortgage loan' by, among other things, advising on residential mortgage loan terms (including rates, fees, and other costs), preparing residential mortgage loan packages, or collecting information on behalf of the consumer with regard to a residential mortgage loan.

"(5) RESIDENTIAL MORTGAGE LOAN.—The term 'residential mortgage loan' means any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling, other than a consumer credit transaction under an open end credit plan or, for purposes of sections 129B and 129C and section 128(a) (16), (17), (18), and (19), and sections 128(f) and 130(k), and any regulations promulgated thereunder, an extension of credit relating to a plan described in section 101(53D) of title 11, United States Code.

"(6) SECRETARY.—The term 'Secretary', when used in connection with any transaction or person involved with a residential mortgage loan, means the Secretary of Housing and Urban Development.

"(7) SERVICER.—The term 'servicer' has the same meaning as in section 6(i)(2) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2605(i)(2)).".

SEC. 1402. RESIDENTIAL MORTGAGE LOAN ORIGINATION.

(a) IN GENERAL.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended—

(1) by redesignating the 2nd of the 2 sections designated as section 129 (15 U.S.C. 1639a) (relating to duty of servicers of residential mortgages) as section 129A; and

(2) by inserting after section 129A (as so redesignated) the following new section:

"§ 129B. Residential mortgage loan origination

"(a) FINDING AND PURPOSE.—

"(1) FINDING.—The Congress finds that economic stabilization would be enhanced by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit, while ensuring that responsible, affordable mortgage credit remains available to consumers.

"(2) PURPOSE.—It is the purpose of this section and section 129C to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive or abusive.

"(b) DUTY OF CARE.—

"(1) STANDARD.—Subject to regulations prescribed under this subsection, each mortgage originator shall, in addition to the duties imposed by otherwise applicable provisions of State or Federal law—

"(A) be qualified and, when required, registered and licensed as a mortgage originator in accordance with applicable State or Federal law, including the Secure and Fair Enforcement for Mortgage Licensing Act of 2008; and

"(B) include on all loan documents any unique identifier of the mortgage originator provided by the Nationwide Mortgage Licensing System and Registry.

"(2) COMPLIANCE PROCEDURES REQUIRED.—The Board shall prescribe regulations requiring depository institutions to establish and maintain procedures reasonably designed to assure and monitor the compliance of such depository institutions, the subsidiaries of such institutions, and the employees of such institutions or subsidiaries with the requirements of this section and the registration procedures established under section 1507 of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 129 the following new items:

"129A. Fiduciary duty of servicers of pooled residential mortgages.
"129B. Residential mortgage loan origination.".

SEC. 1403. PROHIBITION ON STEERING INCENTIVES.

Section 129B of the Truth in Lending Act (as added by section 1402(a)) is amended by inserting after subsection (b) the following new subsection:

"(c) PROHIBITION ON STEERING INCENTIVES.—

"(1) IN GENERAL.—For any residential mortgage loan, no mortgage originator shall receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal).

"(2) RESTRUCTURING OF FINANCING ORIGINATION FEE.—

"(A) IN GENERAL.—For any mortgage loan, a mortgage originator may not receive from any person other than the consumer and no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator may pay a mortgage originator any origination fee or charge except bona fide third party charges not retained by the creditor, mortgage originator, or an affiliate of the creditor or mortgage originator .

"(B) EXCEPTION.—Notwithstanding subparagraph (A), a mortgage originator may receive from a person other than the consumer an origination fee or charge, and a person other than the consumer may pay a mortgage originator an origination fee or charge, if—

"(i) the mortgage originator does not receive any compensation directly from the consumer; and

"(ii) the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator), except that the Board may, by rule, waive or provide exemptions to this clause if the Board determines that such waiver or exemption is in the interest of consumers and in the public interest.

"(3) REGULATIONS.—The Board shall prescribe regulations to prohibit—

"(A) mortgage originators from steering any consumer to a residential mortgage loan that—

"(i) the consumer lacks a reasonable ability to repay (in accordance with regulations prescribed under section 129C(a)); or

"(ii) has predatory characteristics or effects (such as equity stripping, excessive fees, or abusive terms);

"(B) mortgage originators from steering any consumer from a residential mortgage loan for which the consumer is qualified that is a qualified mortgage (as defined in section 129C(b)(2)) to a residential mortgage loan that is not a qualified mortgage;

"(C) abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender, or age; and

"(D) mortgage originators from—

"(i) mischaracterizing the credit history of a consumer or the residential mortgage loans available to a consumer;

"(ii) mischaracterizing or suborning the mischaracterization of the appraised value of the property securing the extension of credit; or

"(iii) if unable to suggest, offer, or recommend to a consumer a loan that is not more expensive than a loan for which the consumer qualifies, discouraging a consumer from seeking a residential mortgage loan secured by a consumer's principal dwelling from another mortgage originator.

"(4) RULES OF CONSTRUCTION.—No provision of this subsection shall be construed as—

"(A) permitting any yield spread premium or other similar compensation that would, for any residential mortgage loan, permit the total amount of direct and indirect compensation from all sources permitted to a mortgage originator to vary based on the terms of the loan (other than the amount of the principal);

"(B) limiting or affecting the amount of compensation received by a creditor upon the sale of a consummated loan to a subsequent purchaser;

"(C) restricting a consumer's ability to finance, at the option of the consumer, including through principal or rate, any origination fees or costs permitted under this subsection, or the mortgage originator's right to receive such fees or costs (including compensation) from any person, subject to paragraph (2)(B), so long as such fees or costs do not vary based on the terms of the loan (other than the amount of the principal) or the consumer's decision about whether to finance such fees or costs; or

"(D) prohibiting incentive payments to a mortgage originator based on the number of residential mortgage loans originated within a specified period of time.".

SEC. 1404. LIABILITY.

Section 129B of the Truth in Lending Act is amended by inserting after subsection (c) (as added by section 1403) the following new subsection:

"(d) LIABILITY FOR VIOLATIONS.—

"(1) IN GENERAL.—For purposes of providing a cause of action for any failure by a mortgage originator, other than a creditor, to comply with any requirement imposed under this section and any regulation prescribed under this section, section 130 shall be applied with respect to any such failure by substituting 'mortgage originator' for 'creditor' each place such term appears in each such subsection.

"(2) MAXIMUM.—The maximum amount of any liability of a mortgage originator under paragraph (1) to a consumer for any violation of this section shall not exceed the greater of actual damages or an amount equal to 3 times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the residential mortgage loan involved in the violation, plus the costs to the consumer of the action, including a reasonable attorney's fee.".

SEC. 1405. REGULATIONS.

(a) DISCRETIONARY REGULATORY AUTHORITY.—Section 129B of the Truth in Lending Act is amended by inserting after subsection (d) (as added by section 1404) the following new subsection:

"(e) DISCRETIONARY REGULATORY AUTHORITY.—

"(1) IN GENERAL.—The Board shall, by regulations, prohibit or condition terms, acts or practices relating to residential mortgage loans that the Board finds to be abusive, unfair, deceptive, predatory, necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section and section 129C, necessary or proper to effectuate the purposes of this section and section 129C, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections, or are not in the interest of the borrower.

"(2) APPLICATION.—The regulations prescribed under paragraph (1) shall be applicable to all residential mortgage loans and shall be applied in the same manner as regulations prescribed under section 105.

"(f) Section 129B and any regulations promulgated thereunder do not apply to an extension of credit relating to a plan described in section 101(53D) of title 11, United States Code.".

(b) DISCLOSURES.—Notwithstanding any other provision of this title, in order to improve consumer awareness and understanding of transactions involving residential mortgage loans through the use of disclosures, the Board may, by rule, exempt from or modify disclosure requirements, in whole or in part, for any class of residential mortgage loans if the Board determines that such exemption or modification is in the interest of consumers and in the public interest.

SEC. 1406. STUDY OF SHARED APPRECIATION MORTGAGES.

(a) STUDY.—The Secretary of Housing and Urban Development, in consultation with the Secretary of the Treasury and other relevant agencies, shall conduct a comprehensive study to determine prudent statutory and regulatory requirements sufficient to provide for the widespread use of shared appreciation mortgages to strengthen local housing markets, provide new opportunities for affordable homeownership, and enable homeowners at risk of foreclosure to refinance or modify their mortgages.

(b) REPORT.—Not later than the expiration of the 6-month period beginning on the date of the enactment of this Act, the Secretary of Housing and Urban Development shall submit a report to the Congress on the results of the study, which shall include recommendations for the regulatory and legislative requirements referred to in subsection (a).

Subtitle B—Minimum Standards For Mortgages

SEC. 1411. ABILITY TO REPAY.

(a) IN GENERAL.—

(1) RULE OF CONSTRUCTION.—No regulation, order, or guidance issued by the Bureau under this title shall be construed as requiring a depository institution to apply mortgage underwriting standards that do not meet the minimum underwriting standards required by the appropriate prudential regulator of the depository institution.

(2) AMENDMENT TO TRUTH IN LENDING ACT.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 129B (as added by section 1402(a)) the following new section:

"§ 129C. Minimum standards for residential mortgage loans

"(a) ABILITY TO REPAY.—

"(1) IN GENERAL.—In accordance with regulations prescribed by the Board, no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.

"(2) MULTIPLE LOANS.—If the creditor knows, or has reason to know, that 1 or more residential mortgage loans secured by the same dwelling will be made to the same consumer, the creditor shall make a reasonable and good faith determination, based on verified and documented information, that the consumer has a reasonable ability to repay the combined payments of all loans on the same dwelling according to the terms of those loans and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.

"(3) BASIS FOR DETERMINATION.—A determination under this subsection of a consumer's ability to repay a residential mortgage loan shall include consideration of the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling or real property that secures repayment of the loan. A creditor shall determine the ability of the consumer to repay using a payment schedule that fully amortizes the loan over the term of the loan.

"(4) INCOME VERIFICATION.—A creditor making a residential mortgage loan shall verify amounts of income or assets that such creditor relies on to determine repayment ability, including expected income or assets, by reviewing the consumer's Internal Revenue Service Form W–2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets. In order to safeguard against fraudulent reporting, any consideration of a consumer's income history in making a determination under this subsection shall include the verification of such income by the use of—

"(A) Internal Revenue Service transcripts of tax returns; or

"(B) a method that quickly and effectively verifies income documentation by a third party subject to rules prescribed by the Board.

"(5) EXEMPTION.—With respect to loans made, guaranteed, or insured by Federal departments or agencies identified in subsection (b)(3)(B)(ii), such departments or agencies may exempt refinancings under a streamlined refinancing from this income verification requirement as long as the following conditions are met:

"(A) The consumer is not 30 days or more past due on the prior existing residential mortgage loan.

"(B) The refinancing does not increase the principal balance outstanding on the prior existing residential mortgage loan, except to the extent of fees and charges allowed by the department or agency making, guaranteeing, or insuring the refinancing.

"(C) Total points and fees (as defined in section 103(aa)(4), other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator) payable in connection with the refinancing do not exceed 3 percent of the total new loan amount.

"(D) The interest rate on the refinanced loan is lower than the interest rate of the original loan, unless the borrower is refinancing from an adjustable rate to a fixed-rate loan, under guidelines that the department or agency shall establish for loans they make, guarantee, or issue.

"(E) The refinancing is subject to a payment schedule that will fully amortize the refinancing in accordance with the regulations prescribed by the department or agency making, guaranteeing, or insuring the refinancing.

"(F) The terms of the refinancing do not result in a balloon payment, as defined in subsection (b)(2)(A)(ii).

"(G) Both the residential mortgage loan being refinanced and the refinancing satisfy all requirements of the department or agency making, guaranteeing, or insuring the refinancing.

"(6) NONSTANDARD LOANS.—

"(A) VARIABLE RATE LOANS THAT DEFER REPAYMENT OF ANY PRINCIPAL OR INTEREST.—For purposes of determining, under this subsection, a consumer's ability to repay a variable rate residential mortgage loan that allows or requires the consumer to defer the repayment of any principal or interest, the creditor shall use a fully amortizing repayment schedule.

"(B) INTEREST-ONLY LOANS.—For purposes of determining, under this subsection, a consumer's ability to repay a residential mortgage loan that permits or requires the payment of interest only, the creditor shall use the payment amount required to amortize the loan by its final maturity.

"(C) CALCULATION FOR NEGATIVE AMORTIZATION.—In making any determination under this subsection, a creditor shall also take into consideration any balance increase that may accrue from any negative amortization provision.

"(D) CALCULATION PROCESS.—For purposes of making any determination under this subsection, a creditor shall calculate the monthly payment amount for principal and interest on any residential mortgage loan by assuming—

"(i) the loan proceeds are fully disbursed on the date of the consummation of the loan;

"(ii) the loan is to be repaid in substantially equal monthly amortizing payments for principal and interest over the entire term of the loan with no balloon payment, unless the loan contract requires more rapid repayment (including balloon payment), in which case the calculation shall be made (I) in accordance with regulations prescribed by the Board, with respect to any loan which has an annual percentage rate that does not exceed the average prime offer rate for a comparable transaction, as of the date the interest rate is set, by 1.5 or more percentage points for a first lien residential mortgage loan; and by 3.5 or more percentage points for a subordinate lien residential mortgage loan; or (II) using the contract's repayment schedule, with respect to a loan which has an annual percentage rate, as of the date the interest rate is set, that is at least 1.5 percentage points above the average prime offer rate for a first lien residential mortgage loan; and 3.5 percentage points above the average prime offer rate for a subordinate lien residential mortgage loan; and "(iii) the interest rate over the entire term of the loan is a fixed rate equal to the fully indexed rate at the time of the loan closing, without considering the introductory rate.

"(E) REFINANCE OF HYBRID LOANS WITH CURRENT LENDER.—In considering any application for refinancing an existing hybrid loan by the creditor into a standard loan to be made by the same creditor in any case in which there would be a reduction in monthly payment and the mortgagor has not been delinquent on any payment on the existing hybrid loan, the creditor may—

"(i) consider the mortgagor's good standing on the existing mortgage;

"(ii) consider if the extension of new credit would prevent a likely default should the original mortgage reset and give such concerns a higher priority as an acceptable underwriting practice; and

"(iii) offer rate discounts and other favorable terms to such mortgagor that would be available to new customers with high credit ratings based on such underwriting practice.

"(7) FULLY-INDEXED RATE DEFINED.—For purposes of this subsection, the term 'fully indexed rate' means the index rate prevailing on a residential mortgage loan at the time the loan is made plus the margin that will apply after the expiration of any introductory interest rates.

"(8) REVERSE MORTGAGES AND BRIDGE LOANS.—This subsection shall not apply with respect to any reverse mortgage or temporary or bridge loan with a term of 12 months or less, including to any loan to purchase a new dwelling where the consumer plans to sell a different dwelling within 12 months.

"(9) SEASONAL INCOME.—If documented income, including income from a small business, is a repayment source for a residential mortgage loan, a creditor may consider the seasonality and irregularity of such income in the underwriting of and scheduling of payments for such credit.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 129B (as added by section 1402(b)) the following new item:

"129C. Minimum standards for residential mortgage loans.".

SEC. 1412. SAFE HARBOR AND REBUTTABLE PRESUMPTION.

Section 129C of the Truth in Lending Act is amended by inserting after subsection (a) (as added by section 1411) the following new subsection:

"(b) PRESUMPTION OF ABILITY TO REPAY.—

"(1) IN GENERAL.—Any creditor with respect to any residential mortgage loan, and any assignee of such loan subject to liability under this title, may presume that the loan has met the requirements of subsection (a), if the loan is a qualified mortgage.

"(2) DEFINITIONS.—For purposes of this subsection, the following definitions shall apply:

"(A) QUALIFIED MORTGAGE.—The term 'qualified mortgage' means any residential mortgage loan—

“(i) for which the regular periodic payments for the loan may not—

“(I) result in an increase of the principal balance; or

“(II) except as provided in subparagraph (E), allow the consumer to defer repayment of principal;

“(ii) except as provided in subparagraph (E), the terms of which do not result in a balloon payment, where a ‘balloon payment’ is a scheduled payment that is more than twice as large as the average of earlier scheduled payments;

“(iii) for which the income and financial resources relied upon to qualify the obligors on the loan are verified and documented;

“(iv) in the case of a fixed rate loan, for which the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;

“(v) in the case of an adjustable rate loan, for which the underwriting is based on the maximum rate permitted under the loan during the first 5 years, and a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance, and assessments;

“(vi) that complies with any guidelines or regulations established by the Board relating to ratios of total monthly debt to monthly income or alternative measures of ability to pay regular expenses after payment of total monthly debt, taking into account the income levels of the borrower and such other factors as the Board may determine relevant and consistent with the purposes described in paragraph (3)(B)(i);

“(vii) for which the total points and fees (as defined in subparagraph (C)) payable in connection with the loan do not exceed 3 percent of the total loan amount;

“(viii) for which the term of the loan does not exceed 30 years, except as such term may be extended under paragraph (3), such as in high-cost areas; and

“(ix) in the case of a reverse mortgage (except for the purposes of subsection (a) of section 129C, to the extent that such mortgages are exempt altogether from those requirements), a reverse mortgage which meets the standards for a qualified mortgage, as set by the Board in rules that are consistent with the purposes of this subsection.

“(B) AVERAGE PRIME OFFER RATE.—The term ‘average prime offer rate’ means the average prime offer rate for a comparable transaction as of the date on which the interest rate for the transaction is set, as published by the Board..

“(C) POINTS AND FEES.—

“(i) IN GENERAL.—For purposes of subparagraph (A), the term ‘points and fees’ means points and fees as defined by section 103(aa)(4) (other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator).

"(ii) COMPUTATION.—For purposes of computing the total points and fees under this subparagraph, the total points and fees shall exclude either of the amounts described in the following subclauses, but not both:

"(I) Up to and including 2 bona fide discount points payable by the consumer in connection with the mortgage, but only if the interest rate from which the mortgage's interest rate will be discounted does not exceed by more than 1 percentage point the average prime offer rate.

"(II) Unless 2 bona fide discount points have been excluded under subclause (I), up to and including 1 bona fide discount point payable by the consumer in connection with the mortgage, but only if the interest rate from which the mortgage's interest rate will be discounted does not exceed by more than 2 percentage points the average prime offer rate.

"(iii) BONA FIDE DISCOUNT POINTS DEFINED.—For purposes of clause (ii), the term 'bona fide discount points' means loan discount points which are knowingly paid by the consumer for the purpose of reducing, and which in fact result in a bona fide reduction of, the interest rate or time-price differential applicable to the mortgage.

"(iv) INTEREST RATE REDUCTION.—Subclauses (I) and (II) of clause (ii) shall not apply to discount points used to purchase an interest rate reduction unless the amount of the interest rate reduction purchased is reasonably consistent with established industry norms and practices for secondary mortgage market transactions.

"(D) SMALLER LOANS.—The Board shall prescribe rules adjusting the criteria under subparagraph (A)(vii) in order to permit lenders that extend smaller loans to meet the requirements of the presumption of compliance under paragraph (1). In prescribing such rules, the Board shall consider the potential impact of such rules on rural areas and other areas where home values are lower.

"(E) BALLOON LOANS.—The Board may, by regulation, provide that the term 'qualified mortgage' includes a balloon loan—

"(i) that meets all of the criteria for a qualified mortgage under subparagraph (A) (except clauses (i)(II), (ii), (iv), and (v) of such subparagraph);

"(ii) for which the creditor makes a determination that the consumer is able to make all scheduled payments, except the balloon payment, out of income or assets other than the collateral;

"(iii) for which the underwriting is based on a payment schedule that fully amortizes the loan over a period of not more than 30 years and takes into account all applicable taxes, insurance, and assessments; and

"(iv) that is extended by a creditor that—

"(I) operates predominantly in rural or underserved areas;

"(II) together with all affiliates, has total annual residential mortgage loan originations that do not exceed a limit set by the Board;

"(III) retains the balloon loans in portfolio; and

"(IV) meets any asset size threshold and any other criteria as the Board may establish, consistent with the purposes of this subtitle.

"(3) REGULATIONS.—

"(A) IN GENERAL.—The Board shall prescribe regulations to carry out the purposes of this subsection.

"(B) REVISION OF SAFE HARBOR CRITERIA.—

"(i) IN GENERAL.—The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.

"(ii) LOAN DEFINITION.—The following agencies shall, in consultation with the Board, prescribe rules defining the types of loans they insure, guarantee, or administer, as the case may be, that are qualified mortgages for purposes of paragraph (2)(A), and such rules may revise, add to, or subtract from the criteria used to define a qualified mortgage under paragraph (2)(A), upon a finding that such rules are consistent with the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections:

"(I) The Department of Housing and Urban Development, with regard to mortgages insured under the National Housing Act (12 U.S.C. 1707 et seq.).

"(II) The Department of Veterans Affairs, with regard to a loan made or guaranteed by the Secretary of Veterans Affairs.

"(III) The Department of Agriculture, with regard loans guaranteed by the Secretary of Agriculture pursuant to 42 U.S.C. 1472(h).

"(IV) The Rural Housing Service, with regard to loans insured by the Rural Housing Service.".

SEC. 1413. DEFENSE TO FORECLOSURE.

Section 130 of the Truth in Lending Act (15 U.S.C. 1640) is amended by adding at the end the following new subsection:

"(k) DEFENSE TO FORECLOSURE.—

"(1) IN GENERAL.—Notwithstanding any other provision of law, when a creditor, assignee, or other holder of a residential mortgage loan or anyone acting on behalf of such creditor, assignee, or holder, initiates a judicial or nonjudicial foreclosure of the residential mortgage loan, or any other action to collect the debt in connection with such loan, a consumer may assert a violation by a creditor of paragraph (1) or (2) of section 129B(c), or of section 129C(a), as a matter of defense by recoupment or set off without regard for the time limit on a private action for damages under subsection (e).

"(2) AMOUNT OF RECOUPMENT OR SETOFF.—

"(A) IN GENERAL.—The amount of recoupment or set-off under paragraph (1) shall equal the amount to which the consumer would be entitled under subsection (a) for damages for a valid claim brought in an original action against the creditor, plus the costs to the consumer of the action, including a reasonable attorney's fee.

"(B) SPECIAL RULE.—Where such judgment is rendered after the expiration of the applicable time limit on a private action for damages under subsection (e), the amount of recoupment or set-off under paragraph (1) derived from damages under subsection (a)(4) shall not exceed the amount to which the consumer would have been entitled under subsection (a)(4) for damages computed up to the day preceding the expiration of the applicable time limit.".

SEC. 1414. ADDITIONAL STANDARDS AND REQUIREMENTS.

(a) IN GENERAL.—Section 129C of the Truth in Lending Act is amended by inserting after subsection (b) (as added by this title) the following new subsections:

"(c) PROHIBITION ON CERTAIN PREPAYMENT PENALTIES.—

"(1) PROHIBITED ON CERTAIN LOANS.—

"(A) IN GENERAL.—A residential mortgage loan that is not a 'qualified mortgage', as defined under subsection (b)(2), may not contain terms under which a consumer must pay a prepayment penalty for paying all or part of the principal after the loan is consummated.

"(B) EXCLUSIONS.—For purposes of this subsection, a 'qualified mortgage' may not include a residential mortgage loan that—

"(i) has an adjustable rate; or

"(ii) has an annual percentage rate that exceeds the average prime offer rate for a comparable transaction, as of the date the interest rate is set—

"(I) by 1.5 or more percentage points, in the case of a first lien residential mortgage loan having a original principal obligation amount that is equal to or less than the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the 6th sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2));

"(II) by 2.5 or more percentage points, in the case of a first lien residential mortgage loan having a original principal obligation amount that is more than the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the 6th sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)); and

"(III) by 3.5 or more percentage points, in the case of a subordinate lien residential mortgage loan.

"(2) PUBLICATION OF AVERAGE PRIME OFFER RATE AND APR THRESHOLDS.—The Board—

"(A) shall publish, and update at least weekly, average prime offer rates;

"(B) may publish multiple rates based on varying types of mortgage transactions; and

"(C) shall adjust the thresholds established under subclause (I), (II), and (III) of paragraph (1)(B)(ii) as necessary to reflect significant changes in market conditions and to effectuate the purposes of the Mortgage Reform and Anti-Predatory Lending Act.

"(3) PHASED-OUT PENALTIES ON QUALIFIED MORTGAGES.—A qualified mortgage (as defined in subsection (b)(2)) may not contain terms under which a consumer must pay a prepayment penalty for paying all or part of the principal after the loan is consummated in excess of the following limitations:

"(A) During the 1-year period beginning on the date the loan is consummated, the prepayment penalty shall not exceed an amount equal to 3 percent of the outstanding balance on the loan.

"(B) During the 1-year period beginning after the period described in subparagraph (A), the prepayment penalty shall not exceed an amount equal to 2 percent of the outstanding balance on the loan.

"(C) During the 1-year period beginning after the 1-year period described in subparagraph (B), the prepayment penalty shall not exceed an amount equal to 1 percent of the outstanding balance on the loan.

"(D) After the end of the 3-year period beginning on the date the loan is consummated, no prepayment penalty may be imposed on a qualified mortgage.

"(4) OPTION FOR NO PREPAYMENT PENALTY REQUIRED.—A creditor may not offer a consumer a residential mortgage loan product that has a prepayment penalty for paying all or part of the principal after the loan is consummated as a term of the loan without offering the consumer a residential mortgage loan product that does not have a prepayment penalty as a term of the loan.

"(d) SINGLE PREMIUM CREDIT INSURANCE PROHIBITED.—No creditor may finance, directly or indirectly, in connection with any residential mortgage loan or with any extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer, any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life, or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract, except that—

"(1) insurance premiums or debt cancellation or suspension fees calculated and paid in full on a monthly basis shall not be considered financed by the creditor; and

"(2) this subsection shall not apply to credit unemployment insurance for which the unemployment insurance premiums are reasonable, the creditor receives no direct or indirect compensation in connection with the unemployment insurance premiums, and the unemployment insurance premiums are paid pursuant to another insurance contract and not paid to an affiliate of the creditor.

"(e) ARBITRATION.—

"(1) IN GENERAL.—No residential mortgage loan and no extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer may include terms which require arbitration or any other nonjudicial procedure as the method for resolving any controversy or settling any claims arising out of the transaction.

"(2) POST-CONTROVERSY AGREEMENTS.—Subject to paragraph (3), paragraph (1) shall not be construed as limiting the right of the consumer and the creditor or any assignee to agree to arbitration or any other nonjudicial procedure as the method for resolving any controversy at any time after a dispute or claim under the transaction arises.

"(3) NO WAIVER OF STATUTORY CAUSE OF ACTION.—No provision of any residential mortgage loan or of any extension of credit under an open end consumer credit plan secured by the principal dwelling of the consumer, and no other agreement between the consumer and the creditor relating to the residential mortgage loan or extension of credit referred to in paragraph (1), shall be applied or interpreted so as to bar a consumer from bringing an action in an appropriate district court of the United States, or any other court of competent jurisdiction, pursuant to section 130 or any other provision of law, for damages or other relief in connection with any alleged violation of this section, any other provision of this title, or any other Federal law.

"(f) MORTGAGES WITH NEGATIVE AMORTIZATION.—No creditor may extend credit to a borrower in connection with a consumer credit transaction under an open or closed end consumer credit plan secured by a dwelling or residential real property that includes a dwelling, other than a reverse mortgage, that provides or permits a payment plan that may, at any time over the term of the extension of credit, result in negative amortization unless, before such transaction is consummated—

"(1) the creditor provides the consumer with a statement that—

"(A) the pending transaction will or may, as the case may be, result in negative amortization;

"(B) describes negative amortization in such manner as the Board shall prescribe;

"(C) negative amortization increases the outstanding principal balance of the account; and

"(D) negative amortization reduces the consumer's equity in the dwelling or real property; and

"(2) in the case of a first-time borrower with respect to a residential mortgage loan that is not a qualified mortgage, the first-time borrower provides the creditor with sufficient documentation to demonstrate that the consumer received homeownership counseling from organizations or counselors certified by the Secretary of Housing and Urban Development as competent to provide such counseling.''.

(b) CONFORMING AMENDMENT RELATING TO ENFORCEMENT.—Section 108(a) of the Truth in Lending Act (15 U.S.C. 1607(a)) is amended by inserting after paragraph (6) the following new paragraph:

''(7) sections 21B and 21C of the Securities Exchange Act of 1934, in the case of a broker or dealer, other than a depository institution, by the Securities and Exchange Commission.''.

(c) PROTECTION AGAINST LOSS OF ANTI-DEFICIENCY PROTECTION.—Section 129C of the Truth in Lending Act is amended by inserting after subsection (f) (as added by subsection (a)) the following new subsection:

''(g) PROTECTION AGAINST LOSS OF ANTI-DEFICIENCY PROTECTION.—

''(1) DEFINITION.—For purposes of this subsection, the term 'anti-deficiency law' means the law of any State which provides that, in the event of foreclosure on the residential property of a consumer securing a mortgage, the consumer is not liable, in accordance with the terms and limitations of such State law, for any deficiency between the sale price obtained on such property through foreclosure and the outstanding balance of the mortgage.

''(2) NOTICE AT TIME OF CONSUMMATION.—In the case of any residential mortgage loan that is, or upon consummation will be, subject to protection under an anti-deficiency law, the creditor or mortgage originator shall provide a written notice to the consumer describing the protection provided by the anti-deficiency law and the significance for the consumer of the loss of such protection before such loan is consummated.

''(3) NOTICE BEFORE REFINANCING THAT WOULD CAUSE LOSS OF PROTECTION.—In the case of any residential mortgage loan that is subject to protection under an anti-deficiency law, if a creditor or mortgage originator provides an application to a consumer, or receives an application from a consumer, for any type of refinancing for such loan that would cause the loan to lose the protection of such anti-deficiency law, the creditor or mortgage originator shall provide a written notice to the consumer describing the protection provided by the anti-deficiency law and the significance for the consumer of the loss of such protection before any agreement for any such refinancing is consummated.''.

(d) POLICY REGARDING ACCEPTANCE OF PARTIAL PAYMENT.—Section 129C of the Truth in Lending Act is amended by inserting after subsection (g) (as added by subsection (c)) the following new subsection:

''(h) POLICY REGARDING ACCEPTANCE OF PARTIAL PAYMENT.—In the case of any residential mortgage loan, a creditor shall disclose prior to settlement or, in the case of a person becoming a creditor with respect to an existing residential mortgage loan, at the time such person becomes a creditor—

''(1) the creditor's policy regarding the acceptance of partial payments; and

"(2) if partial payments are accepted, how such payments will be applied to such mortgage and if such payments will be placed in escrow.

"(i) TIMESHARE PLANS.—This section and any regulations promulgated under this section do not apply to an extension of credit relating to a plan described in section 101(53D) of title 11, United States Code.".

SEC. 1415. RULE OF CONSTRUCTION.

Except as otherwise expressly provided in section 129B or 129C of the Truth in Lending Act (as added by this title), no provision of such section 129B or 129C shall be construed as superseding, repealing, or affecting any duty, right, obligation, privilege, or remedy of any person under any other provision of the Truth in Lending Act or any other provision of Federal or State law.

SEC. 1416. AMENDMENTS TO CIVIL LIABILITY PROVISIONS.

(a) INCREASE IN AMOUNT OF CIVIL MONEY PENALTIES FOR CERTAIN VIOLATIONS.—Section 130(a) of the Truth in Lending Act (15 U.S.C. 1640(a)) is amended—

(1) in paragraph (2)(A)(ii)—

(A) by striking "$100" and inserting "$200"; and

(B) by striking "$1,000" and inserting "$2,000";

(2) in paragraph (2)(B), by striking "$500,000" and inserting "$1,000,000"; and

(3) in paragraph (4), by inserting ", paragraph (1) or (2) of section 129B(c), or section 129C(a)" after "section 129".

(b) STATUTE OF LIMITATIONS EXTENDED FOR SECTION 129 VIOLATIONS.—Section 130(e) of the Truth in Lending Act (15 U.S.C. 1640(e)) is amended—

(1) in the first sentence, by striking "Any action" and inserting "Except as provided in the subsequent sentence, any action"; and

(2) by inserting after the first sentence the following new sentence: "Any action under this section with respect to any violation of section 129, 129B, or 129C may be brought in any United States district court, or in any other court of competent jurisdiction, before the end of the 3-year period beginning on the date of the occurrence of the violation.".

SEC. 1417. LENDER RIGHTS IN THE CONTEXT OF BORROWER DECEPTION.

Section 130 of the Truth in Lending Act (15 U.S.C. 1640) is amended by adding after subsection (k) (as added by this title) the following new subsection:

"(l) EXEMPTION FROM LIABILITY AND RESCISSION IN CASE OF BORROWER FRAUD OR DECEPTION.—In addition to any other remedy available by law or contract, no creditor or assignee shall be liable to an obligor under this section, if such obligor, or co-obligor has been convicted of obtaining by actual fraud such residential mortgage loan.".

SEC. 1418. SIX-MONTH NOTICE REQUIRED BEFORE RESET OF HYBRID ADJUSTABLE RATE MORTGAGES.

(a) IN GENERAL.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 128 the following new section:

"§ 128A. Reset of hybrid adjustable rate mortgages

"(a) HYBRID ADJUSTABLE RATE MORTGAGES DEFINED.—For purposes of this section, the term 'hybrid adjustable rate mortgage' means a consumer credit transaction secured by the consumer's principal residence with a fixed interest rate for an introductory period that adjusts or resets to a variable interest rate after such period.

"(b) NOTICE OF RESET AND ALTERNATIVES.—During the 1-month period that ends 6 months before the date on which the interest rate in effect during the introductory period of a hybrid adjustable rate mortgage adjusts or resets to a variable interest rate or, in the case of such an adjustment or resetting that occurs within the first 6 months after consummation of such loan, at consummation, the creditor or servicer of such loan shall provide a written notice, separate and distinct from all other correspondence to the consumer, that includes the following:

"(1) Any index or formula used in making adjustments to or resetting the interest rate and a source of information about the index or formula.

"(2) An explanation of how the new interest rate and payment would be determined, including an explanation of how the index was adjusted, such as by the addition of a margin.

"(3) A good faith estimate, based on accepted industry standards, of the creditor or servicer of the amount of the monthly payment that will apply after the date of the adjustment or reset, and the assumptions on which this estimate is based.

"(4) A list of alternatives consumers may pursue before the date of adjustment or reset, and descriptions of the actions consumers must take to pursue these alternatives, including—

"(A) refinancing;

"(B) renegotiation of loan terms;

"(C) payment forbearances; and

"(D) pre-foreclosure sales.

"(5) The names, addresses, telephone numbers, and Internet addresses of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publicly available by the Secretary of Housing and Urban Development or a State housing finance authority (as defined in section 1301 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989).

"(6) The address, telephone number, and Internet address for the State housing finance authority (as so defined) for the State in which the consumer resides.

"(c) SAVINGS CLAUSE.—The Board may require the notice in paragraph (b) or other notice consistent with this Act for adjustable rate mortgage loans that are not hybrid adjustable rate mortgage loans.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 128 the following new item:

"128A. Reset of hybrid adjustable rate mortgages.".

SEC. 1419. REQUIRED DISCLOSURES.

Section 128(a) of Truth in Lending Act (15 U.S.C. 1638(a)) is amended by adding at the end the following new paragraphs:

"(16) In the case of a variable rate residential mortgage loan for which an escrow or impound account will be established for the payment of all applicable taxes, insurance, and assessments—

"(A) the amount of initial monthly payment due under the loan for the payment of principal and interest, and the amount of such initial monthly payment including the monthly payment deposited in the account for the payment of all applicable taxes, insurance, and assessments; and

"(B) the amount of the fully indexed monthly payment due under the loan for the payment of principal and interest, and the amount of such fully indexed monthly payment including the monthly payment deposited in the account for the payment of all applicable taxes, insurance, and assessments.

"(17) In the case of a residential mortgage loan, the aggregate amount of settlement charges for all settlement services provided in connection with the loan, the amount of charges that are included in the loan and the amount of such charges the borrower must pay at closing, the approximate amount of the wholesale rate of funds in connection with the loan, and the aggregate amount of other fees or required payments in connection with the loan.

"(18) In the case of a residential mortgage loan, the aggregate amount of fees paid to the mortgage originator in connection with the loan, the amount of such fees paid directly by the consumer, and any additional amount received by the originator from the creditor.

"(19) In the case of a residential mortgage loan, the total amount of interest that the consumer will pay over the life of the loan as a percentage of the principal of the loan. Such amount shall be computed assuming the consumer makes each monthly payment in full and on-time, and does not make any over-payments.".

SEC. 1420. DISCLOSURES REQUIRED IN MONTHLY STATEMENTS FOR RESIDENTIAL MORTGAGE LOANS.

Section 128 of the Truth in Lending Act (15 U.S.C. 1638) is amended by adding at the end the following new subsection:

"(f) PERIODIC STATEMENTS FOR RESIDENTIAL MORTGAGE LOANS.—

"(1) IN GENERAL.—The creditor, assignee, or servicer with respect to any residential mortgage loan shall transmit to the obligor, for each billing cycle, a statement setting forth each of the following items, to the extent applicable, in a conspicuous and prominent manner:

"(A) The amount of the principal obligation under the mortgage.

"(B) The current interest rate in effect for the loan.

"(C) The date on which the interest rate may next reset or adjust.

"(D) The amount of any prepayment fee to be charged, if any.

"(E) A description of any late payment fees.

"(F) A telephone number and electronic mail address that may be used by the obligor to obtain information regarding the mortgage.

"(G) The names, addresses, telephone numbers, and Internet addresses of counseling agencies or programs reasonably available to the consumer that have been certified or approved and made publicly available by the Secretary of Housing and Urban Development or a State housing finance authority (as defined in section 1301 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989).

"(H) Such other information as the Board may prescribe in regulations.

"(2) DEVELOPMENT AND USE OF STANDARD FORM.—The Board shall develop and prescribe a standard form for the disclosure required under this subsection, taking into account that the statements required may be transmitted in writing or electronically.

"(3) EXCEPTION.—Paragraph (1) shall not apply to any fixed rate residential mortgage loan where the creditor, assignee, or servicer provides the obligor with a coupon book that provides the obligor with substantially the same information as required in paragraph (1).".

SEC. 1421. REPORT BY THE GAO.

(a) REPORT REQUIRED.—The Comptroller General of the United States shall conduct a study to determine the effects the enactment of this Act will have on the availability and affordability of credit for consumers, small businesses, homebuyers, and mortgage lending, including the effect—

(1) on the mortgage market for mortgages that are not within the safe harbor provided in the amendments made by this subtitle;

(2) on the ability of prospective homebuyers to obtain financing;

(3) on the ability of homeowners facing resets or adjustments to refinance—for example, do they have fewer refinancing options due to the unavailability of certain loan products that were available before the enactment of this Act;

(4) on minorities' ability to access affordable credit compared with other prospective borrowers;

(5) on home sales and construction;

(6) of extending the rescission right, if any, on adjustable rate loans and its impact on litigation;

(7) of State foreclosure laws and, if any, an investor's ability to transfer a property after foreclosure;

(8) of expanding the existing provisions of the Home Ownership and Equity Protection Act of 1994;

(9) of prohibiting prepayment penalties on high-cost mortgages; and

(10) of establishing counseling services under the Department of Housing and Urban Development and offered through the Office of Housing Counseling.

(b) REPORT.—Before the end of the 1-year period beginning on the date of the enactment of this Act, the Comptroller General shall submit a report to the Congress containing the findings and conclusions of the Comptroller General with respect to the study conducted pursuant to subsection (a).

(c) EXAMINATION RELATED TO CERTAIN CREDIT RISK RETENTION PROVISIONS.—The report required by subsection (b) shall also include an analysis by the Comptroller General of the effect on the capital reserves and funding of lenders of credit risk retention provisions for non-qualified mortgages, including an analysis of the exceptions and adjustments authorized in section 129C(b)(3) of the Truth in Lending Act and a recommendation on whether a uniform standard is needed.

(d) ANALYSIS OF CREDIT RISK RETENTION PROVISIONS.—The report required by subsection (b) shall also include—

(1) an analysis by the Comptroller General of whether the credit risk retention provisions have significantly reduced risks to the larger credit market of the repackaging and selling of securitized loans on a secondary market; and

(2) recommendations to the Congress on adjustments that should be made, or additional measures that should be undertaken.

SEC. 1422. STATE ATTORNEY GENERAL ENFORCEMENT AUTHORITY.

Section 130(e) of the Truth in Lending Act (15 U.S.C. 1640(e)) is amended by striking "section 129 may also" and inserting "section 129, 129B, 129C, 129D, 129E, 129F, 129G, or 129H of this Act may also".

Subtitle C—High-Cost Mortgages

SEC. 1431. DEFINITIONS RELATING TO HIGH-COST MORTGAGES.

(a) HIGH-COST MORTGAGE DEFINED.—Section 103(aa) of the Truth in Lending Act (15 U.S.C. 1602(aa)) is amended by striking all that precedes paragraph (2) and inserting the following:

"(aa) HIGH-COST MORTGAGE.—

"(1) DEFINITION.—

"(A) IN GENERAL.—The term 'high-cost mortgage', and a mortgage referred to in this subsection, means a consumer credit transaction that is secured by the consumer's principal dwelling, other than a reverse mortgage transaction, if—

"(i) in the case of a credit transaction secured—

"(I) by a first mortgage on the consumer's principal dwelling, the annual percentage rate at consummation of the transaction will exceed by more than 6.5 percentage points (8.5 percentage points, if the dwelling is personal property and the transaction is for less than $50,000) the average prime offer rate, as defined in section 129C(b)(2)(B), for a comparable transaction; or

"(II) by a subordinate or junior mortgage on the consumer's principal dwelling, the annual percentage rate at consummation of the transaction will exceed by more than 8.5 percentage points the average prime offer rate, as defined in section 129C(b)(2)(B), for a comparable transaction;

"(ii) the total points and fees payable in connection with the transaction, other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or mortgage originator, exceed—

"(I) in the case of a transaction for $20,000 or more, 5 percent of the total transaction amount; or

"(II) in the case of a transaction for less than $20,000, the lesser of 8 percent of the total transaction amount or $1,000 (or such other dollar amount as the Board shall prescribe by regulation); or

"(iii) the credit transaction documents permit the creditor to charge or collect prepayment fees or penalties more than 36 months after the transaction closing or such fees or penalties exceed, in the aggregate, more than 2 percent of the amount prepaid.

"(B) INTRODUCTORY RATES TAKEN INTO ACCOUNT.—For purposes of subparagraph (A)(i), the annual percentage rate of interest shall be determined based on the following interest rate:

"(i) In the case of a fixed-rate transaction in which the annual percentage rate will not vary during the term of the loan, the interest rate in effect on the date of consummation of the transaction.

"(ii) In the case of a transaction in which the rate of interest varies solely in accordance with an index, the interest rate determined by adding the index rate in effect on the date of consummation of the transaction to the maximum margin permitted at any time during the loan agreement.

"(iii) In the case of any other transaction in which the rate may vary at any time during the term of the loan for any reason, the interest charged on the transaction at the maximum rate that may be charged during the term of the loan.

"(C) MORTGAGE INSURANCE.—For the purposes of computing the total points and fees under paragraph (4), the total points and fees shall exclude—

"(i) any premium provided by an agency of the Federal Government or an agency of a State;

"(ii) any amount that is not in excess of the amount payable under policies in effect at the time of origination under section 203(c)(2)(A) of the National Housing Act (12 U.S.C. 1709(c)(2)(A)), provided that the premium, charge, or fee is required to be refundable on a pro-rated basis and the refund is automatically issued upon notification of the satisfaction of the underlying mortgage loan; and

"(iii) any premium paid by the consumer after closing.".

(b) ADJUSTMENT OF PERCENTAGE POINTS.—Section 103(aa)(2) of the Truth in Lending Act (15 U.S.C. 1602(aa)(2)) is amended by striking subparagraph (B) and inserting the following new subparagraph:

"(B) An increase or decrease under subparagraph (A)—

"(i) may not result in the number of percentage points referred to in paragraph (1)(A)(i)(I) being less than 6 percentage points or greater than 10 percentage points; and "(ii) may not result in the number of percentage points referred to in paragraph (1)(A)(i)(II) being less than 8 percentage points or greater than 12 percentage points.".

(c) POINTS AND FEES DEFINED.—

(1) IN GENERAL.—Section 103(aa)(4) of the Truth in Lending Act (15 U.S.C. 1602(aa)(4)) is amended—

(A) by striking subparagraph (B) and inserting the following:

"(B) all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator from any source, including a mortgage originator that is also the creditor in a table-funded transaction;";

(B) by redesignating subparagraph (D) as subparagraph (G); and

(C) by inserting after subparagraph (C) the following new subparagraphs:

"(D) premiums or other charges payable at or before closing for any credit life, credit disability, credit unemployment, or credit property insurance, or any other accident, loss-of-income, life or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract, except that insurance premiums or debt cancellation or suspension fees calculated and paid in full on a monthly basis shall not be considered financed by the creditor;

"(E) the maximum prepayment fees and penalties which may be charged or collected under the terms of the credit transaction;

"(F) all prepayment fees or penalties that are incurred by the consumer if the loan refinances a previous loan made or currently held by the same creditor or an affiliate of the creditor; and".

(2) CALCULATION OF POINTS AND FEES FOR OPEN-END CONSUMER CREDIT PLANS.—Section 103(aa) of the Truth in Lending Act (15 U.S.C. 1602(aa)) is amended—

(A) by redesignating paragraph (5) as paragraph (6); and

(B) by inserting after paragraph (4) the following new paragraph:

"(5) CALCULATION OF POINTS AND FEES FOR OPEN-END CONSUMER CREDIT PLANS.—In the case of open-end consumer credit plans, points and fees shall be calculated, for purposes of this section and section 129, by adding the total points and fees known at or before closing, including the maximum prepayment penalties which may be charged or collected under the terms of the credit transaction, plus the minimum additional fees the consumer would be required to pay to draw down an amount equal to the total credit line.".

(d) BONA FIDE DISCOUNT LOAN DISCOUNT POINTS.—Section 103 of the Truth in Lending Act (15 U.S.C. 1602) is amended by inserting after subsection (cc) (as added by section 1401) the following new subsection:

"(dd) BONA FIDE DISCOUNT POINTS AND PREPAYMENT PENALTIES.—For the purposes of determining the amount of points and fees for purposes of subsection (aa), either the amounts described in paragraph (1) or (2) of the following paragraphs, but not both, shall be excluded:

"(1) Up to and including 2 bona fide discount points payable by the consumer in connection with the mortgage, but only if the interest rate from which the mortgage's interest rate will be discounted does not exceed by more than 1 percentage point—

"(A) the average prime offer rate, as defined in section 129C; or

"(B) if secured by a personal property loan, the average rate on a loan in connection with which insurance is provided under title I of the National Housing Act (12 U.S.C. 1702 et seq.).

"(2) Unless 2 bona fide discount points have been excluded under paragraph (1), up to and including 1 bona fide discount point payable by the consumer in connection with the mortgage, but only if the interest rate from which the mortgage's interest rate will be discounted does not exceed by more than 2 percentage points—

"(A) the average prime offer rate, as defined in section 129C; or

"(B) if secured by a personal property loan, the average rate on a loan in connection with which insurance is provided under title I of the National Housing Act (12 U.S.C. 1702 et seq.).

"(3) For purposes of paragraph (1), the term 'bona fide discount points' means loan discount points which are knowingly paid by the consumer for the purpose of reducing, and which in fact result in a bona fide reduction of, the interest rate or time-price differential applicable to the mortgage.

"(4) Paragraphs (1) and (2) shall not apply to discount points used to purchase an interest rate reduction unless the amount of the interest rate reduction purchased is reasonably consistent with established industry norms and practices for secondary mortgage market transactions.".

SEC. 1432. AMENDMENTS TO EXISTING REQUIREMENTS FOR CERTAIN MORTGAGES.

(a) PREPAYMENT PENALTY PROVISIONS.—Section 129(c)(2) of the Truth in Lending Act (15 U.S.C. 1639(c)(2)) is hereby repealed.

(b) NO BALLOON PAYMENTS.—Section 129(e) of the Truth in Lending Act (15 U.S.C. 1639(e)) is amended to read as follows:

"(e) NO BALLOON PAYMENTS.—No high-cost mortgage may contain a scheduled payment that is more than twice as large as the average of earlier scheduled payments. This subsection shall not apply when the payment schedule is adjusted to the seasonal or irregular income of the consumer.".

SEC. 1433. ADDITIONAL REQUIREMENTS FOR CERTAIN MORTGAGES.

(a) ADDITIONAL REQUIREMENTS FOR CERTAIN MORTGAGES.—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended—

(1) by redesignating subsections (j), (k), (l) and (m) as subsections (n), (o), (p), and (q) respectively; and

(2) by inserting after subsection (i) the following new subsections:

"(j) RECOMMENDED DEFAULT.—No creditor shall recommend or encourage default on an existing loan or other debt prior to and in connection with the closing or planned closing of a high-cost mortgage that refinances all or any portion of such existing loan or debt.

"(k) LATE FEES.—

"(1) IN GENERAL.—No creditor may impose a late payment charge or fee in connection with a high-cost mortgage—

"(A) in an amount in excess of 4 percent of the amount of the payment past due;

"(B) unless the loan documents specifically authorize the charge or fee;

"(C) before the end of the 15-day period beginning on the date the payment is due, or in the case of a loan on which interest on each installment is paid in advance, before the end of the 30-day period beginning on the date the payment is due; or

"(D) more than once with respect to a single late payment.

"(2) COORDINATION WITH SUBSEQUENT LATE FEES.—If a payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, and the only delinquency or insufficiency of payment is attributable to any late fee or delinquency charge assessed on any earlier payment, no late fee or delinquency charge may be imposed on such payment.

"(3) FAILURE TO MAKE INSTALLMENT PAYMENT.—If, in the case of a loan agreement the terms of which provide that any payment shall first be applied to any past due principal balance, the consumer fails to make an installment payment and the consumer subsequently resumes making installment payments but has not paid all past due installments, the creditor may impose a separate late payment charge or fee for any principal due (without deduction due to late fees or related fees) until the default is cured.

"(l) ACCELERATION OF DEBT.—No high-cost mortgage may contain a provision which permits the creditor to accelerate the indebtedness, except when repayment of the loan has been accelerated by default in payment, or pursuant to a due-on-sale provision, or pursuant to a material violation of some other provision of the loan document unrelated to payment schedule.

"(m) RESTRICTION ON FINANCING POINTS AND FEES.—No creditor may directly or indirectly finance, in connection with any high-cost mortgage, any of the following:

"(1) Any prepayment fee or penalty payable by the consumer in a refinancing transaction if the creditor or an affiliate of the creditor is the noteholder of the note being refinanced.

"(2) Any points or fees.".

(b) PROHIBITIONS ON EVASIONS.—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (q) (as so redesignated by subsection (a)(1)) the following new subsection:

"(r) PROHIBITIONS ON EVASIONS, STRUCTURING OF TRANSACTIONS, AND RECIPROCAL ARRANGEMENTS.—A creditor may not take any action in connection with a high-cost mortgage—

"(1) to structure a loan transaction as an open-end credit plan or another form of loan for the purpose and with the intent of evading the provisions of this title; or

"(2) to divide any loan transaction into separate parts for the purpose and with the intent of evading provisions of this title.".

(c) MODIFICATION OR DEFERRAL FEES.—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (r) (as added by subsection (b) of this section) the following new subsection:

"(s) MODIFICATION AND DEFERRAL FEES PROHIBITED.—A creditor, successor in interest, assignee, or any agent of any of the above, may not charge a consumer any fee to modify, renew, extend, or amend a high-cost mortgage, or to defer any payment due under the terms of such mortgage.".

(d) PAYOFF STATEMENT.—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (s) (as added by subsection (c) of this section) the following new subsection:

"(t) PAYOFF STATEMENT.—

"(1) FEES.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no creditor or servicer may charge a fee for informing or transmitting to any person the balance due to pay off the outstanding balance on a high-cost mortgage.

"(B) TRANSACTION FEE.—When payoff information referred to in subparagraph (A) is provided by facsimile transmission or by a courier service, a creditor or servicer may charge a processing fee to cover the cost of such transmission or service in an amount not to exceed an amount that is comparable to fees imposed for similar services provided in connection with consumer credit transactions that are secured by the consumer's principal dwelling and are not high-cost mortgages.

"(C) FEE DISCLOSURE.—Prior to charging a transaction fee as provided in subparagraph (B), a creditor or servicer shall disclose that payoff balances are available for free pursuant to subparagraph (A).

"(D) MULTIPLE REQUESTS.—If a creditor or servicer has provided payoff information referred to in subparagraph (A) without charge, other than the transaction fee allowed by subparagraph (B), on 4 occasions during a calendar year, the creditor or servicer may thereafter charge a reasonable fee for providing such information during the remainder of the calendar year.

"(2) PROMPT DELIVERY.—Payoff balances shall be provided within 5 business days after receiving a request by a consumer or a person authorized by the consumer to obtain such information.".

(e) PRE-LOAN COUNSELING REQUIRED.—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection t) (as added by subsection (d) of this section) the following new subsection:

"(u) PRE-LOAN COUNSELING.—

"(1) IN GENERAL.—A creditor may not extend credit to a consumer under a high-cost mortgage without first receiving certification from a counselor that is approved by the Secretary of Housing and Urban Development, or at the discretion of the Secretary, a State housing finance authority, that the consumer has received counseling on the advisability of the mortgage. Such counselor shall not be employed by the creditor or an affiliate of the creditor or be affiliated with the creditor.

"(2) DISCLOSURES REQUIRED PRIOR TO COUNSELING.—No counselor may certify that a consumer has received counseling on the advisability of the high-cost mortgage unless the counselor can verify that the consumer has received each statement required (in connection with such loan) by this section or the Real Estate Settlement Procedures Act of 1974 with respect to the transaction.

"(3) REGULATIONS.—The Board may prescribe such regulations as the Board determines to be appropriate to carry out the requirements of paragraph (1).".

(f) CORRECTIONS AND UNINTENTIONAL VIOLATIONS.—Section 129 of the Truth in Lending Act (15 U.S.C. 1639) is amended by inserting after subsection (u) (as added by subsection (e)) the following new subsection:

"(v) CORRECTIONS AND UNINTENTIONAL VIOLATIONS.—A creditor or assignee in a high-cost mortgage who, when acting in good faith, fails to comply with any requirement under this section will not be deemed to have violated such requirement if the creditor or assignee establishes that either—

"(1) within 30 days of the loan closing and prior to the institution of any action, the consumer is notified of or discovers the violation, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—

"(A) make the loan satisfy the requirements of this chapter; or

"(B) in the case of a high-cost mortgage, change the terms of the loan in a manner beneficial to the consumer so that the loan will no longer be a high-cost mortgage; or

"(2) within 60 days of the creditor's discovery or receipt of notification of an unintentional violation or bona fide error and prior to the institution of any action, the consumer is notified of the compliance failure, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—

"(A) make the loan satisfy the requirements of this chapter; or

"(B) in the case of a high-cost mortgage, change the terms of the loan in a manner beneficial so that the loan will no longer be a high-cost mortgage.".

Subtitle D—Office of Housing Counseling

SEC. 1441. SHORT TITLE.

This subtitle may be cited as the "Expand and Preserve Home Ownership Through Counseling Act".

SEC. 1442. ESTABLISHMENT OF OFFICE OF HOUSING COUNSELING.

Section 4 of the Department of Housing and Urban Development Act (42 U.S.C. 3533) is amended by adding at the end the following new subsection:

"(g) OFFICE OF HOUSING COUNSELING.—

"(1) ESTABLISHMENT.—There is established, in the Department, the Office of Housing Counseling.

"(2) DIRECTOR.—There is established the position of Director of Housing Counseling. The Director shall be the head of the Office of Housing Counseling and shall be appointed by, and shall report to, the Secretary. Such position shall be a career-reserved position in the Senior Executive Service.

"(3) FUNCTIONS.—

"(A) IN GENERAL.—The Director shall have primary responsibility within the Department for all activities and matters relating to homeownership counseling and rental housing counseling, including—

"(i) research, grant administration, public outreach, and policy development relating to such counseling; and

"(ii) establishment, coordination, and administration of all regulations, requirements, standards, and performance measures under programs and laws administered by the Department that relate to housing counseling, homeownership counseling (including maintenance of homes), mortgage-related counseling (including home equity conversion mortgages and credit protection options to avoid foreclosure), and rental housing counseling, including the requirements, standards, and performance measures relating to housing counseling.

"(B) SPECIFIC FUNCTIONS.—The Director shall carry out the functions assigned to the Director and the Office under this section and any other provisions of law. Such functions shall include establishing rules necessary for—

"(i) the counseling procedures under section 106(g)(1) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(h)(1));

"(ii) carrying out all other functions of the Secretary under section 106(g) of the Housing and Urban Development Act of 1968, including the establishment, operation, and publication of the availability of the toll-free telephone number under paragraph (2) of such section;

"(iii) contributing to the distribution of home buying information booklets pursuant to section 5 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2604);

"(iv) carrying out the certification program under section 106(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(e));

"(v) carrying out the assistance program under section 106(a)(4) of the Housing and Urban Development Act of 1968, including criteria for selection of applications to receive assistance;

"(vi) carrying out any functions regarding abusive, deceptive, or unscrupulous lending practices relating to residential mortgage loans that the Secretary considers appropriate, which shall include conducting the study under section 6 of the Expand and Preserve Home Ownership Through Counseling Act;

"(vii) providing for operation of the advisory committee established under paragraph (4) of this subsection;

"(viii) collaborating with community-based organizations with expertise in the field of housing counseling; and

"(ix) providing for the building of capacity to provide housing counseling services in areas that lack sufficient services, including underdeveloped areas that lack basic water and sewer systems, electricity services, and safe, sanitary housing.

"(4) ADVISORY COMMITTEE.—

"(A) IN GENERAL.—The Secretary shall appoint an advisory committee to provide advice regarding the carrying out of the functions of the Director.

"(B) MEMBERS.—Such advisory committee shall consist of not more than 12 individuals, and the membership of the committee shall equally represent the mortgage and real estate industry, including consumers and housing counseling agencies certified by the Secretary.

"(C) TERMS.—Except as provided in subparagraph (D), each member of the advisory committee shall be appointed for a term of 3 years. Members may be reappointed at the discretion of the Secretary.

"(D) TERMS OF INITIAL APPOINTEES.—As designated by the Secretary at the time of appointment, of the members first appointed to the advisory committee, 4 shall be appointed for a term of 1 year and 4 shall be appointed for a term of 2 years.

"(E) PROHIBITION OF PAY; TRAVEL EXPENSES.—Members of the advisory committee shall serve without pay, but shall receive travel expenses, including per diem in lieu of subsistence, in accordance with applicable provisions under subchapter I of chapter 57 of title 5, United States Code.

"(F) ADVISORY ROLE ONLY.—The advisory committee shall have no role in reviewing or awarding housing counseling grants.

"(5) SCOPE OF HOMEOWNERSHIP COUNSELING.—In carrying out the responsibilities of the Director, the Director shall ensure that homeownership counseling provided by, in connection with, or pursuant to any function, activity, or program of the Department addresses the entire process of homeownership, including the decision to purchase a home, the selection and purchase of a home, issues arising during or affecting the period of ownership of a home (including refinancing, default and foreclosure, and other financial decisions), and the sale or other disposition of a home.".

SEC. 1443. COUNSELING PROCEDURES.

(a) IN GENERAL.—Section 106 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x) is amended by adding at the end the following new subsection:

"(g) PROCEDURES AND ACTIVITIES.—

"(1) COUNSELING PROCEDURES.—

"(A) In general.—The Secretary shall establish, coordinate, and monitor the administration by the Department of Housing and Urban Development of the counseling procedures for homeownership counseling and rental housing counseling provided in connection with any program of the Department, including all requirements, standards, and performance measures that relate to homeownership and rental housing counseling.

"(B) Homeownership counseling.—For purposes of this subsection and as used in the provisions referred to in this subparagraph, the term 'homeownership counseling' means counseling related to homeownership and residential mortgage loans. Such term includes counseling related to homeownership and residential mortgage loans that is provided pursuant to—

"(i) section 105(a)(20) of the Housing and Community Development Act of 1974 (42 U.S.C. 5305(a)(20));

"(ii) in the United States Housing Act of 1937—

"(I) section 9(e) (42 U.S.C. 1437g(e));

"(II) section 8(y)(1)(D) (42 U.S.C. 1437f(y)(1)(D));

"(III) section 18(a)(4)(D) (42 U.S.C. 1437p(a)(4)(D));

"(IV) section 23(c)(4) (42 U.S.C. 1437u(c)(4));

"(V) section 32(e)(4) (42 U.S.C. 1437z–4(e)(4));

"(VI) section 33(d)(2)(B) (42 U.S.C. 1437z–5(d)(2)(B));

"(VII) sections 302(b)(6) and 303(b)(7) (42 U.S.C. 1437aaa–1(b)(6), 1437aaa–2(b)(7)); and

"(VIII) section 304(c)(4) (42 U.S.C. 1437aaa–3(c)(4));

"(iii) section 302(a)(4) of the American Homeownership and Economic Opportunity Act of 2000 (42 U.S.C. 1437f note);

"(iv) sections 233(b)(2) and 258(b) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12773(b)(2), 12808(b));

"(v) this section and section 101(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x, 1701w(e));

"(vi) section 220(d)(2)(G) of the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (12 U.S.C. 4110(d)(2)(G));

"(vii) sections 422(b)(6), 423(b)(7), 424(c)(4), 442(b)(6), and 443(b)(6) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12872(b)(6), 12873(b)(7), 12874(c)(4), 12892(b)(6), and 12893(b)(6));

"(viii) section 491(b)(1)(F)(iii) of the McKinney-Vento Homeless Assistance Act (42 U.S.C. 11408(b)(1)(F)(iii));

"(ix) sections 202(3) and 810(b)(2)(A) of the Native American Housing and Self-Determination Act of 1996 (25 U.S.C. 4132(3), 4229(b)(2)(A));

"(x) in the National Housing Act—

"(I) in section 203 (12 U.S.C. 1709), the penultimate undesignated paragraph of paragraph (2) of subsection (b), subsection (c)(2)(A), and subsection (r)(4);

"(II) subsections (a) and (c)(3) of section 237 (12 U.S.C. 1715z–2); and

"(III) subsections (d)(2)(B) and (m)(1) of section 255 (12 U.S.C. 1715z–20);

"(xi) section 502(h)(4)(B) of the Housing Act of 1949 (42 U.S.C. 1472(h)(4)(B));

"(xii) section 508 of the Housing and Urban Development Act of 1970 (12 U.S.C. 1701z–7); and

"(xiii) section 106 of the Energy Policy Act of 1992 (42 U.S.C. 12712 note).

"(C) RENTAL HOUSING COUNSELING.—For purposes of this subsection, the term 'rental housing counseling' means counseling related to rental of residential property, which may include counseling regarding future homeownership opportunities and providing referrals for renters and prospective renters to entities providing counseling and shall include counseling related to such topics that is provided pursuant to—

"(i) section 105(a)(20) of the Housing and Community Development Act of 1974 (42 U.S.C. 5305(a)(20));

"(ii) in the United States Housing Act of 1937—

"(I) section 9(e) (42 U.S.C. 1437g(e));

"(II) section 18(a)(4)(D) (42 U.S.C. 1437p(a)(4)(D));

"(III) section 23(c)(4) (42 U.S.C. 1437u(c)(4));

"(IV) section 32(e)(4) (42 U.S.C. 1437z–4(e)(4));

"(V) section 33(d)(2)(B) (42 U.S.C. 1437z–5(d)(2)(B)); and

"(VI) section 302(b)(6) (42 U.S.C. 1437aaa–1(b)(6));

"(iii) section 233(b)(2) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12773(b)(2));

"(iv) section 106 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x);

"(v) section 422(b)(6) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12872(b)(6));

"(vi) section 491(b)(1)(F)(iii) of the McKinney-Vento Homeless Assistance Act (42 U.S.C. 11408(b)(1)(F)(iii));

"(vii) sections 202(3) and 810(b)(2)(A) of the Native American Housing and Self-Determination Act of 1996 (25 U.S.C. 4132(3), 4229(b)(2)(A)); and

"(viii) the rental assistance program under section 8 of the United States Housing Act of 1937 (42 U.S.C. 1437f).

"(2) STANDARDS FOR MATERIALS.—The Secretary, in consultation with the advisory committee established under subsection (g)(4) of the Department of Housing and Urban Development Act, shall establish standards for materials and forms to be used, as appropriate, by organizations providing homeownership counseling services, including any recipients of assistance pursuant to subsection (a)(4).

"(3) MORTGAGE SOFTWARE SYSTEMS.—

"(A) CERTIFICATION.—The Secretary shall provide for the certification of various computer software programs for consumers to use in evaluating different residential mortgage loan proposals. The Secretary shall require, for such certification, that the mortgage software systems take into account—

"(i) the consumer's financial situation and the cost of maintaining a home, including insurance, taxes, and utilities;

"(ii) the amount of time the consumer expects to remain in the home or expected time to maturity of the loan; and

"(iii) such other factors as the Secretary considers appropriate to assist the consumer in evaluating whether to pay points, to lock in an interest rate, to select an adjustable or fixed rate loan, to select a conventional or government-insured or guaranteed loan and to make other choices during the loan application process.

If the Secretary determines that available existing software is inadequate to assist consumers during the residential mortgage loan application process, the Secretary shall arrange for the development by private sector software companies of new mortgage software systems that meet the Secretary's specifications.

"(B) USE AND INITIAL AVAILABILITY.—Such certified computer software programs shall be used to supplement, not replace, housing counseling. The Secretary shall provide that such programs are initially used only in connection with the assistance of housing counselors certified pursuant to subsection (e).

"(C) AVAILABILITY.—After a period of initial availability under subparagraph (B) as the Secretary considers appropriate, the Secretary shall take reasonable steps to make mortgage software systems certified pursuant to this paragraph widely available through the Internet and at public locations, including public libraries, senior-citizen centers, public housing sites, offices of public housing agencies that administer rental housing assistance vouchers, and housing counseling centers.

"(D) BUDGET COMPLIANCE.—This paragraph shall be effective only to the extent that amounts to carry out this paragraph are made available in advance in appropriations Acts.

"(4) NATIONAL PUBLIC SERVICE MULTIMEDIA CAMPAIGNS TO PROMOTE HOUSING COUNSELING.—

"(A) IN GENERAL.—The Director of Housing Counseling shall develop, implement, and conduct national public service multimedia campaigns designed to make persons facing mortgage foreclosure, persons considering a subprime mortgage loan to purchase a home, elderly persons, persons who face language barriers, low-income persons, minorities, and other potentially vulnerable consumers aware that it is advisable, before seeking or maintaining a residential mortgage loan, to obtain homeownership counseling from an unbiased and reliable sources and that such homeownership counseling is available, including through programs sponsored by the Secretary of Housing and Urban Development.

"(B) CONTACT INFORMATION.—Each segment of the multimedia campaign under subparagraph (A) shall publicize the toll-free telephone number and website of the Department of Housing and Urban Development through which persons seeking housing counseling can locate a housing counseling agency in their State that is certified by the Secretary of Housing and Urban Development and can provide advice on buying a home, renting, defaults, foreclosures, credit issues, and reverse mortgages.

"(C) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated to the Secretary, not to exceed $3,000,000 for fiscal years 2009, 2010, and 2011, for the development, implementation, and conduct of national public service multimedia campaigns under this paragraph.

"(D) FORECLOSURE RESCUE EDUCATION PROGRAMS.—

"(i) IN GENERAL.—Ten percent of any funds appropriated pursuant to the authorization under subparagraph (C) shall be used by the Director of Housing Counseling to conduct an education program in areas that have a high density of foreclosure. Such program shall involve direct mailings to persons living in such areas describing—

"(I) tips on avoiding foreclosure rescue scams;

"(II) tips on avoiding predatory lending mortgage agreements;

"(III) tips on avoiding for-profit foreclosure counseling services; and

"(IV) local counseling resources that are approved by the Department of Housing and Urban Development.

"(ii) PROGRAM EMPHASIS.—In conducting the education program described under clause (i), the Director of Housing Counseling shall also place an emphasis on serving communities that have a high percentage of retirement communities or a high percentage of low-income minority communities.

"(iii) TERMS DEFINED.—For purposes of this subparagraph:

"(I) HIGH DENSITY OF FORECLOSURES.—An area has a 'high density of foreclosures' if such area is one of the metropolitan statistical areas (as that term is defined by the Director of the Office of Management and Budget) with the highest home foreclosure rates.

"(II) HIGH PERCENTAGE OF RETIREMENT COMMUNITIES.—An area has a 'high percentage of retirement communities' if such area is one of the metropolitan statistical areas (as that term is defined by the Director of the Office of Management and Budget) with the highest percentage of residents aged 65 or older.

"(III) HIGH PERCENTAGE OF LOW-INCOME MINORITY COMMUNITIES.—An area has a 'high percentage of low-income minority communities' if such area contains a higher-than-normal percentage of residents who are both minorities and low-income, as defined by the Director of Housing Counseling.

"(5) EDUCATION PROGRAMS.—The Secretary shall provide advice and technical assistance to States, units of general local government, and nonprofit organizations regarding the establishment and operation of, including assistance with the development of content and materials for, educational programs to inform and educate consumers, particularly those most vulnerable with respect to residential mortgage loans (such as elderly persons, persons facing language barriers, low-income persons, minorities, and other potentially vulnerable consumers), regarding home mortgages, mortgage refinancing, home equity loans, home repair loans, and where appropriate by region, any requirements and costs associated with obtaining flood or other disaster-specific insurance coverage.".

(b) CONFORMING AMENDMENTS TO GRANT PROGRAM FOR HOMEOWNERSHIP COUNSELING ORGANIZATIONS.—Section 106(c)(5)(A)(ii) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(c)(5)(A)(ii)) is amended—

(1) in subclause (III), by striking "and" at the end;

(2) in subclause (IV) by striking the period at the end and inserting "; and"; and

(3) by inserting after subclause (IV) the following new subclause:

"(V) notify the housing or mortgage applicant of the availability of mortgage software systems provided pursuant to subsection (g)(3).".

SEC. 1444. GRANTS FOR HOUSING COUNSELING ASSISTANCE.

Section 106(a) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(a)) is amended by adding at the end the following new paragraph:

"(4) HOMEOWNERSHIP AND RENTAL COUNSELING ASSISTANCE.—

"(A) IN GENERAL.—The Secretary shall make financial assistance available under this paragraph to HUD-approved housing counseling agencies and State housing finance agencies.

"(B) QUALIFIED ENTITIES.—The Secretary shall establish standards and guidelines for eligibility of organizations (including governmental and nonprofit organizations) to receive assistance under this paragraph, in accordance with subparagraph (D).

"(C) DISTRIBUTION.—Assistance made available under this paragraph shall be distributed in a manner that encourages efficient and successful counseling programs and that ensures adequate distribution of amounts for rural areas having traditionally low levels of access to such counseling services, including areas with insufficient access to the Internet. In distributing such assistance, the Secretary may give priority consideration to entities serving areas with the highest home foreclosure rates.

"(D) LIMITATION ON DISTRIBUTION OF ASSISTANCE.—

"(i) IN GENERAL.—None of the amounts made available under this paragraph shall be distributed to—

"(I) any organization which has been convicted for a violation under Federal law relating to an election for Federal office; or

"(II) any organization which employs applicable individuals.

"(ii) DEFINITION OF APPLICABLE INDIVIDUALS.—In this subparagraph, the term 'applicable individual' means an individual who—

"(I) is—

"(aa) employed by the organization in a permanent or temporary capacity;

"(bb) contracted or retained by the organization; or

"(cc) acting on behalf of, or with the express or apparent authority of, the organization; and

"(II) has been convicted for a violation under Federal law relating to an election for Federal office.

"(E) GRANTMAKING PROCESS.—In making assistance available under this paragraph, the Secretary shall consider appropriate ways of streamlining and improving the processes for grant application, review, approval, and award.

"(F) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated $45,000,000 for each of fiscal years 2009 through 2012 for—

"(i) the operations of the Office of Housing Counseling of the Department of Housing and Urban Development;

"(ii) the responsibilities of the Director of Housing Counseling under paragraphs (2) through (5) of subsection (g); and

"(iii) assistance pursuant to this paragraph for entities providing homeownership and rental counseling.".

SEC. 1445. REQUIREMENTS TO USE HUD-CERTIFIED COUNSELORS UNDER HUD PROGRAMS.

Section 106(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(e)) is amended—

(1) by striking paragraph (1) and inserting the following new paragraph:

"(1) REQUIREMENT FOR ASSISTANCE.—An organization may not receive assistance for counseling activities under subsection (a)(1)(iii), (a)(2), (a)(4), (c), or (d) of this section, or under section 101(e), unless the organization, or the individuals through which the organization provides such counseling, has been certified by the Secretary under this subsection as competent to provide such counseling.";

(2) in paragraph (2)—

(A) by inserting "and for certifying organizations" before the period at the end of the first sentence; and

(B) in the second sentence by striking "for certification" and inserting ", for certification of an organization, that each individual through which the organization provides counseling shall demonstrate, and, for certification of an individual,";

(3) in paragraph (3), by inserting "organizations and" before "individuals";

(4) by redesignating paragraph (3) as paragraph (5); and

(5) by inserting after paragraph (2) the following new paragraphs:

"(3) REQUIREMENT UNDER HUD PROGRAMS.—Any homeownership counseling or rental housing counseling (as such terms are defined in subsection (g)(1)) required under, or provided in connection with, any program administered by the Department of Housing and Urban Development shall be provided only by organizations or counselors certified by the Secretary under this subsection as competent to provide such counseling.

"(4) OUTREACH.—The Secretary shall take such actions as the Secretary considers appropriate to ensure that individuals and organizations providing homeownership or rental housing counseling are aware of the certification requirements and standards of this subsection and of the training and certification programs under subsection (f).".

SEC. 1446. STUDY OF DEFAULTS AND FORECLOSURES.

The Secretary of Housing and Urban Development shall conduct an extensive study of the root causes of default and foreclosure of home loans, using as much empirical data as are available. The study shall also examine the role of escrow accounts in helping prime and nonprime borrowers to avoid defaults and foreclosures, and the role of computer registries of mortgages, including those used for trading mortgage loans. Not later than 12 months after the date of the enactment of this Act, the Secretary shall submit to the Congress a preliminary report regarding the study. Not later than 24 months after such date of enactment, the Secretary shall submit a final report regarding the results of the study, which shall include any recommended legislation relating to the study, and recommendations for best practices and for a process to identify populations that need counseling the most.

SEC. 1447. DEFAULT AND FORECLOSURE DATABASE.

(a) ESTABLISHMENT.—The Secretary of Housing and Urban Development and the Director of the Bureau, in consultation with the Federal agencies responsible for regulation of banking and financial institutions involved in residential mortgage lending and servicing, shall establish and maintain a database of information on foreclosures and defaults on mortgage loans for one- to four-unit residential properties and shall make such information publicly available, subject to subsection (e).

(b) CENSUS TRACT DATA.—Information in the database may be collected, aggregated, and made available on a census tract basis.

(c) REQUIREMENTS.—Information collected and made available through the database shall include—

(1) the number and percentage of such mortgage loans that are delinquent by more than 30 days;

(2) the number and percentage of such mortgage loans that are delinquent by more than 90 days;

(3) the number and percentage of such properties that are real estate-owned;

(4) number and percentage of such mortgage loans that are in the foreclosure process;

(5) the number and percentage of such mortgage loans that have an outstanding principal obligation amount that is greater than the value of the property for which the loan was made; and

(6) such other information as the Secretary of Housing and Urban Development and the Director of the Bureau consider appropriate.

(d) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to encourage discriminatory or unsound allocation of credit or lending policies or practices.

(e) PRIVACY AND CONFIDENTIALITY.—In establishing and maintaining the database described in subsection (a), the Secretary of Housing and Urban Development and the Director of the Bureau shall—

(1) be subject to the standards applicable to Federal agencies for the protection of the confidentiality of personally identifiable information and for data security and integrity;

(2) implement the necessary measures to conform to the standards for data integrity and security described in paragraph (1); and

(3) collect and make available information under this section, in accordance with paragraphs (5) and (6) of section 1022(c) and the rules prescribed under such paragraphs, in order to protect privacy and confidentiality.

SEC. 1448. DEFINITIONS FOR COUNSELING-RELATED PROGRAMS.

Section 106 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x), as amended by the preceding provisions of this subtitle, is amended by adding at the end the following new subsection:

"(h) DEFINITIONS.—For purposes of this section:

"(1) NONPROFIT ORGANIZATION.—The term 'nonprofit organization' has the meaning given such term in section 104(5) of the Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12704(5)), except that subparagraph (D) of such section shall not apply for purposes of this section.

"(2) STATE.—The term 'State' means each of the several States, the Commonwealth of Puerto Rico, the District of Columbia, the Commonwealth of the Northern Mariana Islands, Guam, the Virgin Islands, American Samoa, the Trust Territories of the Pacific, or any other possession of the United States.

"(3) UNIT OF GENERAL LOCAL GOVERNMENT.—The term 'unit of general local government' means any city, county, parish, town, township, borough, village, or other general purpose political subdivision of a State.

"(4) HUD-APPROVED COUNSELING AGENCY.—The term 'HUD-approved counseling agency' means a private or public nonprofit organization that is—

"(A) exempt from taxation under section 501(c) of the Internal Revenue Code of 1986; and

"(B) certified by the Secretary to provide housing counseling services.

"(5) STATE HOUSING FINANCE AGENCY.—The term 'State housing finance agency' means any public body, agency, or instrumentality specifically created under State statute that is authorised to finance activities designed to provide housing and related facilities throughout an entire State through land acquisition, construction, or rehabilitation.".

SEC. 1449. ACCOUNTABILITY AND TRANSPARENCY FOR GRANT RECIPIENTS.

Section 106 of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x), as amended by the preceding provisions of this subtitle, is amended by adding at the end the following:

"(i) ACCOUNTABILITY FOR RECIPIENTS OF COVERED ASSISTANCE.—

"(1) TRACKING OF FUNDS.—The Secretary shall—

"(A) develop and maintain a system to ensure that any organization or entity that receives any covered assistance uses all amounts of covered assistance in accordance with this section, the regulations issued under this section, and any requirements or conditions under which such amounts were provided; and

"(B) require any organization or entity, as a condition of receipt of any covered assistance, to agree to comply with such requirements regarding covered assistance as the Secretary shall establish, which shall include—

"(i) appropriate periodic financial and grant activity reporting, record retention, and audit requirements for the duration of the covered assistance to the organization or entity to ensure compliance with the limitations and requirements of this section, the regulations under this section, and any requirements or conditions under which such amounts were provided; and

"(ii) any other requirements that the Secretary determines are necessary to ensure appropriate administration and compliance.

"(2) MISUSE OF FUNDS.—If any organization or entity that receives any covered assistance is determined by the Secretary to have used any covered assistance in a manner that is materially in violation of this section, the regulations issued under this section, or any requirements or conditions under which such assistance was provided—

"(A) the Secretary shall require that, within 12 months after the determination of such misuse, the organization or entity shall reimburse the Secretary for such misused amounts and return to the Secretary any such amounts that remain unused or uncommitted for use; and

"(B) such organization or entity shall be ineligible, at any time after such determination, to apply for or receive any further covered assistance.

The remedies under this paragraph are in addition to any other remedies that may be available under law.

"(3) COVERED ASSISTANCE.—For purposes of this subsection, the term 'covered assistance' means any grant or other financial assistance provided under this section.".

SEC. 1450. UPDATING AND SIMPLIFICATION OF MORTGAGE INFORMATION BOOKLET.

Section 5 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2604) is amended—

(1) in the section heading, by striking "SPECIAL" and inserting "HOME BUYING";

(2) by striking subsections (a) and (b) and inserting the following new subsections:

"(a) PREPARATION AND DISTRIBUTION.—The Director of the Bureau of Consumer Financial Protection (hereafter in this section referred to as the 'Director') shall prepare, at least once every 5 years, a booklet to help consumers applying for federally related mortgage loans to understand the nature and costs of real estate settlement services. The Director shall prepare the booklet in various languages and cultural styles, as the Director determines to be appropriate, so that the booklet is understandable and accessible to homebuyers of different ethnic and cultural backgrounds. The Director shall distribute such booklets to all lenders that make federally related mortgage loans. The Director shall also distribute to such lenders lists, organized by location, of homeownership counselors certified under section 106(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(e)) for use in complying with the requirement under subsection (c) of this section.

"(b) CONTENTS.—Each booklet shall be in such form and detail as the Director shall prescribe and, in addition to such other information as the Director may provide, shall include in plain and understandable language the following information:

"(1) A description and explanation of the nature and purpose of the costs incident to a real estate settlement or a federally related mortgage loan. The description and explanation shall provide general information about the mortgage process as well as specific information concerning, at a minimum—

"(A) balloon payments;

"(B) prepayment penalties;

"(C) the advantages of prepayment; and

"(D) the trade-off between closing costs and the interest rate over the life of the loan.

"(2) An explanation and sample of the uniform settlement statement required by section 4.

"(3) A list and explanation of lending practices, including those prohibited by the Truth in Lending Act or other applicable Federal law, and of other unfair practices and unreasonable or unnecessary charges to be avoided by the prospective buyer with respect to a real estate settlement.

"(4) A list and explanation of questions a consumer obtaining a federally related mortgage loan should ask regarding the loan, including whether the consumer will have the ability to repay the loan, whether the consumer sufficiently shopped for the loan, whether the loan terms include prepayment penalties or balloon payments, and whether the loan will benefit the borrower.

"(5) An explanation of the right of rescission as to certain transactions provided by sections 125 and 129 of the Truth in Lending Act.

"(6) A brief explanation of the nature of a variable rate mortgage and a reference to the booklet entitled 'Consumer Handbook on Adjustable Rate Mortgages', published by the Director, or to any suitable substitute of such booklet that the Director may subsequently adopt pursuant to such section.

"(7) A brief explanation of the nature of a home equity line of credit and a reference to the pamphlet required to be provided under section 127A of the Truth in Lending Act.

"(8) Information about homeownership counseling services made available pursuant to section 106(a)(4) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(a)(4)), a recommendation that the consumer use such services, and notification that a list of certified providers of homeownership counseling in the area, and their contact information, is available.

"(9) An explanation of the nature and purpose of escrow accounts when used in connection with loans secured by residential real estate and the requirements under section 10 of this Act regarding such accounts.

"(10) An explanation of the choices available to buyers of residential real estate in selecting persons to provide necessary services incidental to a real estate settlement.

"(11) An explanation of a consumer's responsibilities, liabilities, and obligations in a mortgage transaction.

"(12) An explanation of the nature and purpose of real estate appraisals, including the difference between an appraisal and a home inspection.

"(13) Notice that the Office of Housing of the Department of Housing and Urban Development has made publicly available a brochure regarding loan fraud and a World Wide Web address and toll-free telephone number for obtaining the brochure.

The booklet prepared pursuant to this section shall take into consideration differences in real estate settlement procedures that may exist among the several States and territories of the United States and among separate political subdivisions within the same State and territory.";

(3) in subsection (c), by inserting at the end the following new sentence: "Each lender shall also include with the booklet a reasonably complete or updated list of homeownership counselors who are certified pursuant to section 106(e) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(e)) and located in the area of the lender."; and

(4) in subsection (d), by inserting after the period at the end of the first sentence the following: "The lender shall provide the booklet in the version that is most appropriate for the person receiving it.".

SEC. 1451. HOME INSPECTION COUNSELING.

(a) PUBLIC OUTREACH.—

(1) IN GENERAL.—The Secretary of Housing and Urban Development (in this section referred to as the "Secretary") shall take such actions as may be necessary to inform potential homebuyers of the availability and importance of obtaining an independent home inspection. Such actions shall include—

(A) publication of the HUD/FHA form HUD 92564–CN entitled "For Your Protection: Get a Home Inspection", in both English and Spanish languages;

(B) publication of the HUD/FHA booklet entitled "For Your Protection: Get a Home Inspection", in both English and Spanish languages;

(C) development and publication of a HUD booklet entitled "For Your Protection—Get a Home Inspection" that does not reference FHA-insured homes, in both English and Spanish languages; and

(D) publication of the HUD document entitled "Ten Important Questions To Ask Your Home Inspector", in both English and Spanish languages.

(2) AVAILABILITY.—The Secretary shall make the materials specified in paragraph (1) available for electronic access and, where appropriate, inform potential homebuyers of such availability through home purchase counseling public service announcements and toll-free telephone hotlines of the Department of Housing and Urban Development. The Secretary shall give special emphasis to reaching first-time and low-income homebuyers with these materials and efforts.

(3) UPDATING.—The Secretary may periodically update and revise such materials, as the Secretary determines to be appropriate.

(b) REQUIREMENT FOR FHA-APPROVED LENDERS.—Each mortgagee approved for participation in the mortgage insurance programs under title II of the National Housing Act shall provide prospective homebuyers, at first contact, whether upon pre-qualification, pre-approval, or initial application, the materials specified in subparagraphs (A), (B), and (D) of subsection (a)(1).

(c) REQUIREMENTS FOR HUD-APPROVED COUNSELING AGENCIES.—Each counseling agency certified pursuant by the Secretary to provide housing counseling services shall provide each of their clients, as part of the home purchase counseling process, the materials specified in subparagraphs (C) and (D) of subsection (a)(1).

(d) TRAINING.—Training provided the Department of Housing and Urban Development for housing counseling agencies, whether such training is provided directly by the Department or otherwise, shall include—

(1) providing information on counseling potential homebuyers of the availability and importance of getting an independent home inspection;

(2) providing information about the home inspection process, including the reasons for specific inspections such as radon and lead-based paint testing;

(3) providing information about advising potential homebuyers on how to locate and select a qualified home inspector; and

(4) review of home inspection public outreach materials of the Department.

SEC. 1452. WARNINGS TO HOMEOWNERS OF FORECLOSURE RESCUE SCAMS.

(a) ASSISTANCE TO NRC.—Notwithstanding any other provision of law, of any amounts made available for any fiscal year pursuant to section 106(a)(4)(F) of the Housing and Urban Development Act of 1968 (12 U.S.C. 1701x(a)(4)(F)) (as added by section 1444), 10 percent shall be used only for assistance to the Neighborhood Reinvestment Corporation for activities, in consultation with servicers of residential mortgage loans, to provide notice to borrowers under such loans who are delinquent with respect to payments due under such loans that makes such borrowers aware of the dangers of fraudulent activities associated with foreclosure.

(b) NOTICE.—The Neighborhood Reinvestment Corporation, in consultation with servicers of residential mortgage loans, shall use the amounts provided pursuant to subsection (a) to carry out activities to inform borrowers under residential mortgage loans—

(1) that the foreclosure process is complex and can be confusing;

(2) that the borrower may be approached during the foreclosure process by persons regarding saving their home and they should use caution in any such dealings;

(3) that there are Federal Government and nonprofit agencies that may provide information about the foreclosure process, including the Department of Housing and Urban Development;

(4) that they should contact their lender immediately, contact the Department of Housing and Urban Development to find a housing counseling agency certified by the Department to assist in avoiding foreclosure, or visit the Department's website regarding tips for avoiding foreclosure; and

(5) of the telephone number of the loan servicer or successor, the telephone number of the Department of Housing and Urban Development housing counseling line, and the Uniform Resource Locators (URLs) for the Department of Housing and Urban Development Web sites for housing counseling and for tips for avoiding foreclosure.

Subtitle E—Mortgage Servicing

SEC. 1461. ESCROW AND IMPOUND ACCOUNTS RELATING TO CERTAIN CONSUMER CREDIT TRANSACTIONS.

(a) IN GENERAL.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 129C (as added by section 1411) the following new section:

"§ 129D. Escrow or impound accounts relating to certain consumer credit transactions

"(a) IN GENERAL.—Except as provided in subsection (b), (c), (d), or (e), a creditor, in connection with the consummation of a consumer credit transaction secured by a first lien on the principal dwelling of the consumer, other than a consumer credit transaction under an open end credit plan or a reverse mortgage, shall establish, before the consummation of such transaction, an escrow or impound account for the payment of taxes and hazard insurance, and, if applicable, flood insurance, mortgage insurance, ground rents, and any other required periodic payments or premiums with respect to the property or the loan terms, as provided in, and in accordance with, this section.

"(b) WHEN REQUIRED.—No impound, trust, or other type of account for the payment of property taxes, insurance premiums, or other purposes relating to the property may be required as a condition of a real property sale contract or a loan secured by a first deed of trust or mortgage on the principal dwelling of the consumer, other than a consumer credit transaction under an open end credit plan or a reverse mortgage, except when—

"(1) any such impound, trust, or other type of escrow or impound account for such purposes is required by Federal or State law;

"(2) a loan is made, guaranteed, or insured by a State or Federal governmental lending or insuring agency;

"(3) the transaction is secured by a first mortgage or lien on the consumer's principal dwelling having an original principal obligation amount that—

"(A) does not exceed the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)), and the annual percentage rate will exceed the average prime offer rate as defined in section 129C by 1.5 or more percentage points; or

"(B) exceeds the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)), and the annual percentage rate will exceed the average prime offer rate as defined in section 129C by 2.5 or more percentage points; or

"(4) so required pursuant to regulation.

"(c) EXEMPTIONS.—The Board may, by regulation, exempt from the requirements of subsection (a) a creditor that—

"(1) operates predominantly in rural or underserved areas;

"(2) together with all affiliates, has total annual mortgage loan originations that do not exceed a limit set by the Board;

"(3) retains its mortgage loan originations in portfolio; and

"(4) meets any asset size threshold and any other criteria the Board may establish, consistent with the purposes of this subtitle.

"(d) DURATION OF MANDATORY ESCROW OR IMPOUND ACCOUNT.—An escrow or impound account established pursuant to subsection (b) shall remain in existence for a minimum period of 5 years, beginning with the date of the consummation of the loan, unless and until—

"(1) such borrower has sufficient equity in the dwelling securing the consumer credit transaction so as to no longer be required to maintain private mortgage insurance;

"(2) such borrower is delinquent;

"(3) such borrower otherwise has not complied with the legal obligation, as established by rule; or

"(4) the underlying mortgage establishing the account is terminated.

"(e) LIMITED EXEMPTIONS FOR LOANS SECURED BY SHARES IN A COOPERATIVE OR IN WHICH AN ASSOCIATION MUST MAINTAIN A MASTER INSURANCE POLICY.—Escrow accounts need not be established for loans secured by shares in a cooperative. Insurance premiums need not be included in escrow accounts for loans secured by dwellings or units, where the borrower must join an association as a condition of ownership, and that association has an obligation to the dwelling or unit owners to maintain a master policy insuring the dwellings or units.

"(f) CLARIFICATION ON ESCROW ACCOUNTS FOR LOANS NOT MEETING STATUTORY TEST.—For mortgages not covered by the requirements of subsection (b), no provision of this section shall be construed as precluding the establishment of an impound, trust, or other type of account for the payment of property taxes, insurance premiums, or other purposes relating to the property—

"(1) on terms mutually agreeable to the parties to the loan;

"(2) at the discretion of the lender or servicer, as provided by the contract between the lender or servicer and the borrower; or

"(3) pursuant to the requirements for the escrowing of flood insurance payments for regulated lending institutions in section 102(d) of the Flood Disaster Protection Act of 1973.

"(g) ADMINISTRATION OF MANDATORY ESCROW OR IMPOUND ACCOUNTS.—

"(1) IN GENERAL.—Except as may otherwise be provided for in this title or in regulations prescribed by the Board, escrow or impound accounts established pursuant to subsection (b) shall be established in a federally insured depository institution or credit union.

"(2) ADMINISTRATION.—Except as provided in this section or regulations prescribed under this section, an escrow or impound account subject to this section shall be administered in accordance with—

"(A) the Real Estate Settlement Procedures Act of 1974 and regulations prescribed under such Act;

"(B) the Flood Disaster Protection Act of 1973 and regulations prescribed under such Act; and

"(C) the law of the State, if applicable, where the real property securing the consumer credit transaction is located.

"(3) APPLICABILITY OF PAYMENT OF INTEREST.—If prescribed by applicable State or Federal law, each creditor shall pay interest to the consumer on the amount held in any impound, trust, or escrow account that is subject to this section in the manner as prescribed by that applicable State or Federal law.

"(4) PENALTY COORDINATION WITH RESPA.—Any action or omission on the part of any person which constitutes a violation of the Real Estate Settlement Procedures Act of 1974 or any regulation prescribed under such Act for which the person has paid any fine, civil money penalty, or other damages shall not give rise to any additional fine, civil money penalty, or other damages under this section, unless the action or omission also constitutes a direct violation of this section.

"(h) DISCLOSURES RELATING TO MANDATORY ESCROW OR IMPOUND ACCOUNT.—In the case of any impound, trust, or escrow account that is required under subsection (b), the creditor shall disclose by written notice to the consumer at least 3 business days before the consummation of the consumer credit transaction giving rise to such account or in accordance with timeframes established in prescribed regulations the following information:

"(1) The fact that an escrow or impound account will be established at consummation of the transaction.

"(2) The amount required at closing to initially fund the escrow or impound account.

"(3) The amount, in the initial year after the consummation of the transaction, of the estimated taxes and hazard insurance, including flood insurance, if applicable, and any other required periodic payments or premiums that reflects, as appropriate, either the taxable assessed value of the real property securing the transaction, including the value of any improvements on the property or to be constructed on the property (whether or not such construction will be financed from the proceeds of the transaction) or the replacement costs of the property.

"(4) The estimated monthly amount payable to be escrowed for taxes, hazard insurance (including flood insurance, if applicable) and any other required periodic payments or premiums.

"(5) The fact that, if the consumer chooses to terminate the account in the future, the consumer will become responsible for the payment of all taxes, hazard insurance, and flood insurance, if applicable, as well as any other required periodic payments or premiums on the property unless a new escrow or impound account is established.

"(6) Such other information as the Board determines necessary for the protection of the consumer.

"(i) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

"(1) FLOOD INSURANCE.—The term 'flood insurance' means flood insurance coverage provided under the national flood insurance program pursuant to the National Flood Insurance Act of 1968.

"(2) HAZARD INSURANCE.—The term 'hazard insurance' shall have the same meaning as provided for 'hazard insurance', 'casualty insurance', 'homeowner's insurance', or other similar term under the law of the State where the real property securing the consumer credit transaction is located.".

(b) EXEMPTIONS AND MODIFICATIONS.—The Board may prescribe rules that revise, add to, or subtract from the criteria of section 129D(b) of the Truth in Lending Act if the Board determines that such rules are in the interest of consumers and in the public interest.

(c) CLERICAL AMENDMENT.—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 129C (as added by section 1411) the following new item:

"129D. Escrow or impound accounts relating to certain consumer credit transactions.".

SEC. 1462. DISCLOSURE NOTICE REQUIRED FOR CONSUMERS WHO WAIVE ESCROW SERVICES.

Section 129D of the Truth in Lending Act (as added by section 1461) is amended by adding at the end the following new subsection:

"(j) DISCLOSURE NOTICE REQUIRED FOR CONSUMERS WHO WAIVE ESCROW SERVICES.—

"(1) IN GENERAL.—If—

"(A) an impound, trust, or other type of account for the payment of property taxes, insurance premiums, or other purposes relating to real property securing a consumer credit transaction is not established in connection with the transaction; or

"(B) a consumer chooses, and provides written notice to the creditor or servicer of such choice, at any time after such an account is established in connection with any such transaction and in accordance with any statute, regulation, or contractual agreement, to close such account,

the creditor or servicer shall provide a timely and clearly written disclosure to the consumer that advises the consumer of the responsibilities of the consumer and implications for the consumer in the absence of any such account.

"(2) DISCLOSURE REQUIREMENTS.—Any disclosure provided to a consumer under paragraph (1) shall include the following:

"(A) Information concerning any applicable fees or costs associated with either the non-establishment of any such account at the time of the transaction, or any subsequent closure of any such account.

"(B) A clear and prominent statement that the consumer is responsible for personally and directly paying the non-escrowed items, in addition to paying the mortgage loan payment, in the absence of any such account, and the fact that the costs for taxes, insurance, and related fees can be substantial.

"(C) A clear explanation of the consequences of any failure to pay non-escrowed items, including the possible requirement for the forced placement of insurance by the creditor or servicer and the potentially higher cost (including any potential commission payments to the servicer) or reduced coverage for the consumer in the event of any such creditor-placed insurance.

"(D) Such other information as the Board determines necessary for the protection of the consumer.".

SEC. 1463. REAL ESTATE SETTLEMENT PROCEDURES ACT OF 1974 AMENDMENTS.

(a) SERVICER PROHIBITIONS.—Section 6 of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2605) is amended by adding at the end the following new subsections:

"(k) SERVICER PROHIBITIONS.—

"(1) IN GENERAL.—A servicer of a federally related mortgage shall not—

"(A) obtain force-placed hazard insurance unless there is a reasonable basis to believe the borrower has failed to comply with the loan contract's requirements to maintain property insurance;

"(B) charge fees for responding to valid qualified written requests (as defined in regulations which the Bureau of Consumer Financial Protection shall prescribe) under this section;

"(C) fail to take timely action to respond to a borrower's requests to correct errors relating to allocation of payments, final balances for purposes of paying off the loan, or avoiding foreclosure, or other standard servicer's duties;

"(D) fail to respond within 10 business days to a request from a borrower to provide the identity, address, and other relevant contact information about the owner or assignee of the loan; or

"(E) fail to comply with any other obligation found by the Bureau of Consumer Financial Protection, by regulation, to be appropriate to carry out the consumer protection purposes of this Act.

"(2) FORCE-PLACED INSURANCE DEFINED.—For purposes of this subsection and subsections (l) and (m), the term 'force-placed insurance' means hazard insurance coverage obtained by a servicer of a federally related mortgage when the borrower has failed to maintain or renew hazard insurance on such property as required of the borrower under the terms of the mortgage.

"(l) REQUIREMENTS FOR FORCE-PLACED INSURANCE.—A servicer of a federally related mortgage shall not be construed as having a reasonable basis for obtaining force-placed insurance unless the requirements of this subsection have been met.

"(1) WRITTEN NOTICES TO BORROWER.—A servicer may not impose any charge on any borrower for force-placed insurance with respect to any property securing a federally related mortgage unless—

"(A) the servicer has sent, by first-class mail, a written notice to the borrower containing—

"(i) a reminder of the borrower's obligation to maintain hazard insurance on the property securing the federally related mortgage;

"(ii) a statement that the servicer does not have evidence of insurance coverage of such property;

"(iii) a clear and conspicuous statement of the procedures by which the borrower may demonstrate that the borrower already has insurance coverage; and

"(iv) a statement that the servicer may obtain such coverage at the borrower's expense if the borrower does not provide such demonstration of the borrower's existing coverage in a timely manner;

"(B) the servicer has sent, by first-class mail, a second written notice, at least 30 days after the mailing of the notice under subparagraph (A) that contains all the information described in each clause of such subparagraph; and

"(C) the servicer has not received from the borrower any demonstration of hazard insurance coverage for the property securing the mortgage by the end of the 15-day period beginning on the date the notice under subparagraph (B) was sent by the servicer.

"(2) SUFFICIENCY OF DEMONSTRATION.—A servicer of a federally related mortgage shall accept any reasonable form of written confirmation from a borrower of existing insurance coverage, which shall include the existing insurance policy number along with the identity of, and contact information for, the insurance company or agent, or as otherwise required by the Bureau of Consumer Financial Protection.

"(3) TERMINATION OF FORCE-PLACED INSURANCE.—Within 15 days of the receipt by a servicer of confirmation of a borrower's existing insurance coverage, the servicer shall—

"(A) terminate the force-placed insurance; and

"(B) refund to the consumer all force-placed insurance premiums paid by the borrower during any period during which the borrower's insurance coverage and the force-placed insurance coverage were each in effect, and any related fees charged to the consumer's account with respect to the force-placed insurance during such period.

"(4) CLARIFICATION WITH RESPECT TO FLOOD DISASTER PROTECTION ACT.—No provision of this section shall be construed as prohibiting a servicer from providing simultaneous or concurrent notice of a lack of flood insurance pursuant to section 102(e) of the Flood Disaster Protection Act of 1973.

"(m) LIMITATIONS ON FORCE-PLACED INSURANCE CHARGES.—All charges, apart from charges subject to State regulation as the business of insurance, related to force-placed insurance imposed on the borrower by or through the servicer shall be bona fide and reasonable.".

(b) INCREASE IN PENALTY AMOUNTS.—Section 6(f) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2605(f)) is amended—

(1) in paragraphs (1)(B) and (2)(B), by striking "$1,000" each place such term appears and inserting "$2,000"; and

(2) in paragraph (2)(B)(i), by striking "$500,000" and inserting "$1,000,000".

(c) DECREASE IN RESPONSE TIMES.—Section 6(e) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2605(e)) is amended—

(1) in paragraph (1)(A), by striking "20 days" and inserting "5 days";

(2) in paragraph (2), by striking "60 days" and inserting "30 days"; and

(3) by adding at the end the following new paragraph:

"(4) LIMITED EXTENSION OF RESPONSE TIME.—The 30-day period described in paragraph (2) may be extended for not more than 15 days if, before the end of such 30-day period, the servicer notifies the borrower of the extension and the reasons for the delay in responding.".

(d) PROMPT REFUND OF ESCROW ACCOUNTS UPON PAYOFF.—Section 6(g) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2605(g)) is amended by adding at the end the following new sentence: "Any balance in any such account that is within the servicer's control at the time the loan is paid off shall be promptly returned to the borrower within 20 business days or credited to a similar account for a new mortgage loan to the borrower with the same lender.".

SEC. 1464. TRUTH IN LENDING ACT AMENDMENTS.

(a) REQUIREMENTS FOR PROMPT CREDITING OF HOME LOAN PAYMENTS.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 129E (as added by section 1472) the following new section:

"§ 129F. Requirements for prompt crediting of home loan payments

"(a) IN GENERAL.—In connection with a consumer credit transaction secured by a consumer's principal dwelling, no servicer shall fail to credit a payment to the consumer's loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency, except as required in subsection (b).

"(b) EXCEPTION.—If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer shall credit the payment as of 5 days after receipt.".

(b) REQUESTS FOR PAYOFF AMOUNTS.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.), as amended by this title, is amended by inserting after section 129F (as added by subsection (a)) the following new section:

"§ 129G. Requests for payoff amounts of home loan

"A creditor or servicer of a home loan shall send an accurate payoff balance within a reasonable time, but in no case more than 7 business days, after the receipt of a written request for such balance from or on behalf of the borrower.".

SEC. 1465. ESCROWS INCLUDED IN REPAYMENT ANALYSIS.

Section 128(b) of the Truth in Lending Act (15 U.S.C. 1638(b)) is amended by adding at the end the following new paragraph:

"(4) REPAYMENT ANALYSIS REQUIRED TO INCLUDE ESCROW PAYMENTS.—

"(A) IN GENERAL.—In the case of any consumer credit transaction secured by a first mortgage or lien on the principal dwelling of the consumer, other than a consumer credit transaction under an open end credit plan or a reverse mortgage, for which an impound, trust, or other type of account has been or will be established in connection with the transaction for the payment of property taxes, hazard and flood (if any) insurance premiums, or other periodic payments or premiums with respect to the property, the information required to be provided under subsection (a) with respect to the number, amount, and due dates or period of payments scheduled to repay the total of payments shall take into account the amount of any monthly payment to such account for each such repayment in accordance with section 10(a)(2) of the Real Estate Settlement Procedures Act of 1974.

"(B) ASSESSMENT VALUE.—The amount taken into account under subparagraph (A) for the payment of property taxes, hazard and flood (if any) insurance premiums, or other periodic payments or premiums with respect to the property shall reflect the taxable assessed value of the real property securing the transaction after the consummation of the transaction, including the value of any improvements on the property or to be constructed on the property (whether or not such construction will be financed from the proceeds of the transaction), if known, and the replacement costs of the property for hazard insurance, in the initial year after the transaction.".

Subtitle F—Appraisal Activities

SEC. 1471. PROPERTY APPRAISAL REQUIREMENTS.

Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after 129G (as added by section 1464(b)) the following new section:

"§ 129H. Property appraisal requirements

"(a) IN GENERAL.—A creditor may not extend credit in the form of a higher-risk mortgage to any consumer without first obtaining a written appraisal of the property to be mortgaged prepared in accordance with the requirements of this section.

"(b) APPRAISAL REQUIREMENTS.—

"(1) PHYSICAL PROPERTY VISIT.—Subject to the rules prescribed under paragraph (4), an appraisal of property to be secured by a higher-risk mortgage does not meet the requirement of this section unless it is performed by a certified or licensed appraiser who conducts a physical property visit of the interior of the mortgaged property.

"(2) SECOND APPRAISAL UNDER CERTAIN CIRCUMSTANCES.—

"(A) IN GENERAL.—If the purpose of a higher-risk mortgage is to finance the purchase or acquisition of the mortgaged property from a person within 180 days of the purchase or acquisition of such property by that person at a price that was lower than the current sale price of the property, the creditor shall obtain a second appraisal from a different certified or licensed appraiser. The second appraisal shall include an analysis of the difference in sale prices, changes in market conditions, and any improvements made to the property between the date of the previous sale and the current sale.

"(B) NO COST TO APPLICANT.—The cost of any second appraisal required under subparagraph (A) may not be charged to the applicant.

"(3) CERTIFIED OR LICENSED APPRAISER DEFINED.—For purposes of this section, the term 'certified or licensed appraiser' means a person who—

"(A) is, at a minimum, certified or licensed by the State in which the property to be appraised is located; and

"(B) performs each appraisal in conformity with the Uniform Standards of Professional Appraisal Practice and title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and the regulations prescribed under such title, as in effect on the date of the appraisal.

"(4) REGULATIONS.—

"(A) IN GENERAL.—The Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau shall jointly prescribe regulations to implement this section.

"(B) EXEMPTION.—The agencies listed in subparagraph (A) may jointly exempt, by rule, a class of loans from the requirements of this subsection or subsection (a) if the agencies determine that the exemption is in the public interest and promotes the safety and soundness of creditors.

"(c) FREE COPY OF APPRAISAL.—A creditor shall provide 1 copy of each appraisal conducted in accordance with this section in connection with a higher-risk mortgage to the applicant without charge, and at least 3 days prior to the transaction closing date.

"(d) CONSUMER NOTIFICATION.—At the time of the initial mortgage application, the applicant shall be provided with a statement by the creditor that any appraisal prepared for the mortgage is for the sole use of the creditor, and that the applicant may choose to have a separate appraisal conducted at the expense of the applicant.

"(e) VIOLATIONS.—In addition to any other liability to any person under this title, a creditor found to have willfully failed to obtain an appraisal as required in this section shall be liable to the applicant or borrower for the sum of $2,000.

"(f) HIGHER-RISK MORTGAGE DEFINED.—For purposes of this section, the term 'higher-risk mortgage' means a residential mortgage loan, other than a reverse mortgage loan that is a qualified mortgage, as defined in section 129C, secured by a principal dwelling—

"(1) that is not a qualified mortgage, as defined in section 129C; and

"(2) with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction, as defined in section 129C, as of the date the interest rate is set—

"(A) by 1.5 or more percentage points, in the case of a first lien residential mortgage loan having an original principal obligation amount that does not exceed the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2));

"(B) by 2.5 or more percentage points, in the case of a first lien residential mortgage loan having an original principal obligation amount that exceeds the amount of the maximum limitation on the original principal obligation of mortgage in effect for a residence of the applicable size, as of the date of such interest rate set, pursuant to the sixth sentence of section 305(a)(2) the Federal Home Loan Mortgage Corporation Act (12 U.S.C. 1454(a)(2)); and

"(C) by 3.5 or more percentage points for a subordinate lien residential mortgage loan.".

SEC. 1472. APPRAISAL INDEPENDENCE REQUIREMENTS.

(a) IN GENERAL.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 129D (as added by section 1461(a)) the following new section:

"§ 129E. Appraisal independence requirements

"(a) IN GENERAL.—It shall be unlawful, in extending credit or in providing any services for a consumer credit transaction secured by the principal dwelling of the consumer, to engage in any act or practice that violates appraisal independence as described in or pursuant to regulations prescribed under this section.

"(b) APPRAISAL INDEPENDENCE.—For purposes of subsection (a), acts or practices that violate appraisal independence shall include—

"(1) any appraisal of a property offered as security for repayment of the consumer credit transaction that is conducted in connection with such transaction in which a person with an interest in the underlying transaction compensates, coerces, extorts, colludes, instructs, induces, bribes, or intimidates a person, appraisal management company, firm, or other entity conducting or involved in an appraisal, or attempts, to compensate, coerce, extort, collude, instruct, induce, bribe, or intimidate such a person, for the purpose of causing the appraised value assigned, under the appraisal, to the property to be based on any factor other than the independent judgment of the appraiser;

"(2) mischaracterizing, or suborning any mischaracterization of, the appraised value of the property securing the extension of the credit;

"(3) seeking to influence an appraiser or otherwise to encourage a targeted value in order to facilitate the making or pricing of the transaction; and

"(4) withholding or threatening to withhold timely payment for an appraisal report or for appraisal services rendered when the appraisal report or services are provided for in accordance with the contract between the parties.

"(c) EXCEPTIONS.—The requirements of subsection (b) shall not be construed as prohibiting a mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, consumer, or any other person with an interest in a real estate transaction from asking an appraiser to undertake 1 or more of the following:

"(1) Consider additional, appropriate property information, including the consideration of additional comparable properties to make or support an appraisal.

"(2) Provide further detail, substantiation, or explanation for the appraiser's value conclusion.

"(3) Correct errors in the appraisal report.

"(d) PROHIBITIONS ON CONFLICTS OF INTEREST.—No certified or licensed appraiser conducting, and no appraisal management company procuring or facilitating, an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer may have a direct or indirect interest, financial or otherwise, in the property or transaction involving the appraisal.

"(e) MANDATORY REPORTING.—Any mortgage lender, mortgage broker, mortgage banker, real estate broker, appraisal management company, employee of an appraisal management company, or any other person involved in a real estate transaction involving an appraisal in connection with a consumer credit transaction secured by the principal dwelling of a consumer who has a reasonable basis to believe an appraiser is failing to comply with the Uniform Standards of Professional Appraisal Practice, is violating applicable laws, or is otherwise engaging in unethical or unprofessional conduct, shall refer the matter to the applicable State appraiser certifying and licensing agency.

"(f) NO EXTENSION OF CREDIT.—In connection with a consumer credit transaction secured by a consumer's principal dwelling, a creditor who knows, at or before loan consummation, of a violation of the appraisal independence standards established in subsections (b) or (d) shall not extend credit based on such appraisal unless the creditor documents that the creditor has acted with reasonable diligence to determine that the appraisal does not materially misstate or misrepresent the value of such dwelling.

"(g) RULES AND INTERPRETIVE GUIDELINES.—

"(1) IN GENERAL.—Except as provided under paragraph (2), the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau may jointly issue rules, interpretive guidelines, and general statements of policy with respect to acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer and mortgage brokerage services for such a transaction, within the meaning of subsections (a), (b), (c), (d), (e), (f), (h), and (i).

"(2) INTERIM FINAL REGULATIONS.—The Board shall, for purposes of this section, prescribe interim final regulations no later than 90 days after the date of enactment of this section defining with specificity acts or practices that violate appraisal independence in the provision of mortgage lending services for a consumer credit transaction secured by the principal dwelling of the consumer or mortgage brokerage services for such a transaction and defining any terms in this section or such regulations. Rules prescribed by the Board under this paragraph shall be deemed to be rules prescribed by the agencies jointly under paragraph (1).

"(h) APPRAISAL REPORT PORTABILITY.—Consistent with the requirements of this section, the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau may jointly issue regulations that address the issue of appraisal report portability, including regulations that ensure the portability of the appraisal report between lenders for a consumer credit transaction secured by a 1-4 unit single family residence that is the principal dwelling of the consumer, or mortgage brokerage services for such a transaction.

"(i) CUSTOMARY AND REASONABLE FEE.—

"(1) IN GENERAL.—Lenders and their agents shall compensate fee appraisers at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised. Evidence for such fees may be established by objective third-party information, such as government agency fee schedules, academic studies, and independent private sector surveys. Fee studies shall exclude assignments ordered by known appraisal management companies.

"(2) FEE APPRAISER DEFINITION.—For purposes of this section, the term 'fee appraiser' means a person who is not an employee of the mortgage loan originator or appraisal management company engaging the appraiser and is—

"(A) a State licensed or certified appraiser who receives a fee for performing an appraisal and certifies that the appraisal has been prepared in accordance with the Uniform Standards of Professional Appraisal Practice; or

"(B) a company not subject to the requirements of section 1124 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.) that utilizes the services of State licensed or certified appraisers and receives a fee for performing appraisals in accordance with the Uniform Standards of Professional Appraisal Practice.

"(3) EXCEPTION FOR COMPLEX ASSIGNMENTS.—In the case of an appraisal involving a complex assignment, the customary and reasonable fee may reflect the increased time, difficulty, and scope of the work required for such an appraisal and include an amount over and above the customary and reasonable fee for non-complex assignments.

"(j) SUNSET.—Effective on the date the interim final regulations are promulgated pursuant to subsection (g), the Home Valuation Code of Conduct announced by the Federal Housing Finance Agency on December 23, 2008, shall have no force or effect.

"(k) PENALTIES.—

"(1) FIRST VIOLATION.—In addition to the enforcement provisions referred to in section 130, each person who violates this section shall forfeit and pay a civil penalty of not more than $10,000 for each day any such violation continues.

"(2) SUBSEQUENT VIOLATIONS.—In the case of any person on whom a civil penalty has been imposed under paragraph (1), paragraph (1) shall be applied by substituting '$20,000' for '$10,000' with respect to all subsequent violations.

"(3) ASSESSMENT.—The agency referred to in subsection (a) or (c) of section 108 with respect to any person described in paragraph (1) shall assess any penalty under this subsection to which such person is subject.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 2 of the Truth in Lending Act is amended by inserting after the item relating to section 129D (as added by section 1461(c)) the following new items:

"129E. Appraisal independence requirements.
"129F. Requirements for prompt crediting of home loan payments.
"129G. Requests for payoff amounts of home loan.
"129H. Property appraisal requirements.".

(c) DEFERENCE.—Section 105 of the Truth in Lending Act (15 U.S.C. 1604) is amended by adding at the end the following:

"(h) DEFERENCE.—Notwithstanding any power granted to any Federal agency under this title, the deference that a court affords to the Bureau with respect to a determination made by the Bureau relating to the meaning or interpretation of any provision of this title, other than section 129E or 129H, shall be applied as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of this title.".

(d) CONFORMING AMENDMENTS IN TITLE X NOT APPLICABLE TO SECTIONS 129E AND 129H.—Notwithstanding section 1099A, the term "Board" in sections 129E and 129H, as added by this subtitle, shall not be substituted by the term "Bureau".

SEC. 1473. AMENDMENTS RELATING TO APPRAISAL SUBCOMMITTEE OF FFIEC, APPRAISER INDEPENDENCE MONITORING, APPROVED APPRAISER EDUCATION, APPRAISAL MANAGEMENT COMPANIES, APPRAISER COMPLAINT HOTLINE, AUTOMATED VALUATION MODELS, AND BROKER PRICE OPINIONS.

(a) THRESHOLD LEVELS.—Section 1112(b) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3341(b)) is amended by inserting before the period the following: ", and receives concurrence from the Bureau of Consumer Financial Protection that such threshold level provides reasonable protection for consumers who purchase 1–4 unit single-family residences".

(b) ANNUAL REPORT OF APPRAISAL SUBCOMMITTEE.—Section 1103(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3332(a)) is amended at the end by inserting the following new paragraph:

"(5) transmit an annual report to the Congress not later than June 15 of each year that describes the manner in which each function assigned to the Appraisal Subcommittee has been carried out during the preceding year. The report shall also detail the activities of the Appraisal Subcommittee, including the results of all audits of State appraiser regulatory agencies, and provide an accounting of disapproved actions and warnings taken in the previous year, including a description of the conditions causing the disapproval and actions taken to achieve compliance.".

(c) OPEN MEETINGS.—Section 1104(b) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3333(b)) is amended—

(1) by inserting "in public session after notice in the Federal Register, but may close certain portions of these meetings related to personnel and review of preliminary State audit reports," after "shall meet"; and

(2) by adding after the final period the following: "The subject matter discussed in any closed or executive session shall be described in the Federal Register notice of the meeting.".

(d) REGULATIONS.—Section 1106 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3335) is amended—

(1) by inserting "prescribe regulations in accordance with chapter 5 of title 5, United States Code (commonly referred to as the Administrative Procedures Act) after notice and opportunity for comment," after "hold hearings"; and

(2) at the end by inserting "Any regulations prescribed by the Appraisal Subcommittee shall (unless otherwise provided in this title) be limited to the following functions: temporary practice, national registry, information sharing, and enforcement. For purposes of prescribing regulations, the Appraisal Subcommittee shall establish an advisory committee of industry participants, including appraisers, lenders, consumer advocates, real estate agents, and government agencies, and hold meetings as necessary to support the development of regulations.".

(e) APPRAISAL REVIEWS AND COMPLEX APPRAISALS.—

(1) SECTION 1110.—Section 1110 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3339) is amended—

(A) in paragraph (1), by striking "and";

(B) in paragraph (2), by striking the period at the end and inserting "; and"; and

(C) by inserting after paragraph (2) the following:

"(3) that such appraisals shall be subject to appropriate review for compliance with the Uniform Standards of Professional Appraisal Practice.".

(2) SECTION 1113.—Section 1113 of the Financial Institutions and Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3342) is amended by inserting before the period the following: ", where a complex 1-to-4 unit single family residential appraisal means an appraisal for which the property to be appraised, the form of ownership, the property characteristics, or the market conditions are atypical".

(f) APPRAISAL MANAGEMENT SERVICES.—

(1) SUPERVISION OF THIRD PARTY PROVIDERS OF APPRAISAL MANAGEMENT SERVICES.—Section 1103(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3332(a)) (as previously amended by this section) is amended—

(A) by amending paragraph (1) to read as follows: "(1) monitor the requirements established by States—

"(A) for the certification and licensing of individuals who are qualified to perform appraisals in connection with federally related transactions, including a code of professional responsibility; and

"(B) for the registration and supervision of the operations and activities of an appraisal management company;"; and

(B) by adding at the end the following new paragraph:

"(6) maintain a national registry of appraisal management companies that either are registered with and subject to supervision of a State appraiser certifying and licensing agency or are operating subsidiaries of a Federally regulated financial institution.".

(2) APPRAISAL MANAGEMENT COMPANY MINIMUM REQUIREMENTS.—Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.) is amended by adding at the end the following new section (and amending the table of contents accordingly):

"SEC. 1124. APPRAISAL MANAGEMENT COMPANY MINIMUM REQUIREMENTS.

"(a) IN GENERAL.—The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection shall jointly, by rule, establish minimum requirements to be applied by a State in the registration of appraisal management companies. Such requirements shall include a requirement that such companies—

"(1) register with and be subject to supervision by a State appraiser certifying and licensing agency in each State in which such company operates;

"(2) verify that only licensed or certified appraisers are used for federally related transactions;

"(3) require that appraisals coordinated by an appraisal management company comply with the Uniform Standards of Professional Appraisal Practice; and

"(4) require that appraisals are conducted independently and free from inappropriate influence and coercion pursuant to the appraisal independence standards established under section 129E of the Truth in Lending Act.

"(b) RELATION TO STATE LAW.—Nothing in this section shall be construed to prevent States from establishing requirements in addition to any rules promulgated under subsection (a).

"(c) FEDERALLY REGULATED FINANCIAL INSTITUTIONS.—The requirements of subsection (a) shall apply to an appraisal management company that is a subsidiary owned and controlled by a financial institution and regulated by a Federal financial institution regulatory agency. An appraisal management company that is a subsidiary owned and controlled by a financial institution regulated by a Federal financial institution regulatory agency shall not be required to register with a State.

"(d) REGISTRATION LIMITATIONS.—An appraisal management company shall not be registered by a State or included on the national registry if such company, in whole or in part, directly or indirectly, is owned by any person who has had an appraiser license or certificate refused, denied, cancelled, surrendered in lieu of revocation, or revoked in any State. Additionally, each person that owns more than 10 percent of an appraisal management company shall be of good moral character, as determined by the State appraiser certifying and licensing agency, and shall submit to a background investigation carried out by the State appraiser certifying and licensing agency.

"(e) REPORTING.—The Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection shall jointly promulgate regulations for the reporting of the activities of appraisal management companies to the Appraisal Subcommittee in determining the payment of the annual registry fee.

"(f) EFFECTIVE DATE.—

"(1) IN GENERAL.—No appraisal management company may perform services related to a federally related transaction in a State after the date that is 36 months after the date on which the regulations required to be prescribed under subsection (a) are prescribed in final form unless such company is registered with such State or subject to oversight by a Federal financial institutions regulatory agency.

"(2) EXTENSION OF EFFECTIVE DATE.—Subject to the approval of the Council, the Appraisal Subcommittee may extend by an additional 12 months the requirements for the registration and supervision of appraisal management companies if it makes a written finding that a State has made substantial progress in establishing a State appraisal management company registration and supervision system that appears to conform with the provisions of this title.".

(3) STATE APPRAISER CERTIFYING AND LICENSING AGENCY AUTHORITY.—Section 1117 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3346) is amended by adding at the end the following: "The duties of such agency may additionally include the registration and supervision of appraisal management companies and the addition of information about the appraisal management company to the national registry.".

(4) APPRAISAL MANAGEMENT COMPANY DEFINITION.—Section 1121 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3350) is amended by adding at the end the following:

"(11) APPRAISAL MANAGEMENT COMPANY.—The term 'appraisal management company' means, in connection with valuing properties collateralizing mortgage loans or mortgages incorporated into a securitization, any external third party authorized either by a creditor of a consumer credit transaction secured by a consumer's principal dwelling or by an underwriter of or other principal in the secondary mortgage markets, that oversees a network or panel of more than 15 certified or licensed appraisers in a State or 25 or more nationally within a given year—

"(A) to recruit, select, and retain appraisers;

"(B) to contract with licensed and certified appraisers to perform appraisal assignments;

"(C) to manage the process of having an appraisal performed, including providing administrative duties such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and underwriters, collecting fees from creditors and underwriters for services provided, and reimbursing appraisers for services performed; or

"(D) to review and verify the work of appraisers.".

(g) STATE AGENCY REPORTING REQUIREMENT.—Section 1109(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3338(a)) is amended—

(1) by striking "and" after the semicolon in paragraph (1);

(2) by redesignating paragraph (2) as paragraph (4); and

(3) by inserting after paragraph (1) the following new paragraphs:

"(2) transmit reports on the issuance and renewal of licenses and certifications, sanctions, disciplinary actions, license and certification revocations, and license and certification suspensions on a timely basis to the national registry of the Appraisal Subcommittee;

"(3) transmit reports on a timely basis of supervisory activities involving appraisal management companies or other third-party providers of appraisals and appraisal management services, including investigations initiated and disciplinary actions taken; and".

(h) REGISTRY FEES MODIFIED.—

(1) IN GENERAL.—Section 1109(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3338(a)) is amended—

(A) by amending paragraph (4) (as modified by section 1473(g)) to read as follows:

"(4) collect—

"(A) from such individuals who perform or seek to perform appraisals in federally related transactions, an annual registry fee of not more than $40, such fees to be transmitted by the State agencies to the Council on an annual basis; and

"(B) from an appraisal management company that either has registered with a State appraiser certifying and licensing agency in accordance with this title or operates as a subsidiary of a federally regulated financial institution, an annual registry fee of—

"(i) in the case of such a company that has been in existence for more than a year, $25 multiplied by the number of appraisers working for or contracting with such company in such State during the previous year, but where such $25 amount may be adjusted, up to a maximum of $50, at the discretion of the Appraisal Subcommittee, if necessary to carry out the Subcommittee's functions under this title; and

"(ii) in the case of such a company that has not been in existence for more than a year, $25 multiplied by an appropriate number to be determined by the Appraisal Subcommittee, and where such number will be used for determining the fee of all such companies that were not in existence for more than a year, but where such $25 amount may be adjusted, up to a maximum of $50, at the discretion of the Appraisal Subcommittee, if necessary to carry out the Subcommittee's functions under this title."; and

(B) by amending the matter following paragraph (4), as redesignated, to read as follows:

"Subject to the approval of the Council, the Appraisal Subcommittee may adjust the dollar amount of registry fees under paragraph (4)(A), up to a maximum of $80 per annum, as necessary to carry out its functions under this title. The Appraisal Subcommittee shall consider at least once every 5 years whether to adjust the dollar amount of the registry fees to account for inflation. In implementing any change in registry fees, the Appraisal Subcommittee shall provide flexibility to the States for multi-year certifications and licenses already in place, as well as a transition period to implement the changes in registry fees. In establishing the amount of the annual registry fee for an appraisal management company, the Appraisal Subcommittee shall have the discretion to impose a minimum annual registry fee for an appraisal management company to protect against the under reporting of the number of appraisers working for or contracted by the appraisal management company.".

(2) INCREMENTAL REVENUES.—Incremental revenues collected pursuant to the increases required by this subsection shall be placed in a separate account at the United States Treasury, entitled the "Appraisal Subcommittee Account".

(i) GRANTS AND REPORTS.—Section 1109(b) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3338(b)) is amended—

(1) by striking "and" after the semicolon in paragraph (3);

(2) by striking the period at the end of paragraph (4) and inserting a semicolon;

(3) by adding at the end the following new paragraphs:

"(5) to make grants to State appraiser certifying and licensing agencies, in accordance with policies to be developed by the Appraisal Subcommittee, to support the efforts of such agencies to comply with this title, including—

"(A) the complaint process, complaint investigations, and appraiser enforcement activities of such agencies; and

"(B) the submission of data on State licensed and certified appraisers and appraisal management companies to the National appraisal registry, including information affirming that the appraiser or appraisal management company meets the required qualification criteria and formal and informal disciplinary actions; and

"(6) to report to all State appraiser certifying and licensing agencies when a license or certification is surrendered, revoked, or suspended.".

Obligations authorized under this subsection may not exceed 75 percent of the fiscal year total of incremental increase in fees collected and deposited in the "Appraisal Subcommittee Account" pursuant to subsection (h).

(j) CRITERIA.—Section 1116 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3345) is amended—

(1) in subsection (c), by inserting "whose criteria for the licensing of a real estate appraiser currently meet or exceed the minimum criteria issued by the Appraisal Qualifications Board of The Appraisal Foundation for the licensing of real estate appraisers" before the period at the end; and

(2) by striking subsection (e) and inserting the following new subsection:

"(e) MINIMUM QUALIFICATION REQUIREMENTS.—Any requirements established for individuals in the position of 'Trainee Appraiser' and 'Supervisory Appraiser' shall meet or exceed the minimum qualification requirements of the Appraiser Qualifications Board of The Appraisal Foundation. The Appraisal Subcommittee shall have the authority to enforce these requirements.".

(k) MONITORING OF STATE APPRAISER CERTIFYING AND LICENSING AGENCIES.—Section 1118 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3347) is amended—

(1) by amending subsection (a) to read as follows:

"(a) IN GENERAL.—The Appraisal Subcommittee shall monitor each State appraiser certifying and licensing agency for the purposes of determining whether such agency—

"(1) has policies, practices, funding, staffing, and procedures that are consistent with this title;

"(2) processes complaints and completes investigations in a reasonable time period;

"(3) appropriately disciplines sanctioned appraisers and appraisal management companies;

"(4) maintains an effective regulatory program; and

"(5) reports complaints and disciplinary actions on a timely basis to the national registries on appraisers and appraisal management companies maintained by the Appraisal Subcommittee.

The Appraisal Subcommittee shall have the authority to remove a State licensed or certified appraiser or a registered appraisal management company from a national registry on an interim basis, not to exceed 90 days, pending State agency action on licensing, certification, registration, and disciplinary proceedings. The Appraisal Subcommittee and all agencies, instrumentalities, and Federally recognized entities under this title shall not recognize appraiser certifications and licenses from States whose appraisal policies, practices, funding, staffing, or procedures are found to be inconsistent with this title. The Appraisal Subcommittee shall have the authority to impose sanctions, as described in this section, against a State agency that fails to have an effective appraiser regulatory program. In determining whether such a program is effective, the Appraisal Subcommittee shall include an analysis of the licensing and certification of appraisers, the registration of appraisal management companies, the issuance of temporary licenses and certifications for appraisers, the receiving and tracking of submitted complaints against appraisers and appraisal management companies, the investigation of complaints, and enforcement actions against appraisers and appraisal management companies. The Appraisal Subcommittee shall have the authority to impose interim actions and suspensions against a State agency as an alternative to, or in advance of, the derecognition of a State agency.".

(2) in subsection (b)(2), by inserting after "authority" the following: "or sufficient funding".

(l) RECIPROCITY.—Subsection (b) of section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351(b)) is amended to read as follows:

"(b) RECIPROCITY.—Notwithstanding any other provisions of this title, a federally related transaction shall not be appraised by a certified or licensed appraiser unless the State appraiser certifying or licensing agency of the State certifying or licensing such appraiser has in place a policy of issuing a reciprocal certification or license for an individual from another State when—

"(1) the appraiser licensing and certification program of such other State is in compliance with the provisions of this title; and

"(2) the appraiser holds a valid certification from a State whose requirements for certification or licensing meet or exceed the licensure standards established by the State where an individual seeks appraisal licensure.".

(m) CONSIDERATION OF PROFESSIONAL APPRAISAL DESIGNATIONS.—Section 1122(d) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351(d)) is amended by striking "shall not exclude" and all that follows through the end of the subsection and inserting the following: "may include education achieved, experience, sample appraisals, and references from prior clients. Membership in a nationally recognized professional appraisal organization may be a criteria considered, though lack of membership therein shall not be the sole bar against consideration for an assignment under these criteria.".

(n) APPRAISER INDEPENDENCE.—Section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351) is amended by adding at the end the following new subsection:

"(g) APPRAISER INDEPENDENCE MONITORING.—The Appraisal Subcommittee shall monitor each State appraiser certifying and licensing agency for the purpose of determining whether such agency's policies, practices, and procedures are consistent with the purposes of maintaining appraiser independence and whether such State has adopted and maintains effective laws, regulations, and policies aimed at maintaining appraiser independence.".

(o) APPRAISER EDUCATION.—Section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351) is amended by inserting after subsection (g) (as added by subsection (l) of this section) the following new subsection:

"(h) APPROVED EDUCATION.—The Appraisal Subcommittee shall encourage the States to accept courses approved by the Appraiser Qualification Board's Course Approval Program.".

(p) APPRAISAL COMPLAINT HOTLINE.—Section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351), as amended by this section, is amended by adding at the end the following new subsection:

"(i) APPRAISAL COMPLAINT NATIONAL HOTLINE.—If, 6 months after the date of the enactment of this subsection, the Appraisal Subcommittee determines that no national hotline exists to receive complaints of non-compliance with appraisal independence standards and Uniform Standards of Professional Appraisal Practice, including complaints from appraisers, individuals, or other entities concerning the improper influencing or attempted improper influencing of appraisers or the appraisal process, the Appraisal Subcommittee shall establish and operate such a national hotline, which shall include a toll-free telephone number and an email address. If the Appraisal Subcommittee operates such a national hotline, the Appraisal Subcommittee shall refer complaints for further action to appropriate governmental bodies, including a State appraiser certifying and licensing agency, a financial institution regulator, or other appropriate legal authorities. For complaints referred to State appraiser certifying and licensing agencies or to Federal regulators, the Appraisal Subcommittee shall have the authority to follow up such complaint referrals in order to determine the status of the resolution of the complaint.''.

(q) AUTOMATED VALUATION MODELS.—Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.), as amended by this section, is amended by adding at the end the following new section (and amending the table of contents accordingly):

''SEC. 1125. AUTOMATED VALUATION MODELS USED TO ESTIMATE COLLATERAL VALUE FOR MORTGAGE LENDING PURPOSES.

''(a) IN GENERAL.—Automated valuation models shall adhere to quality control standards designed to—

''(1) ensure a high level of confidence in the estimates produced by automated valuation models;

''(2) protect against the manipulation of data;

''(3) seek to avoid conflicts of interest;

''(4) require random sample testing and reviews; and

''(5) account for any other such factor that the agencies listed in subsection (b) determine to be appropriate.

''(b) ADOPTION OF REGULATIONS.—The Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Bureau of Consumer Financial Protection, in consultation with the staff of the Appraisal Subcommittee and the Appraisal Standards Board of the Appraisal Foundation, shall promulgate regulations to implement the quality control standards required under this section.

''(c) ENFORCEMENT.—Compliance with regulations issued under this subsection shall be enforced by—

''(1) with respect to a financial institution, or subsidiary owned and controlled by a financial institution and regulated by a Federal financial institution regulatory agency, the Federal financial institution regulatory agency that acts as the primary Federal supervisor of such financial institution or subsidiary; and

''(2) with respect to other participants in the market for appraisals of 1-to-4 unit single family residential real estate, the Federal Trade Commission, the Bureau of Consumer Financial Protection, and a State attorney general.

''(d) AUTOMATED VALUATION MODEL DEFINED.—For purposes of this section, the term 'automated valuation model' means any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer's principal dwelling.''.

(r) BROKER PRICE OPINIONS.—Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3331 et seq.), as amended by this section, is amended by adding at the end the following new section (and amending the table of contents accordingly):

''SEC. 1126. BROKER PRICE OPINIONS.

''(a) GENERAL PROHIBITION.—In conjunction with the purchase of a consumer's principal dwelling, broker price opinions may not be used as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property.

"(b) BROKER PRICE OPINION DEFINED.—For purposes of this section, the term 'broker price opinion' means an estimate prepared by a real estate broker, agent, or sales person that details the probable selling price of a particular piece of real estate property and provides a varying level of detail about the property's condition, market, and neighborhood, and information on comparable sales, but does not include an automated valuation model, as defined in section 1125(c).".

(s) AMENDMENTS TO APPRAISAL SUBCOMMITTEE.—Section 1011 of the Federal Financial Institutions Examination Council Act of 1978 (12 U.S.C. 3310) is amended—

(1) in the first sentence, by adding before the period the following: ", the Bureau of Consumer Financial Protection, and the Federal Housing Finance Agency"; and

(2) by inserting at the end the following: "At all times at least one member of the Appraisal Subcommittee shall have demonstrated knowledge and competence through licensure, certification, or professional designation within the appraisal profession.".

(t) TECHNICAL CORRECTIONS.—

(1) Section 1119(a)(2) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3348(a)(2)) is amended by striking "council," and inserting "Council,".

(2) Section 1121(6) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3350(6)) is amended by striking "Corporations," and inserting "Corporation,".

(3) Section 1121(8) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3350(8)) is amended by striking "council" and inserting "Council".

(4) Section 1122 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3351) is amended—

(A) in subsection (a)(1) by moving the left margin of subparagraphs (A), (B), and (C) 2 ems to the right; and

(B) in subsection (c)—

(i) by striking "Federal Financial Institutions Examination Council" and inserting "Financial Institutions Examination Council"; and

(ii) by striking "the council's functions" and inserting "the Council's functions".

SEC. 1474. EQUAL CREDIT OPPORTUNITY ACT AMENDMENT.

Subsection (e) of section 701 of the Equal Credit Opportunity Act (15 U.S.C. 1691) is amended to read as follows:

"(e) COPIES FURNISHED TO APPLICANTS.—

"(1) IN GENERAL.—Each creditor shall furnish to an applicant a copy of any and all written appraisals and valuations developed in connection with the applicant's application for a loan that is secured or would have been secured by a first lien on a dwelling promptly upon completion, but in no case later than 3 days prior to the closing of the loan, whether the creditor grants or denies the applicant's request for credit or the application is incomplete or withdrawn.

"(2) WAIVER.—The applicant may waive the 3 day requirement provided for in paragraph (1), except where otherwise required in law.

"(3) REIMBURSEMENT.—The applicant may be required to pay a reasonable fee to reimburse the creditor for the cost of the appraisal, except where otherwise required in law.

"(4) FREE COPY.—Notwithstanding paragraph (3), the creditor shall provide a copy of each written appraisal or valuation at no additional cost to the applicant.

"(5) NOTIFICATION TO APPLICANTS.—At the time of application, the creditor shall notify an applicant in writing of the right to receive a copy of each written appraisal and valuation under this subsection.

"(6) VALUATION DEFINED.—For purposes of this subsection, the term 'valuation' shall include any estimate of the value of a dwelling developed in connection with a creditor's decision to provide credit, including those values developed pursuant to a policy of a government sponsored enterprise or by an automated valuation model, a broker price opinion, or other methodology or mechanism.".

SEC. 1475. REAL ESTATE SETTLEMENT PROCEDURES ACT OF 1974 AMENDMENT RELATING TO CERTAIN APPRAISAL FEES.

Section 4 of the Real Estate Settlement Procedures Act of 1974 is amended by adding at the end the following new subsection:

"(c) The standard form described in subsection (a) may include, in the case of an appraisal coordinated by an appraisal management company (as such term is defined in section 1121(11) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 3350(11))), a clear disclosure of—

"(1) the fee paid directly to the appraiser by such company; and

"(2) the administration fee charged by such company.".

SEC. 1476. GAO STUDY ON THE EFFECTIVENESS AND IMPACT OF VARIOUS APPRAISAL METHODS, VALUATION MODELS AND DISTRIBUTIONS CHANNELS, AND ON THE HOME VALUATION CODE OF CONDUCT AND THE APPRAISAL SUBCOMMITTEE.

(a) IN GENERAL.—The Government Accountability Office shall conduct a study on—

(1) the effectiveness and impact of—

(A) appraisal methods, including the cost approach, the comparative sales approach, the income approach, and others that may be available;

(B) appraisal valuation models, including licensed and certified appraisals, broker-priced opinions, and automated valuation models; and

(C) appraisal distribution channels, including appraisal management companies, independent appraisal operations within mortgage originators, and fee-for-service appraisers;

(2) the Home Valuation Code of Conduct; and

(3) the Appraisal Subcommittee's functions pursuant to title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

(b) STUDY.—Not later than—

(1) 12 months after the date of enactment of this Act, the Government Accountability Office shall submit a study

to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives; and

(2) 90 days after the date of enactment of this Act, the Government Accountability Office shall provide a report on the status of the study and any preliminary findings to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

(c) CONTENT OF STUDY.—The study required by this section shall include an examination of the following:

(1) APPRAISAL APPROACHES, VALUATION MODELS, AND DISTRIBUTION CHANNELS.—

(A) The prevalence, alone or in combination, of certain appraisal approaches, models, and channels in purchase-money and refinance mortgage transactions.

(B) The accuracy of these approaches, models, and channels in assessing the property as collateral.

(C) Whether and how these approaches, models, and channels contributed to price speculation during the previous cycle.

(D) The costs to consumers of these approaches, models, and channels.

(E) The disclosure of fees to consumers in the appraisal process.

(F) To what extent the usage of these approaches, models, and channels may be influenced by a conflict of interest between the mortgage lender and the appraiser and the mechanism by which the lender selects and compensates the appraiser.

(G) The suitability of these approaches, models, and channels in rural versus urban areas.

(2) HOME VALUATION CODE OF CONDUCT (HVCC).—

(A) How the HVCC affects mortgage lenders' selection of appraisers.

(B) How the HVCC affects State regulation of appraisers and appraisal distribution channels.

(C) How the HVCC affects the quality and cost of appraisals and the length of time to obtain an appraisal.

(D) How the HVCC affects mortgage brokers, small businesses, and consumers.

(d) ADDITIONAL STUDY REQUIRED.—

(1) IN GENERAL.—Not later than 18 months after the date of enactment of this Act, the Government Accountability Office shall submit a study to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

(2) CONTENT OF ADDITIONAL STUDY.—The study required under paragraph (1) shall include—

(A) an examination of—

(i) the Appraisal Subcommittee's ability to monitor and enforce State and Federal certification requirements and standards, including by providing a summary with a statistical breakdown of enforcement actions taken during the last 10 years;

(ii) whether existing Federal financial institutions regulatory agency exemptions on appraisals for federally related transactions needs to be revised; and

(iii) whether new means of data collection, such as the establishment of a national repository, would benefit the Appraisal Subcommittee's ability to perform its functions; and

(B) recommendations from this examination for administrative and legislative action at the Federal and State level.

Subtitle G—Mortgage Resolution and Modification

SEC. 1481. MULTIFAMILY MORTGAGE RESOLUTION PROGRAM.

(a) ESTABLISHMENT.—The Secretary of Housing and Urban Development shall develop a program under this subsection to ensure the protection of current and future tenants and at-risk multifamily properties, where feasible, based on criteria that may include—

(1) creating sustainable financing of such properties, that may take into consideration such factors as—

(A) the rental income generated by such properties; and

(B) the preservation of adequate operating reserves;

(2) maintaining the level of Federal, State, and city subsidies in effect as of the date of the enactment of this Act;

(3) providing funds for rehabilitation; and

(4) facilitating the transfer of such properties, when appropriate and with the agreement of owners, to responsible new owners and ensuring affordability of such properties.

(b) COORDINATION.—The Secretary of Housing and Urban Development may, in carrying out the program developed under this section, coordinate with the Secretary of the Treasury, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Federal Housing Finance Agency, and any other Federal Government agency that the Secretary considers appropriate.

(c) DEFINITION.—For purposes of this section, the term "multifamily properties" means a residential structure that consists of 5 or more dwelling units.

(d) PREVENTION OF QUALIFICATION FOR CRIMINAL APPLICANTS.—

(1) IN GENERAL.—No person shall be eligible to begin receiving assistance from the Making Home Affordable Program authorized under the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5201 et seq.), or any other mortgage assistance program authorized or funded by that Act, on or after 60 days after the date of the enactment of this Act, if such person, in connection with a mortgage or real estate transaction, has been convicted, within the last 10 years, of any one of the following:

(A) Felony larceny, theft, fraud, or forgery.

(B) Money laundering.

(C) Tax evasion.

(2) PROCEDURES.—The Secretary shall establish procedures to ensure compliance with this subsection.

(3) REPORT.—The Secretary shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate regarding the implementation of this provision. The report shall also describe the steps taken to implement this subsection.

SEC. 1482. HOME AFFORDABLE MODIFICATION PROGRAM GUIDELINES.

(a) NET PRESENT VALUE INPUT DATA.—The Secretary of the Treasury (in this section referred to as the "Secretary") shall revise the supplemental directives and other guidelines for the Home Affordable Modification Program of the Making Home Affordable initiative of the Secretary of the Treasury, authorized under the Emergency Economic Stabilization Act of 2008 (Public Law 110–343), to require each mortgage servicer participating in such program to provide each borrower under a mortgage whose request for a mortgage modification under the Program is denied with all borrower-related and mortgage-related input data used in any net present value (NPV) analyses performed in connection with the subject mortgage. Such input data shall be provided to the borrower at the time of such denial.

(b) WEB-BASED SITE FOR NPV CALCULATOR AND APPLICATION.—

(1) NPV CALCULATOR.—In carrying out the Home Affordable Modification Program, the Secretary shall establish and maintain a site on the World Wide Web that provides a calculator for net present value analyses of a mortgage, based on the Secretary's methodology for calculating such value, that mortgagors can use to enter information regarding their own mortgages and that provides a determination after entering such information regarding a mortgage of whether such mortgage would be accepted or rejected for modification under the Program, using such methodology.

(2) DISCLOSURE.—Such Web site shall also prominently disclose that each mortgage servicer participating in such Program may use a method for calculating net present value of a mortgage that is different than the method used by such calculator.

(3) APPLICATION.—The Secretary shall make a reasonable effort to include on such World Wide Web site a method for homeowners to apply for a mortgage modification under the Home Affordable Modification Program.

(c) PUBLIC AVAILABILITY OF NPV METHODOLOGY, COMPUTER MODEL, AND VARIABLES.—The Secretary shall make publicly available, including by posting on a World Wide Web site of the Secretary—

(1) the Secretary's methodology and computer model, including all formulae used in such computer model, used for calculating net present value of a mortgage that is used by the calculator established pursuant to subsection (b); and

(2) all non-proprietary variables used in such net present value analysis.

SEC. 1483. PUBLIC AVAILABILITY OF INFORMATION OF MAKING HOME AFFORDABLE PROGRAM.

(a) REVISIONS TO PROGRAM GUIDELINES.—The Secretary of the Treasury (in this section referred to as the "Secretary") shall revise the guidelines for the Home Affordable Modification Program of the Making Home Affordable initiative of the Secretary of the

Treasury, authorized under the Emergency Economic Stabilization Act of 2008 (Public Law 110–343), to provide that the data being collected by the Secretary from each mortgage servicer and lender participating in the Program is made public in accordance with subsection (b).

(b) PUBLIC AVAILABILITY.—Data shall be made available according to the following guidelines:

(1) Not more than 14 days after each monthly deadline for submission of data by mortgage servicers and lenders participating in the Program, reports shall be made publicly available by means of a World Wide Web site of the Secretary, and by submitting a report to the Congress, that shall includes the following information:

(A) The number of requests for mortgage modifications under the Program that the servicer or lender has received.

(B) The number of requests for mortgage modifications under the Program that the servicer or lender has processed.

(C) The number of requests for mortgage modifications under the Program that the servicer or lender has approved.

(D) The number of requests for mortgage modifications under the Program that the servicer or lender has denied.

(2) Not more than 60 days after each monthly deadline for submission of data by mortgage servicers and lenders participating in the Program, the Secretary shall make data tables available to the public at the individual record level. The Secretary shall issue regulations prescribing—

(A) the procedures for disclosing such data to the public; and

(B) such deletions as the Secretary may determine to be appropriate to protect any privacy interest of any mortgage modification applicant, including the deletion or alteration of the applicant's name and identification number.

SEC. 1484. PROTECTING TENANTS AT FORECLOSURE EXTENSION AND CLARIFICATION.

The Protecting Tenants at Foreclosure Act is amended—

(1) in section 702 (12 U.S.C. 5220 note)—

(A) in subsection (a)(2), by striking ", as of the date of such notice of foreclosure"; and

(B) in subsection (c), by inserting after the period the following: "For purposes of this section, the date of a notice of foreclosure shall be deemed to be the date on which complete title to a property is transferred to a successor entity or person as a result of an order of a court or pursuant to provisions in a mortgage, deed of trust, or security deed."; and

(2) in section 704 (12 U.S.C. 5201 note), by striking "2012" and inserting "2014".

Subtitle H—Miscellaneous Provisions

SEC. 1491. SENSE OF CONGRESS REGARDING THE IMPORTANCE OF GOVERNMENT-SPONSORED ENTERPRISES REFORM TO ENHANCE THE PROTECTION, LIMITATION, AND REGULATION OF THE TERMS OF RESIDENTIAL MORTGAGE CREDIT.

(a) FINDINGS.—The Congress finds as follows:

(1) The Government-sponsored enterprises, Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), were chartered by Congress to ensure a reliable and affordable supply of mortgage funding, but enjoy a dual legal status as privately owned corporations with Government mandated affordable housing goals.

(2) In 1996, the Department of Housing and Urban Development required that 42 percent of Fannie Mae's and Freddie Mac's mortgage financing should go to borrowers with income levels below the median for a given area.

(3) In 2004, the Department of Housing and Urban Development revised those goals, increasing them to 56 percent of their overall mortgage purchases by 2008, and additionally mandated that 12 percent of all mortgage purchases by Fannie Mae and Freddie Mac be "special affordable" loans made to borrowers with incomes less than 60 percent of an area's median income, a target that ultimately increased to 28 percent for 2008.

(4) To help fulfill those mandated affordable housing goals, in 1995 the Department of Housing and Urban Development authorized Fannie Mae and Freddie Mac to purchase subprime securities that included loans made to low-income borrowers.

(5) After this authorization to purchase subprime securities, subprime and near-prime loans increased from 9 percent of securitized mortgages in 2001 to 40 percent in 2006, while the market share of conventional mortgages dropped from 78.8 percent in 2003 to 50.1 percent by 2007 with a corresponding increase in subprime and Alt-A loans from 10.1 percent to 32.7 percent over the same period.

(6) In 2004 alone, Fannie Mae and Freddie Mac purchased $175,000,000,000 in subprime mortgage securities, which accounted for 44 percent of the market that year, and from 2005 through 2007, Fannie Mae and Freddie Mac purchased approximately $1,000,000,000,000 in subprime and Alt-A loans, while Fannie Mae's acquisitions of mortgages with less than 10 percent down payments almost tripled.

(7) According to data from the Federal Housing Finance Agency (FHFA) for the fourth quarter of 2008, Fannie Mae and Freddie Mac own or guarantee 75 percent of all newly originated mortgages, and Fannie Mae and Freddie Mac currently own 13.3 percent of outstanding mortgage debt in the United States and have issued mortgage-backed securities for 31.0 percent of the residential debt market, a combined total of 44.3 percent of outstanding mortgage debt in the United States.

(8) On September 7, 2008, the FHFA placed Fannie Mae and Freddie Mac into conservatorship, with the Treasury

Department subsequently agreeing to purchase at least $200,000,000,000 of preferred stock from each enterprise in exchange for warrants for the purchase of 79.9 percent of each enterprise's common stock.

(9) The conservatorship for Fannie Mae and Freddie Mac has potentially exposed taxpayers to upwards of $5,300,000,000,000 worth of risk.

(10) The hybrid public-private status of Fannie Mae and Freddie Mac is untenable and must be resolved to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive.

(b) SENSE OF THE CONGRESS.—It is the sense of the Congress that efforts to enhance by the protection, limitation, and regulation of the terms of residential mortgage credit and the practices related to such credit would be incomplete without enactment of meaningful structural reforms of Fannie Mae and Freddie Mac.

SEC. 1492. GAO STUDY REPORT ON GOVERNMENT EFFORTS TO COMBAT MORTGAGE FORECLOSURE RESCUE SCAMS AND LOAN MODIFICATION FRAUD.

(a) STUDY.—The Comptroller General of the United States shall conduct a study of the current inter-agency efforts of the Secretary of the Treasury, the Secretary of Housing and Urban Development, the Attorney General, and the Federal Trade Commission to crackdown on mortgage foreclosure rescue scams and loan modification fraud in order to advise the Congress to the risks and vulnerabilities of emerging schemes in the loan modification arena.

(b) REPORT.—

(1) IN GENERAL.—The Comptroller General shall submit a report to the Congress on the study conducted under subsection (a) containing such recommendations for legislative and administrative actions as the Comptroller General may determine to be appropriate in addition to the recommendations required under paragraph (2).

(2) SPECIFIC TOPICS.—The report made under paragraph (1) shall include—

(A) an evaluation of the effectiveness of the interagency task force current efforts to combat mortgage foreclosure rescue scams and loan modification fraud scams;

(B) specific recommendations on agency or legislative action that are essential to properly protect homeowners from mortgage foreclosure rescue scams and loan modification fraud scams; and

(C) the adequacy of financial resources that the Federal Government is allocating to—

(i) crackdown on loan modification and foreclosure rescue scams; and

(ii) the education of homeowners about fraudulent scams relating to loan modification and foreclosure rescues.

SEC. 1493. REPORTING OF MORTGAGE DATA BY STATE.

(a) IN GENERAL.—Section 104(a) of the Helping Families Save Their Homes Act of 2009 (division A of Public Law 111–22) is amended—

(1) in paragraph (2), by striking "resulting" and inserting "in each State that result";

(2) in paragraph (3), by inserting "each State for" after "modifications in"; and

(3) in paragraph (4), by inserting "in each State" after "total number of loans".

(b) CONFORMING AMENDMENT.—Section 104(b)(1)(A) of such Act is amended by adding at the end the following sentence: "Not later than 60 days after the date of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Comptroller of the Currency and the Director of the Office of Thrift Supervision shall update such requirements to reflect amendments made to this section by such Act.".

SEC. 1494. STUDY OF EFFECT OF DRYWALL PRESENCE ON FORECLOSURES.

(a) STUDY.—The Secretary of Housing and Urban Development, in consultation with the Secretary of the Treasury, shall conduct a study of the effect on residential mortgage loan foreclosures of—

(1) the presence in residential structures subject to such mortgage loans of drywall that was imported from China during the period beginning with 2004 and ending at the end of 2007; and

(2) the availability of property insurance for residential structures in which such drywall is present.

(b) REPORT.—Not later than the expiration of the 120-day period beginning on the date of the enactment of this Act, the Secretary of Housing and Urban Development shall submit to the Congress a report on the study conducted under subsection (a) containing its findings, conclusions, and recommendations.

SEC. 1495. DEFINITION.

For purposes of this title, the term "designated transfer date" means the date established under section 1062 of this Act.

SEC. 1496. EMERGENCY MORTGAGE RELIEF.

(a) EMERGENCY HOMEOWNERS' RELIEF FUND.—Effective October 1, 2010, and notwithstanding any other provision of law, there is hereby made available to the Secretary of Housing and Urban Development such sums as are necessary to provide $1,000,000,000 in assistance through the Emergency Homeowners' Relief Fund, which such Secretary shall establish pursuant to section 107 of the Emergency Housing Act of 1975 (12 U.S.C. 2706), as such Act is amended by this section, for use for emergency mortgage assistance in accordance with title I of such Act.

(b) REAUTHORIZATION OF EMERGENCY MORTGAGE RELIEF PROGRAM.—Title I of the Emergency Housing Act of 1975 is amended—

(1) in section 103 (12 U.S.C. 2702)—

(A) in paragraph (2)—

(i) by striking "have indicated" and all that follows through "regulation of the holder" and insert "have certified";

(ii) by striking "(such as the volume of delinquent loans in its portfolio)"; and

(iii) by striking ", except that such statement" and all that follows through "purposes of this title"; and

(B) in paragraph (4), by inserting “or medical conditions” after “adverse economic conditions”;

(2) in section 104 (12 U.S.C. 2703)—

(A) in subsection (b), by striking “, but such assistance” and all that follows through the period at the end and inserting the following: “. The amount of assistance provided to a homeowner under this title shall be an amount that the Secretary determines is reasonably necessary to supplement such amount as the homeowner is capable of contributing toward such mortgage payment, except that the aggregate amount of such assistance provided for any homeowner shall not exceed $50,000.”;

(B) in subsection (d), by striking “interest on a loan or advance” and all that follows through the end of the subsection and inserting the following: “(1) the rate of interest on any loan or advance of credit insured under this title shall be fixed for the life of the loan or advance of credit and shall not exceed the rate of interest that is generally charged for mortgages on single-family housing insured by the Secretary of Housing and Urban Development under title II of the National Housing Act at the time such loan or advance of credit is made, and (2) no interest shall be charged on interest which is deferred on a loan or advance of credit made under this title. In establishing rates, terms and conditions for loans or advances of credit made under this title, the Secretary shall take into account a homeowner’s ability to repay such loan or advance of credit.”; and

(C) in subsection (e), by inserting after the period at the end of the first sentence the following: “Any eligible homeowner who receives a grant or an advance of credit under this title may repay the loan in full, without penalty, by lump sum or by installment payments at any time before the loan becomes due and payable.”;

(3) in section 105 (12 U.S.C. 2704)—

(A) by striking subsection (b);

(B) in subsection (e)—

(i) by inserting “and emergency mortgage relief payments made under section 106” after “insured under this section”; and

(ii) by striking “$1,500,000,000 at any one time” and inserting “$3,000,000,000”;

(C) by redesignating subsections (c), (d), and (e) as subsections (b), (c), and (d), respectively; and

(D) by adding at the end the following new subsection:

“(e) The Secretary shall establish underwriting guidelines or procedures to allocate amounts made available for loans and advances insured under this section and for emergency relief payments made under section 106 based on the likelihood that a mortgagor will be able to resume mortgage payments, pursuant to the requirement under section 103(5).”;

(4) in section 107—

(A) by striking “(a)”; and

(B) by striking subsection (b);

(5) in section 108 (12 U.S.C. 2707), by adding at the end the following new subsection:

"(d) COVERAGE OF EXISTING PROGRAMS.—The Secretary shall allow funds to be administered by a State that has an existing program that is determined by the Secretary to provide substantially similar assistance to homeowners. After such determination is made such State shall not be required to modify such program to comply with the provisions of this title.";

(6) in section 109 (12 U.S.C. 2708)—

(A) in the section heading, by striking "AUTHORIZATION AND";

(B) by striking subsection (a);

(C) by striking "(b)"; and

(D) by striking "1977" and inserting "2011";

(7) by striking sections 110, 111, and 113 (12 U.S.C. 2709, 2710, 2712); and

(8) by redesignating section 112 (12 U.S.C. 2711) as section 110.

SEC. 1497. ADDITIONAL ASSISTANCE FOR NEIGHBORHOOD STABILIZATION PROGRAM.

(a) IN GENERAL.—Effective October 1, 2010, out of funds in the Treasury not otherwise appropriated, there is hereby made available to the Secretary of Housing and Urban Development $1,000,000,000, and the Secretary of Housing and Urban Development shall use such amounts for assistance to States and units of general local government for the redevelopment of abandoned and foreclosed homes, in accordance with the same provisions applicable under the second undesignated paragraph under the heading "Community Planning and Development—Community Development Fund" in title XII of division A of the American Recovery and Reinvestment Act of 2009 (Public Law 111–5; 123 Stat. 217) to amounts made available under such second undesignated paragraph, except as follows:

(1) Notwithstanding the matter of such second undesignated paragraph that precedes the first proviso, amounts made available by this section shall remain available until expended.

(2) The 3rd, 4th, 5th, 6th, 7th, and 15th provisos of such second undesignated paragraph shall not apply to amounts made available by this section.

(3) Amounts made available by this section shall be allocated based on a funding formula for such amounts established by the Secretary in accordance with section 2301(b) of the Housing and Economic Recovery Act of 2008 (42 U.S.C. 5301 note), except that—

(A) notwithstanding paragraph (2) of such section 2301(b), the formula shall be established not later than 30 days after the date of the enactment of this Act;

(B) notwithstanding such section 2301(b), each State shall receive, at a minimum, not less than 0.5 percent of funds made available under this section;

(C) the Secretary may establish a minimum grant amount for direct allocations to units of general local government located within a State, which shall not exceed $1,000,000;

(D) each State and local government receiving grant amounts shall establish procedures to create preferences for the development of affordable rental housing for properties assisted with amounts made available by this section; and

(E) the Secretary may use not more than 2 percent of the funds made available under this section for technical assistance to grantees.

(4) Paragraph (1) of section 2301(c) of the Housing and Economic Recovery Act of 2008 shall not apply to amounts made available by this section.

(5) The fourth proviso from the end of such second undesignated paragraph shall be applied to amounts made available by this section by substituting "2013" for "2012".

(6) Notwithstanding section 2301(a) of the Housing and Economic Recovery Act of 2008, the term "State" means any State, as defined in section 102 of the Housing and Community Development Act of 1974 (42 U.S.C. 5302), and the District of Columbia, for purposes of this section and this title, as applied to amounts made available by this section.

(7)(A) None of the amounts made available by this section shall be distributed to—

(i) any organization which has been convicted for a violation under Federal law relating to an election for Federal office; or

(ii) any organization which employs applicable individuals.

(B) In this paragraph, the term "applicable individual" means an individual who—

(i) is—

(I) employed by the organization in a permanent or temporary capacity;

(II) contracted or retained by the organization; or

(III) acting on behalf of, or with the express or apparent authority of, the organization; and

(ii) has been convicted for a violation under Federal law relating to an election for Federal office.

(8) An eligible entity receiving a grant under this section shall, to the maximum extent feasible, provide for the hiring of employees who reside in the vicinity, as such term is defined by the Secretary, of projects funded under this section or contract with small businesses that are owned and operated by persons residing in the vicinity of such projects.

(b) ADDITIONAL AMENDMENTS.—

(1) SECTION 2301.—Section 2301(f)(3)(A)(ii) of the Housing and Economic Recovery Act of 2008 (42 U.S.C. 5301(f)(3)(A)(ii))—

(A) is amended by striking "for the purchase and redevelopment of abandoned and foreclosed upon homes or residential properties that will be used"; and

(B) shall apply with respect to any unexpended or unobligated balances, including recaptured and reallocated funds made available under this Act, section 2301 of the Housing and Economic Recovery Act of 2008 (42 U.S.C. 5301), and the heading "Community Planning and Development—Community Development Fund" in title XII of division A of the American Recovery and Reinvestment Act of 2009 (Public Law 111-5; 123 Stat. 217).

(2) NOTICE OF FORECLOSURE.—For any amounts made available under this section, under division B, title III of the Housing and Economic Recovery Act of 2008 (42 U.S.C. 5301), or under the heading "Community Planning and Development—Community Development Fund" in title XII of division A of the American Recovery and Reinvestment Act of 2009 (Public Law 111-5; 123 Stat. 217), the date of a notice of foreclosure shall be deemed to be the date on which complete title to a property is transferred to a successor entity or person as a result of an order of a court or pursuant to provisions in a mortgage, deed of trust, or security deed.

SEC. 1498. LEGAL ASSISTANCE FOR FORECLOSURE-RELATED ISSUES.

(a) ESTABLISHMENT.—The Secretary of Housing and Urban Development (hereafter in this section referred to as the "Secretary") shall establish a program for making grants for providing a full range of foreclosure legal assistance to low- and moderate-income homeowners and tenants related to home ownership preservation, home foreclosure prevention, and tenancy associated with home foreclosure.

(b) COMPETITIVE ALLOCATION.—The Secretary shall allocate amounts made available for grants under this section to State and local legal organizations on the basis of a competitive process. For purposes of this subsection "State and local legal organizations" are those State and local organizations whose primary business or mission is to provide legal assistance.

(c) PRIORITY TO CERTAIN AREAS.—In allocating amounts in accordance with subsection (b), the Secretary shall give priority consideration to State and local legal organizations that are operating in the 125 metropolitan statistical areas (as that term is defined by the Director of the Office of Management and Budget) with the highest home foreclosure rates.

(d) LEGAL ASSISTANCE.—

(1) IN GENERAL.—Any State or local legal organization that receives financial assistance pursuant to this section may use such amounts only to assist—

(A) homeowners of owner-occupied homes with mortgages in default, in danger of default, or subject to or at risk of foreclosure; and

(B) tenants at risk of or subject to eviction as a result of foreclosure of the property in which such tenant resides.

(2) COMMENCE USE WITHIN 90 DAYS.—Any State or local legal organization that receives financial assistance pursuant to this section shall begin using any financial assistance received under this section within 90 days after receipt of the assistance.

(3) PROHIBITION ON CLASS ACTIONS.—No funds provided to a State or local legal organization under this section may be used to support any class action litigation.

(4) LIMITATION ON LEGAL ASSISTANCE.—Legal assistance funded with amounts provided under this section shall be limited to mortgage-related default, eviction, or foreclosure proceedings, without regard to whether such foreclosure is judicial or nonjudicial.

(5) EFFECTIVE DATE.—Notwithstanding any other provision of this Act, this subsection shall take effect on the date of the enactment of this Act.

(e) LIMITATION ON DISTRIBUTION OF ASSISTANCE.—

(1) IN GENERAL.—None of the amounts made available under this section shall be distributed to—

(A) any organization which has been convicted for a violation under Federal law relating to an election for Federal office; or

(B) any organization which employs applicable individuals.

(2) DEFINITION OF APPLICABLE INDIVIDUALS.—In this subsection, the term "applicable individual" means an individual who—

(A) is—

(i) employed by the organization in a permanent or temporary capacity;

(ii) contracted or retained by the organization; or

(iii) acting on behalf of, or with the express or apparent authority of, the organization; and

(B) has been convicted for a violation under Federal law relating to an election for Federal office.

(f) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated to the Secretary $35,000,000 for each of fiscal years 2011 through 2012 for grants under this section.

TITLE XV—MISCELLANEOUS PROVISIONS

SEC. 1501. RESTRICTIONS ON USE OF UNITED STATES FUNDS FOR FOREIGN GOVERNMENTS; PROTECTION OF AMERICAN TAXPAYERS.

The Bretton Woods Agreements Act (22 U.S.C. 286 et seq.) is amended by adding at the end the following:

"SEC. 68. RESTRICTIONS ON USE OF UNITED STATES FUNDS FOR FOREIGN GOVERNMENTS; PROTECTION OF AMERICAN TAXPAYERS.

"(a) IN GENERAL.—The Secretary of the Treasury shall instruct the United States Executive Director at the International Monetary Fund—

"(1) to evaluate, prior to consideration by the Board of Executive Directors of the Fund , any proposal submitted to the Board for the Fund to make a loan to a country if—

"(A) the amount of the public debt of the country exceeds the gross domestic product of the country as of the most recent year for which such information is available; and

"(B) the country is not eligible for assistance from the International Development Association.

"(2) OPPOSITION TO LOANS UNLIKELY TO BE REPAID IN FULL.—If any such evaluation indicates that the proposed loan is not likely to be repaid in full, the Secretary of the Treasury shall instruct the United States Executive Director at the Fund to use the voice and vote of the United States to oppose the proposal.

"(b) REPORTS TO CONGRESS.—Within 30 days after the Board of Executive Directors of the Fund approves a proposal described in subsection (a), and annually thereafter by June 30, for the duration of any program approved under such proposals, the Secretary of the Treasury shall report in writing to the Committee on Financial Services of the House of Representatives and the Committee on Foreign Relations and the Committee on Banking, Housing, and Urban Affairs of the Senate assessing the likelihood that loans made pursuant to such proposals will be repaid in full, including—

"(1) the borrowing country's current debt status, including, to the extent possible, its maturity structure, whether it has fixed or floating rates, whether it is indexed, and by whom it is held;

"(2) the borrowing country's external and internal vulnerabilities that could potentially affect its ability to repay; and

"(3) the borrowing country's debt management strategy.".

SEC. 1502. CONFLICT MINERALS.

(a) SENSE OF CONGRESS ON EXPLOITATION AND TRADE OF CONFLICT MINERALS ORIGINATING IN THE DEMOCRATIC REPUBLIC OF THE CONGO.—It is the sense of Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein, warranting the provisions of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b).

(b) DISCLOSURE RELATING TO CONFLICT MINERALS ORIGINATING IN THE DEMOCRATIC REPUBLIC OF THE CONGO.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following new subsection:

"(p) DISCLOSURES RELATING TO CONFLICT MINERALS ORIGINATING IN THE DEMOCRATIC REPUBLIC OF THE CONGO.—

"(1) REGULATIONS.—

"(A) IN GENERAL.—Not later than 270 days after the date of the enactment of this subsection, the Commission shall promulgate regulations requiring any person described in paragraph (2) to disclose annually, beginning with the person's first full fiscal year that begins after the date of promulgation of such regulations, whether conflict minerals that are necessary as described in paragraph (2)(B), in the year for which such reporting is required, did originate in the Democratic Republic of the Congo or an adjoining country and, in cases in which such conflict minerals did originate in any such country, submit to the Commission a report that includes, with respect to the period covered by the report—

"(i) a description of the measures taken by the person to exercise due diligence on the source and chain of custody of such minerals, which measures shall include an independent private sector audit of such report submitted through the Commission that is conducted in accordance with standards established by the Comptroller General of the United States, in accordance with rules promulgated by the Commission, in consultation with the Secretary of State; and "(ii) a description of the products manufactured or contracted to be manufactured that are not DRC conflict free ('DRC conflict free' is defined to mean the products that do not contain minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country), the entity that conducted the independent private sector audit in accordance with clause (i), the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.

"(B) CERTIFICATION.—The person submitting a report under subparagraph (A) shall certify the audit described in clause (i) of such subparagraph that is included in such report. Such a certified audit shall constitute a critical component of due diligence in establishing the source and chain of custody of such minerals.

"(C) UNRELIABLE DETERMINATION.—If a report required to be submitted by a person under subparagraph (A) relies on a determination of an independent private sector audit, as described under subparagraph (A)(i), or other due diligence processes previously determined by the Commission to be unreliable, the report shall not satisfy the requirements of the regulations promulgated under subparagraph (A)(i).

"(D) DRC CONFLICT FREE.—For purposes of this paragraph, a product may be labeled as 'DRC conflict free' if the product does not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country.

"(E) INFORMATION AVAILABLE TO THE PUBLIC.—Each person described under paragraph (2) shall make available to the public on the Internet website of such person the information disclosed by such person under subparagraph (A).

"(2) PERSON DESCRIBED.—A person is described in this paragraph if—

"(A) the person is required to file reports with the Commission pursuant to paragraph (1)(A); and

"(B) conflict minerals are necessary to the functionality or production of a product manufactured by such person.

"(3) REVISIONS AND WAIVERS.—The Commission shall revise or temporarily waive the requirements described in paragraph (1) if the President transmits to the Commission a determination that—

"(A) such revision or waiver is in the national security interest of the United States and the President includes the reasons therefor; and

"(B) establishes a date, not later than 2 years after the initial publication of such exemption, on which such exemption shall expire.

"(4) TERMINATION OF DISCLOSURE REQUIREMENTS.—The requirements of paragraph (1) shall terminate on the date on which the President determines and certifies to the appropriate congressional committees, but in no case earlier than the date that is one day after the end of the 5-year period beginning on the date of the enactment of this subsection, that no armed groups continue to be directly involved and benefitting from commercial activity involving conflict minerals.

"(5) DEFINITIONS.—For purposes of this subsection, the terms 'adjoining country', 'appropriate congressional committees', 'armed group', and 'conflict mineral' have the meaning given those terms under section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.".

(c) STRATEGY AND MAP TO ADDRESS LINKAGES BETWEEN CONFLICT MINERALS AND ARMED GROUPS.—

(1) STRATEGY.—

(A) IN GENERAL.—Not later than 180 days after the date of the enactment of this Act, the Secretary of State, in consultation with the Administrator of the United States Agency for International Development, shall submit to the appropriate congressional committees a strategy to address the linkages between human rights abuses, armed groups, mining of conflict minerals, and commercial products.

(B) CONTENTS.—The strategy required by subparagraph (A) shall include the following:

(i) A plan to promote peace and security in the Democratic Republic of the Congo by supporting efforts of the Government of the Democratic Republic of the Congo, including the Ministry of Mines and other relevant agencies, adjoining countries, and the international community, in particular the United Nations Group of Experts on the Democratic Republic of Congo, to—

(I) monitor and stop commercial activities involving the natural resources of the Democratic Republic of the Congo that contribute to the activities of armed groups and human rights violations in the Democratic Republic of the Congo; and

(II) develop stronger governance and economic institutions that can facilitate and improve transparency in the cross-border trade involving the natural resources of the Democratic Republic of the Congo to reduce exploitation by armed groups and promote local and regional development.

(ii) A plan to provide guidance to commercial entities seeking to exercise due diligence on and formalize the origin and chain of custody of conflict minerals used in their products and on their suppliers to ensure that conflict minerals used in the products of such suppliers do not directly or indirectly finance armed conflict or result in labor or human rights violations.

(iii) A description of punitive measures that could be taken against individuals or entities whose commercial activities are supporting armed groups and human rights violations in the Democratic Republic of the Congo.

(2) MAP.—

(A) IN GENERAL.—Not later than 180 days after the date of the enactment of this Act, the Secretary of State shall, in accordance with the recommendation of the United

Nations Group of Experts on the Democratic Republic of the Congo in their December 2008 report—

(i) produce a map of mineral-rich zones, trade routes, and areas under the control of armed groups in the Democratic Republic of the Congo and adjoining countries based on data from multiple sources, including—

(I) the United Nations Group of Experts on the Democratic Republic of the Congo;

(II) the Government of the Democratic Republic of the Congo, the governments of adjoining countries, and the governments of other Member States of the United Nations; and

(III) local and international nongovernmental organizations;

(ii) make such map available to the public; and

(iii) provide to the appropriate congressional committees an explanatory note describing the sources of information from which such map is based and the identification, where possible, of the armed groups or other forces in control of the mines depicted.

(B) DESIGNATION.—The map required under subparagraph (A) shall be known as the "Conflict Minerals Map", and mines located in areas under the control of armed groups in the Democratic Republic of the Congo and adjoining countries, as depicted on such Conflict Minerals Map, shall be known as "Conflict Zone Mines".

(C) UPDATES.—The Secretary of State shall update the map required under subparagraph (A) not less frequently than once every 180 days until the date on which the disclosure requirements under paragraph (1) of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b), terminate in accordance with the provisions of paragraph (4) of such section 13(p).

(D) PUBLICATION IN FEDERAL REGISTER.—The Secretary of State shall add minerals to the list of minerals in the definition of conflict minerals under section 1502, as appropriate. The Secretary shall publish in the Federal Register notice of intent to declare a mineral as a conflict mineral included in such definition not later than one year before such declaration.

(d) REPORTS.—

(1) BASELINE REPORT.—Not later than 1 year after the date of the enactment of this Act and annually thereafter until the termination of the disclosure requirements under section 13(p) of the Securities Exchange Act of 1934, the Comptroller General of the United States shall submit to appropriate congressional committees a report that includes an assessment of the rate of sexual- and gender-based violence in war-torn areas of the Democratic Republic of the Congo and adjoining countries.

(2) REGULAR REPORT ON EFFECTIVENESS.—Not later than 2 years after the date of the enactment of this Act and annually thereafter, the Comptroller General of the United States shall submit to the appropriate congressional committees a report that includes the following:

(A) An assessment of the effectiveness of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b), in promoting peace and security in the Democratic Republic of the Congo and adjoining countries.

(B) A description of issues encountered by the Securities and Exchange Commission in carrying out the provisions of such section 13(p).

(C)(i) A general review of persons described in clause (ii) and whether information is publicly available about—

(I) the use of conflict minerals by such persons; and

(II) whether such conflict minerals originate from the Democratic Republic of the Congo or an adjoining country.

(ii) A person is described in this clause if—

(I) the person is not required to file reports with the Securities and Exchange Commission pursuant to section 13(p)(1)(A) of the Securities Exchange Act of 1934, as added by subsection (b); and

(II) conflict minerals are necessary to the functionality or production of a product manufactured by such person.

(3) REPORT ON PRIVATE SECTOR AUDITING.—Not later than 30 months after the date of the enactment of this Act, and annually thereafter, the Secretary of Commerce shall submit to the appropriate congressional committees a report that includes the following:

(A) An assessment of the accuracy of the independent private sector audits and other due diligence processes described under section 13(p) of the Securities Exchange Act of 1934.

(B) Recommendations for the processes used to carry out such audits, including ways to—

(i) improve the accuracy of such audits; and

(ii) establish standards of best practices.

(C) A listing of all known conflict mineral processing facilities worldwide.

(e) DEFINITIONS.—For purposes of this section:

(1) ADJOINING COUNTRY.—The term “adjoining country”, with respect to the Democratic Republic of the Congo, means a country that shares an internationally recognized border with the Democratic Republic of the Congo.

(2) APPROPRIATE CONGRESSIONAL COMMITTEES.—The term “appropriate congressional committees” means—

(A) the Committee on Appropriations, the Committee on Foreign Affairs, the Committee on Ways and Means, and the Committee on Financial Services of the House of Representatives; and

(B) the Committee on Appropriations, the Committee on Foreign Relations, the Committee on Finance, and the Committee on Banking, Housing, and Urban Affairs of the Senate.

(3) ARMED GROUP.—The term “armed group” means an armed group that is identified as perpetrators of serious human rights abuses in the annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of the Foreign Assistance Act of 1961 (22 U.S.C. 2151n(d) and 2304(b)) relating

to the Democratic Republic of the Congo or an adjoining country.

(4) CONFLICT MINERAL.—The term "conflict mineral" means—

(A) columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives; or

(B) any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.

(5) UNDER THE CONTROL OF ARMED GROUPS.—The term "under the control of armed groups" means areas within the Democratic Republic of the Congo or adjoining countries in which armed groups—

(A) physically control mines or force labor of civilians to mine, transport, or sell conflict minerals;

(B) tax, extort, or control any part of trade routes for conflict minerals, including the entire trade route from a Conflict Zone Mine to the point of export from the Democratic Republic of the Congo or an adjoining country; or

(C) tax, extort, or control trading facilities, in whole or in part, including the point of export from the Democratic Republic of the Congo or an adjoining country.

SEC. 1503. REPORTING REQUIREMENTS REGARDING COAL OR OTHER MINE SAFETY.

(a) REPORTING MINE SAFETY INFORMATION.—Each issuer that is required to file reports pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o) and that is an operator, or that has a subsidiary that is an operator, of a coal or other mine shall include, in each periodic report filed with the Commission under the securities laws on or after the date of enactment of this Act, the following information for the time period covered by such report:

(1) For each coal or other mine of which the issuer or a subsidiary of the issuer is an operator—

(A) the total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under section 104 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 814) for which the operator received a citation from the Mine Safety and Health Administration;

(B) the total number of orders issued under section 104(b) of such Act (30 U.S.C. 814(b));

(C) the total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under section 104(d) of such Act (30 U.S.C. 814(d));

(D) the total number of flagrant violations under section 110(b)(2) of such Act (30 U.S.C. 820(b)(2));

(E) the total number of imminent danger orders issued under section 107(a) of such Act (30 U.S.C. 817(a));

(F) the total dollar value of proposed assessments from the Mine Safety and Health Administration under such Act (30 U.S.C. 801 et seq.); and

(G) the total number of mining-related fatalities.

(2) A list of such coal or other mines, of which the issuer or a subsidiary of the issuer is an operator, that receive written notice from the Mine Safety and Health Administration of—

(A) a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of such Act (30 U.S.C. 814(e)); or

(B) the potential to have such a pattern.

(3) Any pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine.

(b) REPORTING SHUTDOWNS AND PATTERNS OF VIOLATIONS.—Beginning on and after the date of enactment of this Act, each issuer that is an operator, or that has a subsidiary that is an operator, of a coal or other mine shall file a current report with the Commission on Form 8–K (or any successor form) disclosing the following regarding each coal or other mine of which the issuer or subsidiary is an operator:

(1) The receipt of an imminent danger order issued under section 107(a) of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 817(a)).

(2) The receipt of written notice from the Mine Safety and Health Administration that the coal or other mine has—

(A) a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of such Act (30 U.S.C. 814(e)); or

(B) the potential to have such a pattern.

(c) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to affect any obligation of a person to make a disclosure under any other applicable law in effect before, on, or after the date of enactment of this Act.

(d) COMMISSION AUTHORITY.—

(1) ENFORCEMENT.—A violation by any person of this section, or any rule or regulation of the Commission issued under this section, shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or the rules and regulations issued thereunder, consistent with the provisions of this section, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of such Act or the rules or regulations issued thereunder.

(2) RULES AND REGULATIONS.—The Commission is authorized to issue such rules or regulations as are necessary or appropriate for the protection of investors and to carry out the purposes of this section.

(e) DEFINITIONS.—In this section—

(1) the terms "issuer" and "securities laws" have the meaning given the terms in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c);

(2) the term "coal or other mine" means a coal or other mine, as defined in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802), that is subject to the provisions of such Act (30 U.S.C. 801 et seq.); and

(3) the term "operator" has the meaning given the term in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802).

(f) EFFECTIVE DATE.—This section shall take effect on the day that is 30 days after the date of enactment of this Act.

SEC. 1504. DISCLOSURE OF PAYMENTS BY RESOURCE EXTRACTION ISSUERS.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

"(q) DISCLOSURE OF PAYMENTS BY RESOURCE EXTRACTION ISSUERS.—

"(1) DEFINITIONS.—In this subsection—

"(A) the term 'commercial development of oil, natural gas, or minerals' includes exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity, as determined by the Commission;

"(B) the term 'foreign government' means a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government, as determined by the Commission;

"(C) the term 'payment'—

"(i) means a payment that is—

"(I) made to further the commercial development of oil, natural gas, or minerals; and

"(II) not de minimis; and

"(ii) includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, consistent with the guidelines of the Extractive Industries Transparency Initiative (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals;

"(D) the term 'resource extraction issuer' means an issuer that—

"(i) is required to file an annual report with the Commission; and

"(ii) engages in the commercial development of oil, natural gas, or minerals;

"(E) the term 'interactive data format' means an electronic data format in which pieces of information are identified using an interactive data standard; and

"(F) the term 'interactive data standard' means standardized list of electronic tags that mark information included in the annual report of a resource extraction issuer.

"(2) DISCLOSURE.—

"(A) INFORMATION REQUIRED.—Not later than 270 days after the date of enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Commission shall issue final rules that require each resource extraction issuer to include in an annual report of the resource extraction issuer information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including—

"(i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals; and

"(ii) the type and total amount of such payments made to each government.

"(B) CONSULTATION IN RULEMAKING.—In issuing rules under subparagraph (A), the Commission may consult with any agency or entity that the Commission determines is relevant.

"(C) INTERACTIVE DATA FORMAT.—The rules issued under subparagraph (A) shall require that the information included in the annual report of a resource extraction issuer be submitted in an interactive data format.

"(D) INTERACTIVE DATA STANDARD.—

"(i) IN GENERAL.—The rules issued under subparagraph (A) shall establish an interactive data standard for the information included in the annual report of a resource extraction issuer.

"(ii) ELECTRONIC TAGS.—The interactive data standard shall include electronic tags that identify, for any payments made by a resource extraction issuer to a foreign government or the Federal Government—

"(I) the total amounts of the payments, by category;

"(II) the currency used to make the payments;

"(III) the financial period in which the payments were made;

"(IV) the business segment of the resource extraction issuer that made the payments;

"(V) the government that received the payments, and the country in which the government is located;

"(VI) the project of the resource extraction issuer to which the payments relate; and

"(VII) such other information as the Commission may determine is necessary or appropriate in the public interest or for the protection of investors.

"(E) INTERNATIONAL TRANSPARENCY EFFORTS.—To the extent practicable, the rules issued under subparagraph (A) shall support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.

"(F) EFFECTIVE DATE.—With respect to each resource extraction issuer, the final rules issued under subparagraph (A) shall take effect on the date on which the resource extraction issuer is required to submit an annual report relating to the fiscal year of the resource extraction issuer that ends not earlier than 1 year after the date on which the Commission issues final rules under subparagraph (A).

"(3) PUBLIC AVAILABILITY OF INFORMATION.—

"(A) IN GENERAL.—To the extent practicable, the Commission shall make available online, to the public, a compilation of the information required to be submitted under the rules issued under paragraph (2)(A).

"(B) OTHER INFORMATION.—Nothing in this paragraph shall require the Commission to make available online information other than the information required to be submitted under the rules issued under paragraph (2)(A).

"(4) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated to the Commission such sums as may be necessary to carry out this subsection.".

SEC. 1505. STUDY BY THE COMPTROLLER GENERAL.

(a) IN GENERAL.—Not later than 1 year after the date of enactment of this Act, the Comptroller General of the United States shall issue a report assessing the relative independence, effectiveness, and expertise of presidentially appointed inspectors general and inspectors general of designated Federal entities, as such term is defined under section 8G of the Inspector General Act of 1978, and the effects on independence of the amendments to the Inspector General Act of 1978 made by this Act.

(b) REPORT.—The report required by subsection (a) shall be issued to the Committees on Financial Services and Oversight and Government Reform of the House of Representatives and the Committees on Banking, Housing, and Urban Affairs and Homeland Security and Governmental Affairs of the Senate.

SEC. 1506. STUDY ON CORE DEPOSITS AND BROKERED DEPOSITS.

(a) STUDY.—The Corporation shall conduct a study to evaluate—

(1) the definition of core deposits for the purpose of calculating the insurance premiums of banks;

(2) the potential impact on the Deposit Insurance Fund of revising the definitions of brokered deposits and core deposits to better distinguish between them;

(3) an assessment of the differences between core deposits and brokered deposits and their role in the economy and banking sector of the United States;

(4) the potential stimulative effect on local economies of redefining core deposits; and

(5) the competitive parity between large institutions and community banks that could result from redefining core deposits.

(b) REPORT TO CONGRESS.—Not later than 1 year after the date of enactment of this Act, the Corporation shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives a report on the results of the study under subsection (a) that includes legislative recommendations, if any, to address concerns arising in connection with the definitions of core deposits and brokered deposits.

TITLE XVI—SECTION 1256 CONTRACTS

SEC. 1601. CERTAIN SWAPS, ETC., NOT TREATED AS SECTION 1256 CONTRACTS.

(a) IN GENERAL.—Subsection (b) of section 1256 of the Internal Revenue Code of 1986 is amended—

(1) by redesignating paragraphs (1) through (5) as subparagraphs (A) through (E), respectively, and by indenting such subparagraphs (as so redesignated) accordingly,

(2) by striking "For purposes of" and inserting the following: "(1) IN GENERAL.—For purposes of", and

(3) by striking the last sentence and inserting the following new paragraph:

"(2) EXCEPTIONS.—The term 'section 1256 contract' shall not include—

"(A) any securities futures contract or option on such a contract unless such contract or option is a dealer securities futures contract, or

"(B) any interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

Speaker of the House of Representatives.

Vice President of the United States and
President of the Senate.

Public Law 107–204
107th Congress

An Act

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

July 30, 2002
[H.R. 3763]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Sarbanes-Oxley Act of 2002. Corporate responsibility. 15 USC 7201 note.

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Sarbanes-Oxley Act of 2002".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

15 USC 7201.

SEC. 2. DEFINITIONS.

(a) IN GENERAL.—In this Act, the following definitions shall apply:

(1) APPROPRIATE STATE REGULATORY AUTHORITY.—The term “appropriate State regulatory authority” means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States

having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(2) AUDIT.—The term "audit" means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission (or, for the period preceding the adoption of applicable rules of the Board under section 103, in accordance with then-applicable generally accepted auditing and related standards for such purposes), for the purpose of expressing an opinion on such statements.

(3) AUDIT COMMITTEE.—The term "audit committee" means—

(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

(4) AUDIT REPORT.—The term "audit report" means a document or other record—

(A) prepared following an audit performed for purposes of compliance by an issuer with the requirements of the securities laws; and

(B) in which a public accounting firm either—

(i) sets forth the opinion of that firm regarding a financial statement, report, or other document; or

(ii) asserts that no such opinion can be expressed.

(5) BOARD.—The term "Board" means the Public Company Accounting Oversight Board established under section 101.

(6) COMMISSION.—The term "Commission" means the Securities and Exchange Commission.

(7) ISSUER.—The term "issuer" means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

(8) NON-AUDIT SERVICES.—The term "non-audit services" means any professional services provided to an issuer by a registered public accounting firm, other than those provided to an issuer in connection with an audit or a review of the financial statements of an issuer.

(9) PERSON ASSOCIATED WITH A PUBLIC ACCOUNTING FIRM.—

(A) IN GENERAL.—The terms "person associated with a public accounting firm" (or with a "registered public accounting firm") and "associated person of a public accounting firm" (or of a "registered public accounting firm") mean any individual proprietor, partner, shareholder, principal, accountant, or other professional employee of a public accounting firm, or any other independent contractor or entity that, in connection with the preparation or issuance of any audit report—

(i) shares in the profits of, or receives compensation in any other form from, that firm; or

(ii) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.

(B) EXEMPTION AUTHORITY.—The Board may, by rule, exempt persons engaged only in ministerial tasks from the definition in subparagraph (A), to the extent that the Board determines that any such exemption is consistent with the purposes of this Act, the public interest, or the protection of investors.

(10) PROFESSIONAL STANDARDS.—The term "professional standards" means—

(A) accounting principles that are—

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by this Act, or prescribed by the Commission under section 19(a) of that Act (15 U.S.C. 17a(s)) or section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78a(m)); and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing title II) that the Board or the Commission determines—

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a), or are promulgated as rules of the Commission.

(11) PUBLIC ACCOUNTING FIRM.—The term "public accounting firm" means—

(A) a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports; and

(B) to the extent so designated by the rules of the Board, any associated person of any entity described in subparagraph (A).

(12) REGISTERED PUBLIC ACCOUNTING FIRM.—The term "registered public accounting firm" means a public accounting firm registered with the Board in accordance with this Act.

(13) RULES OF THE BOARD.—The term "rules of the Board" means the bylaws and rules of the Board (as submitted to, and approved, modified, or amended by the Commission, in accordance with section 107), and those stated policies, practices, and interpretations of the Board that the Commission, by rule, may deem to be rules of the Board, as necessary or appropriate in the public interest or for the protection of investors.

(14) SECURITY.—The term "security" has the same meaning as in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

(15) SECURITIES LAWS.—The term “securities laws” means the provisions of law referred to in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), as amended by this Act, and includes the rules, regulations, and orders issued by the Commission thereunder.

(16) STATE.—The term “State” means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other territory or possession of the United States.

(b) CONFORMING AMENDMENT.—Section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) is amended by inserting “the Sarbanes-Oxley Act of 2002,” before “the Public”.

SEC. 3. COMMISSION RULES AND ENFORCEMENT. 15 USC 7202.

(a) REGULATORY ACTION.—The Commission shall promulgate such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors, and in furtherance of this Act.

(b) ENFORCEMENT.—

(1) IN GENERAL.—A violation by any person of this Act, any rule or regulation of the Commission issued under this Act, or any rule of the Board shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or the rules and regulations issued thereunder, consistent with the provisions of this Act, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations.

(2) INVESTIGATIONS, INJUNCTIONS, AND PROSECUTION OF OFFENSES.—Section 21 of the Securities Exchange Act of 1934 (15 U.S.C. 78u) is amended—

(A) in subsection (a)(1), by inserting “the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,” after “is a participant,”;

(B) in subsection (d)(1), by inserting “the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,” after “is a participant,”;

(C) in subsection (e), by inserting “the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,” after “is a participant,”; and

(D) in subsection (f), by inserting “or the Public Company Accounting Oversight Board” after “self-regulatory organization” each place that term appears.

(3) CEASE-AND-DESIST PROCEEDINGS.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)(2)) is amended by inserting “registered public accounting firm (as defined in section 2 of the Sarbanes-Oxley Act of 2002),” after “government securities dealer,”.

(4) ENFORCEMENT BY FEDERAL BANKING AGENCIES.—Section 12(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(i)) is amended by—

(A) striking “sections 12,” each place it appears and inserting “sections 10A(m), 12,”; and

(B) striking "and 16," each place it appears and inserting "and 16 of this Act, and sections 302, 303, 304, 306, 401(b), 404, 406, and 407 of the Sarbanes-Oxley Act of 2002,".

(c) EFFECT ON COMMISSION AUTHORITY.—Nothing in this Act or the rules of the Board shall be construed to impair or limit—

(1) the authority of the Commission to regulate the accounting profession, accounting firms, or persons associated with such firms for purposes of enforcement of the securities laws;

(2) the authority of the Commission to set standards for accounting or auditing practices or auditor independence, derived from other provisions of the securities laws or the rules or regulations thereunder, for purposes of the preparation and issuance of any audit report, or otherwise under applicable law; or

(3) the ability of the Commission to take, on the initiative of the Commission, legal, administrative, or disciplinary action against any registered public accounting firm or any associated person thereof.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

15 USC 7211.

SEC. 101. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.

(a) ESTABLISHMENT OF BOARD.—There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.

(b) STATUS.—The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

(c) DUTIES OF THE BOARD.—The Board shall, subject to action by the Commission under section 107, and once a determination is made by the Commission under subsection (d) of this section—

(1) register public accounting firms that prepare audit reports for issuers, in accordance with section 102;

(2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, in accordance with section 103;

(3) conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board;

(4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon,

registered public accounting firms and associated persons of such firms, in accordance with section 105;

(5) perform such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this Act, in order to protect investors, or to further the public interest;

(6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and

(7) set the budget and manage the operations of the Board and the staff of the Board.

(d) COMMISSION DETERMINATION.—The members of the Board shall take such action (including hiring of staff, proposal of rules, and adoption of initial and transitional auditing and other professional standards) as may be necessary or appropriate to enable the Commission to determine, not later than 270 days after the date of enactment of this Act, that the Board is so organized and has the capacity to carry out the requirements of this title, and to enforce compliance with this title by registered public accounting firms and associated persons thereof. The Commission shall be responsible, prior to the appointment of the Board, for the planning for the establishment and administrative transition to the Board's operation.

(e) BOARD MEMBERSHIP.—

(1) COMPOSITION.—The Board shall have 5 members, appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures.

(2) LIMITATION.—Two members, and only 2 members, of the Board shall be or have been certified public accountants pursuant to the laws of 1 or more States, provided that, if 1 of those 2 members is the chairperson, he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board.

(3) FULL-TIME INDEPENDENT SERVICE.—Each member of the Board shall serve on a full-time basis, and may not, concurrent with service on the Board, be employed by any other person or engage in any other professional or business activity. No member of the Board may share in any of the profits of, or receive payments from, a public accounting firm (or any other person, as determined by rule of the Commission), other than fixed continuing payments, subject to such conditions as the Commission may impose, under standard arrangements for the retirement of members of public accounting firms.

(4) APPOINTMENT OF BOARD MEMBERS.—

(A) INITIAL BOARD.—Not later than 90 days after the date of enactment of this Act, the Commission, after consultation with the Chairman of the Board of Governors Deadline.

of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson and other initial members of the Board, and shall designate a term of service for each.

(B) VACANCIES.—A vacancy on the Board shall not affect the powers of the Board, but shall be filled in the same manner as provided for appointments under this section.

(5) TERM OF SERVICE.—

(A) IN GENERAL.—The term of service of each Board member shall be 5 years, and until a successor is appointed, except that—

(i) the terms of office of the initial Board members (other than the chairperson) shall expire in annual increments, 1 on each of the first 4 anniversaries of the initial date of appointment; and

(ii) any Board member appointed to fill a vacancy occurring before the expiration of the term for which the predecessor was appointed shall be appointed only for the remainder of that term.

(B) TERM LIMITATION.—No person may serve as a member of the Board, or as chairperson of the Board, for more than 2 terms, whether or not such terms of service are consecutive.

(6) REMOVAL FROM OFFICE.—A member of the Board may be removed by the Commission from office, in accordance with section 107(d)(3), for good cause shown before the expiration of the term of that member.

(f) POWERS OF THE BOARD.—In addition to any authority granted to the Board otherwise in this Act, the Board shall have the power, subject to section 107—

(1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court;

(2) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to any qualification, licensing, or other provision of law in effect in such State (or a political subdivision thereof);

(3) to lease, purchase, accept gifts or donations of or otherwise acquire, improve, use, sell, exchange, or convey, all of or an interest in any property, wherever situated;

(4) to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation (at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions);

(5) to allocate, assess, and collect accounting support fees established pursuant to section 109, for the Board, and other fees and charges imposed under this title; and

Contracts.

(6) to enter into contracts, execute instruments, incur liabilities, and do any and all other acts and things necessary, appropriate, or incidental to the conduct of its operations and the exercise of its obligations, rights, and powers imposed or granted by this title.

(g) RULES OF THE BOARD.—The rules of the Board shall, subject to the approval of the Commission—

(1) provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under this Act;

(2) permit, as the Board determines necessary or appropriate, delegation by the Board of any of its functions to an individual member or employee of the Board, or to a division of the Board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter, except that—

(A) the Board shall retain a discretionary right to review any action pursuant to any such delegated function, upon its own motion;

(B) a person shall be entitled to a review by the Board with respect to any matter so delegated, and the decision of the Board upon such review shall be deemed to be the action of the Board for all purposes (including appeal or review thereof); and

(C) if the right to exercise a review described in subparagraph (A) is declined, or if no such review is sought within the time stated in the rules of the Board, then the action taken by the holder of such delegation shall for all purposes, including appeal or review thereof, be deemed to be the action of the Board;

(3) establish ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the Commission, with respect to Board-related matters) of 1 year for former members of the Board, and appropriate periods (not to exceed 1 year) for former staff of the Board; and

(4) provide as otherwise required by this Act.

(h) ANNUAL REPORT TO THE COMMISSION.—The Board shall submit an annual report (including its audited financial statements) to the Commission, and the Commission shall transmit a copy of that report to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, not later than 30 days after the date of receipt of that report by the Commission. Deadline.

SEC. 102. REGISTRATION WITH THE BOARD. 15 USC 7212.

(a) MANDATORY REGISTRATION.—Beginning 180 days after the date of the determination of the Commission under section 101(d), it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.

(b) APPLICATIONS FOR REGISTRATION.—

(1) FORM OF APPLICATION.—A public accounting firm shall use such form as the Board may prescribe, by rule, to apply for registration under this section.

(2) CONTENTS OF APPLICATIONS.—Each public accounting firm shall submit, as part of its application for registration, in such detail as the Board shall specify—

(A) the names of all issuers for which the firm prepared or issued audit reports during the immediately preceding calendar year, and for which the firm expects to prepare or issue audit reports during the current calendar year;

(B) the annual fees received by the firm from each such issuer for audit services, other accounting services, and non-audit services, respectively;

(C) such other current financial information for the most recently completed fiscal year of the firm as the Board may reasonably request;

(D) a statement of the quality control policies of the firm for its accounting and auditing practices;

(E) a list of all accountants associated with the firm who participate in or contribute to the preparation of audit reports, stating the license or certification number of each such person, as well as the State license numbers of the firm itself;

(F) information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against the firm or any associated person of the firm in connection with any audit report;

(G) copies of any periodic or annual disclosure filed by an issuer with the Commission during the immediately preceding calendar year which discloses accounting disagreements between such issuer and the firm in connection with an audit report furnished or prepared by the firm for such issuer; and

(H) such other information as the rules of the Board or the Commission shall specify as necessary or appropriate in the public interest or for the protection of investors.

(3) CONSENTS.—Each application for registration under this subsection shall include—

(A) a consent executed by the public accounting firm to cooperation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities under this title (and an agreement to secure and enforce similar consents from each of the associated persons of the public accounting firm as a condition of their continued employment by or other association with such firm); and

(B) a statement that such firm understands and agrees that cooperation and compliance, as described in the consent required by subparagraph (A), and the securing and enforcement of such consents from its associated persons, in accordance with the rules of the Board, shall be a condition to the continuing effectiveness of the registration of the firm with the Board.

(c) ACTION ON APPLICATIONS.—

Deadline.

(1) TIMING.—The Board shall approve a completed application for registration not later than 45 days after the date of receipt of the application, in accordance with the rules of the Board, unless the Board, prior to such date, issues a written notice of disapproval to, or requests more information from, the prospective registrant.

(2) TREATMENT.—A written notice of disapproval of a completed application under paragraph (1) for registration shall be treated as a disciplinary sanction for purposes of sections 105(d) and 107(c).

(d) PERIODIC REPORTS.—Each registered public accounting firm shall submit an annual report to the Board, and may be required to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b)(2).

(e) PUBLIC AVAILABILITY.—Registration applications and annual reports required by this subsection, or such portions of such applications or reports as may be designated under rules of the Board, shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information contained in such applications or reports, provided that, in all events, the Board shall protect from public disclosure information reasonably identified by the subject accounting firm as proprietary information.

(f) REGISTRATION AND ANNUAL FEES.—The Board shall assess and collect a registration fee and an annual fee from each registered public accounting firm, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.

SEC. 103. AUDITING, QUALITY CONTROL, AND INDEPENDENCE STANDARDS AND RULES. 15 USC 7213.

(a) AUDITING, QUALITY CONTROL, AND ETHICS STANDARDS.—

(1) IN GENERAL.—The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4), and amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) RULE REQUIREMENTS.—In carrying out paragraph (1), the Board—

(A) shall include in the auditing standards that it adopts, requirements that each registered public accounting firm shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report;

(ii) provide a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board); and

(iii) describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer, required by section 404(b), and present (in such report or in a separate report)—

(I) the findings of the auditor from such testing;

(II) an evaluation of whether such internal control structure and procedures—

(aa) include maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

(bb) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and

(III) a description, at a minimum, of material weaknesses in such internal controls, and of any material noncompliance found on the basis of such testing.

(B) shall include, in the quality control standards that it adopts with respect to the issuance of audit reports, requirements for every registered public accounting firm relating to—

(i) monitoring of professional ethics and independence from issuers on behalf of which the firm issues audit reports;

(ii) consultation within such firm on accounting and auditing questions;

(iii) supervision of audit work;

(iv) hiring, professional development, and advancement of personnel;

(v) the acceptance and continuation of engagements;

(vi) internal inspection; and

(vii) such other requirements as the Board may prescribe, subject to subsection (a)(1).

(3) AUTHORITY TO ADOPT OTHER STANDARDS.—

(A) IN GENERAL.—In carrying out this subsection, the Board—

(i) may adopt as its rules, subject to the terms of section 107, any portion of any statement of auditing standards or other professional standards that the Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of accountants that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and

(ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) INITIAL AND TRANSITIONAL STANDARDS.—The Board shall adopt standards described in subparagraph (A)(i) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the

Commission under section 101(d), and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 107 that otherwise would apply to the approval of rules of the Board.

(4) ADVISORY GROUPS.—The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

(b) INDEPENDENCE STANDARDS AND RULES.—The Board shall establish such rules as may be necessary or appropriate in the public interest or for the protection of investors, to implement, or as authorized under, title II of this Act.

(c) COOPERATION WITH DESIGNATED PROFESSIONAL GROUPS OF ACCOUNTANTS AND ADVISORY GROUPS.—

(1) IN GENERAL.—The Board shall cooperate on an ongoing basis with professional groups of accountants designated under subsection (a)(3)(A) and advisory groups convened under subsection (a)(4) in the examination of the need for changes in any standards subject to its authority under subsection (a), recommend issues for inclusion on the agendas of such designated professional groups of accountants or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(2) BOARD RESPONSES.—The Board shall respond in a timely fashion to requests from designated professional groups of accountants and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) EVALUATION OF STANDARD SETTING PROCESS.—The Board shall include in the annual report required by section 101(h) the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated professional groups of accountants and advisory groups described in paragraphs (3)(A) and (4) of subsection (a), and its pending issues agenda for future standard setting projects.

SEC. 104. INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS. 15 USC 7214.

(a) IN GENERAL.—The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.

(b) INSPECTION FREQUENCY.—

(1) IN GENERAL.—Subject to paragraph (2), inspections required by this section shall be conducted—

(A) annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and

(B) not less frequently than once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers.

(2) ADJUSTMENTS TO SCHEDULES.—The Board may, by rule, adjust the inspection schedules set under paragraph (1) if the Board finds that different inspection schedules are consistent with the purposes of this Act, the public interest, and the protection of investors. The Board may conduct special inspections at the request of the Commission or upon its own motion.

(c) PROCEDURES.—The Board shall, in each inspection under this section, and in accordance with its rules for such inspections—

(1) identify any act or practice or omission to act by the registered public accounting firm, or by any associated person thereof, revealed by such inspection that may be in violation of this Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards;

(2) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and

(3) begin a formal investigation or take disciplinary action, if appropriate, with respect to any such violation, in accordance with this Act and the rules of the Board.

(d) CONDUCT OF INSPECTIONS.—In conducting an inspection of a registered public accounting firm under this section, the Board shall—

(1) inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board;

(2) evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and

(3) perform such other testing of the audit, supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

(e) RECORD RETENTION.—The rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by section 103 or the rules issued thereunder.

(f) PROCEDURES FOR REVIEW.—The rules of the Board shall provide a procedure for the review of and response to a draft inspection report by the registered public accounting firm under inspection. The Board shall take such action with respect to such response as it considers appropriate (including revising the draft report or continuing or supplementing its inspection activities before issuing a final report), but the text of any such response, appropriately redacted to protect information reasonably identified by the accounting firm as confidential, shall be attached to and made part of the inspection report.

(g) REPORT.—A written report of the findings of the Board for each inspection under this section, subject to subsection (h), shall be—

(1) transmitted, in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm; and

(2) made available in appropriate detail to the public (subject to section 105(b)(5)(A), and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

(h) INTERIM COMMISSION REVIEW.—

(1) REVIEWABLE MATTERS.—A registered public accounting firm may seek review by the Commission, pursuant to such rules as the Commission shall promulgate, if the firm—

(A) has provided the Board with a response, pursuant to rules issued by the Board under subsection (f), to the substance of particular items in a draft inspection report, and disagrees with the assessments contained in any final report prepared by the Board following such response; or

(B) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board within 12 months of the date of the inspection report, for purposes of subsection (g)(2).

(2) TREATMENT OF REVIEW.—Any decision of the Commission with respect to a review under paragraph (1) shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y), or deemed to be "final agency action" for purposes of section 704 of title 5, United States Code.

(3) TIMING.—Review under paragraph (1) may be sought during the 30-day period following the date of the event giving rise to the review under subparagraph (A) or (B) of paragraph (1).

SEC. 105. INVESTIGATIONS AND DISCIPLINARY PROCEEDINGS. 15 USC 7215.

Establishment.

(a) IN GENERAL.—The Board shall establish, by rule, subject to the requirements of this section, fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms.

(b) INVESTIGATIONS.—

(1) AUTHORITY.—In accordance with the rules of the Board, the Board may conduct an investigation of any act or practice, or omission to act, by a registered public accounting firm, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, regardless of how the act, practice, or omission is brought to the attention of the Board.

(2) TESTIMONY AND DOCUMENT PRODUCTION.—In addition to such other actions as the Board determines to be necessary or appropriate, the rules of the Board may—

(A) require the testimony of the firm or of any person associated with a registered public accounting firm, with respect to any matter that the Board considers relevant or material to an investigation;

(B) require the production of audit work papers and any other document or information in the possession of a registered public accounting firm or any associated person thereof, wherever domiciled, that the Board considers relevant or material to the investigation, and may inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied;

(C) request the testimony of, and production of any document in the possession of, any other person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section, with appropriate notice, subject to the needs of the investigation, as permitted under the rules of the Board; and

(D) provide for procedures to seek issuance by the Commission, in a manner established by the Commission, of a subpoena to require the testimony of, and production of any document in the possession of, any person, including any client of a registered public accounting firm, that the Board considers relevant or material to an investigation under this section.

(3) NONCOOPERATION WITH INVESTIGATIONS.—

(A) IN GENERAL.—If a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation under this section, the Board may—

(i) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;

(ii) suspend or revoke the registration of the public accounting firm; and

(iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) PROCEDURE.—Any action taken by the Board under this paragraph shall be subject to the terms of section 107(c).

(4) COORDINATION AND REFERRAL OF INVESTIGATIONS.—

Notification.

(A) COORDINATION.—The Board shall notify the Commission of any pending Board investigation involving a potential violation of the securities laws, and thereafter coordinate its work with the work of the Commission's Division of Enforcement, as necessary to protect an ongoing Commission investigation.

(B) REFERRAL.—The Board may refer an investigation under this section—

(i) to the Commission;

(ii) to any other Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), in the case of an investigation that concerns an audit report for an institution that is subject to the jurisdiction of such regulator; and

(iii) at the direction of the Commission, to—

(I) the Attorney General of the United States;

(II) the attorney general of 1 or more States; and

(III) the appropriate State regulatory authority.

(5) USE OF DOCUMENTS.—

(A) CONFIDENTIALITY.—Except as provided in subparagraph (B), all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

(B) AVAILABILITY TO GOVERNMENT AGENCIES.—Without the loss of its status as confidential and privileged in the hands of the Board, all information referred to in subparagraph (A) may—

(i) be made available to the Commission; and

(ii) in the discretion of the Board, when determined by the Board to be necessary to accomplish the purposes of this Act or to protect investors, be made available to—

(I) the Attorney General of the United States;

(II) the appropriate Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), other than the Commission, with respect to an audit report for an institution subject to the jurisdiction of such regulator;

(III) State attorneys general in connection with any criminal investigation; and

(IV) any appropriate State regulatory authority,

each of which shall maintain such information as confidential and privileged.

(6) IMMUNITY.—Any employee of the Board engaged in carrying out an investigation under this Act shall be immune from any civil liability arising out of such investigation in the same manner and to the same extent as an employee of the Federal Government in similar circumstances.

(c) DISCIPLINARY PROCEDURES.—

(1) NOTIFICATION; RECORDKEEPING.—The rules of the Board shall provide that in any proceeding by the Board to determine

whether a registered public accounting firm, or an associated person thereof, should be disciplined, the Board shall—

(A) bring specific charges with respect to the firm or associated person;

(B) notify such firm or associated person of, and provide to the firm or associated person an opportunity to defend against, such charges; and

(C) keep a record of the proceedings.

(2) PUBLIC HEARINGS.—Hearings under this section shall not be public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties to such hearing.

(3) SUPPORTING STATEMENT.—A determination by the Board to impose a sanction under this subsection shall be supported by a statement setting forth—

(A) each act or practice in which the registered public accounting firm, or associated person, has engaged (or omitted to engage), or that forms a basis for all or a part of such sanction;

(B) the specific provision of this Act, the securities laws, the rules of the Board, or professional standards which the Board determines has been violated; and

(C) the sanction imposed, including a justification for that sanction.

(4) SANCTIONS.—If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (5), including—

(A) temporary suspension or permanent revocation of registration under this title;

(B) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;

(C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);

(D) a civil money penalty for each such violation, in an amount equal to—

(i) not more than $100,000 for a natural person or $2,000,000 for any other person; and

(ii) in any case to which paragraph (5) applies, not more than $750,000 for a natural person or $15,000,000 for any other person;

(E) censure;

(F) required additional professional education or training; or

(G) any other appropriate sanction provided for in the rules of the Board.

(5) INTENTIONAL OR OTHER KNOWING CONDUCT.—The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to—

(A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or

(B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

(6) FAILURE TO SUPERVISE.—

(A) IN GENERAL.—The Board may impose sanctions under this section on a registered accounting firm or upon the supervisory personnel of such firm, if the Board finds that—

(i) the firm has failed reasonably to supervise an associated person, either as required by the rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under this Act, or professional standards; and

(ii) such associated person commits a violation of this Act, or any of such rules, laws, or standards.

(B) RULE OF CONSTRUCTION.—No associated person of a registered public accounting firm shall be deemed to have failed reasonably to supervise any other person for purposes of subparagraph (A), if—

(i) there have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of the Board and that would reasonably be expected to prevent and detect any such violation by such associated person; and

(ii) such person has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system, and had no reasonable cause to believe that such procedures and system were not being complied with.

(7) EFFECT OF SUSPENSION.—

(A) ASSOCIATION WITH A PUBLIC ACCOUNTING FIRM.—It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(B) ASSOCIATION WITH AN ISSUER.—It shall be unlawful for any person that is suspended or barred from being associated with an issuer under this subsection willfully to become or remain associated with any issuer in an accountancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(d) REPORTING OF SANCTIONS.—

(1) RECIPIENTS.—If the Board imposes a disciplinary sanction, in accordance with this section, the Board shall report the sanction to—

(A) the Commission;

(B) any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licensed or certified; and

(C) the public (once any stay on the imposition of such sanction has been lifted).

(2) CONTENTS.—The information reported under paragraph (1) shall include—

(A) the name of the sanctioned person;

(B) a description of the sanction and the basis for its imposition; and

(C) such other information as the Board deems appropriate.

(e) STAY OF SANCTIONS.—

(1) IN GENERAL.—Application to the Commission for review, or the institution by the Commission of review, of any disciplinary action of the Board shall operate as a stay of any such disciplinary action, unless and until the Commission orders (summarily or after notice and opportunity for hearing on the question of a stay, which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that no such stay shall continue to operate.

(2) EXPEDITED PROCEDURES.—The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of the duration of a stay pending review of any disciplinary action of the Board under this subsection.

15 USC 7216.

SEC. 106. FOREIGN PUBLIC ACCOUNTING FIRMS.

(a) APPLICABILITY TO CERTAIN FOREIGN FIRMS.—

(1) IN GENERAL.—Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State, except that registration pursuant to section 102 shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board.

(2) BOARD AUTHORITY.—The Board may, by rule, determine that a foreign public accounting firm (or a class of such firms) that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that it is necessary or appropriate, in light of the purposes of this Act and in the public interest or for the protection of investors, that such firm (or class of firms) should be treated as a public accounting firm

(or firms) for purposes of registration under, and oversight by the Board in accordance with, this title.

(b) PRODUCTION OF AUDIT WORKPAPERS.—

(1) CONSENT BY FOREIGN FIRMS.—If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that foreign public accounting firm shall be deemed to have consented—

(A) to produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

(B) to be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers.

(2) CONSENT BY DOMESTIC FIRMS.—A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1), shall be deemed—

(A) to have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and

(B) to have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

(c) EXEMPTION AUTHORITY.—The Commission, and the Board, subject to the approval of the Commission, may, by rule, regulation, or order, and as the Commission (or Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act.

(d) DEFINITION.—In this section, the term "foreign public accounting firm" means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof.

SEC. 107. COMMISSION OVERSIGHT OF THE BOARD. 15 USC 7217.

(a) GENERAL OVERSIGHT RESPONSIBILITY.—The Commission shall have oversight and enforcement authority over the Board, as provided in this Act. The provisions of section 17(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(a)(1)), and of section 17(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(b)(1)) shall apply to the Board as fully as if the Board were a "registered securities association" for purposes of those sections 17(a)(1) and 17(b)(1).

(b) RULES OF THE BOARD.—

(1) DEFINITION.—In this section, the term "proposed rule" means any proposed rule of the Board, and any modification of any such rule.

(2) PRIOR APPROVAL REQUIRED.—No rule of the Board shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 103(a)(3)(B) with respect to initial or transitional standards.

(3) APPROVAL CRITERIA.—The Commission shall approve a proposed rule, if it finds that the rule is consistent with the requirements of this Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.

(4) PROPOSED RULE PROCEDURES.—The provisions of paragraphs (1) through (3) of section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) shall govern the proposed rules of the Board, as fully as if the Board were a "registered securities association" for purposes of that section 19(b), except that, for purposes of this paragraph—

(A) the phrase "consistent with the requirements of this title and the rules and regulations thereunder applicable to such organization" in section 19(b)(2) of that Act shall be deemed to read "consistent with the requirements of title I of the Sarbanes-Oxley Act of 2002, and the rules and regulations issued thereunder applicable to such organization, or as necessary or appropriate in the public interest or for the protection of investors"; and

(B) the phrase "otherwise in furtherance of the purposes of this title" in section 19(b)(3)(C) of that Act shall be deemed to read "otherwise in furtherance of the purposes of title I of the Sarbanes-Oxley Act of 2002".

(5) COMMISSION AUTHORITY TO AMEND RULES OF THE BOARD.—The provisions of section 19(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(c)) shall govern the abrogation, deletion, or addition to portions of the rules of the Board by the Commission as fully as if the Board were a "registered securities association" for purposes of that section 19(c), except that the phrase "to conform its rules to the requirements of this title and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this title" in section 19(c) of that Act shall, for purposes of this paragraph, be deemed to read "to assure the fair administration of the Public Company Accounting Oversight Board, conform the rules promulgated by that Board to the requirements of title I of the Sarbanes-Oxley Act of 2002, or otherwise further the purposes of that Act, the securities laws, and the rules and regulations thereunder applicable to that Board".

(c) COMMISSION REVIEW OF DISCIPLINARY ACTION TAKEN BY THE BOARD.—

(1) NOTICE OF SANCTION.—The Board shall promptly file notice with the Commission of any final sanction on any registered public accounting firm or on any associated person thereof, in such form and containing such information as the Commission, by rule, may prescribe.

(2) REVIEW OF SANCTIONS.—The provisions of sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s (d)(2) and (e)(1)) shall govern the review by the Commission of final disciplinary sanctions imposed by the Board (including sanctions imposed under section 105(b)(3) of this Act for noncooperation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 19(d)(2) and 19(e)(1), except that, for purposes of this paragraph—

(A) section 105(e) of this Act (rather than that section 19(d)(2)) shall govern the extent to which application for, or institution by the Commission on its own motion of, review of any disciplinary action of the Board operates as a stay of such action;

(B) references in that section 19(e)(1) to "members" of such an organization shall be deemed to be references to registered public accounting firms;

(C) the phrase "consistent with the purposes of this title" in that section 19(e)(1) shall be deemed to read "consistent with the purposes of this title and title I of the Sarbanes-Oxley Act of 2002";

(D) references to rules of the Municipal Securities Rulemaking Board in that section 19(e)(1) shall not apply; and

(E) the reference to section 19(e)(2) of the Securities Exchange Act of 1934 shall refer instead to section 107(c)(3) of this Act.

(3) COMMISSION MODIFICATION AUTHORITY.—The Commission may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board upon a registered public accounting firm or associated person thereof, if the Commission, having due regard for the public interest and the protection of investors, finds, after a proceeding in accordance with this subsection, that the sanction—

(A) is not necessary or appropriate in furtherance of this Act or the securities laws; or

(B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

(d) CENSURE OF THE BOARD; OTHER SANCTIONS.—

(1) RESCISSION OF BOARD AUTHORITY.—The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compliance with any provision of this Act, the securities laws, the rules of the Board, or professional standards.

(2) CENSURE OF THE BOARD; LIMITATIONS.—The Commission may, by order, as it determines necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board—

(A) has violated or is unable to comply with any provision of this Act, the rules of the Board, or the securities laws; or

(B) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by a registered public accounting firm or an associated person thereof.

(3) CENSURE OF BOARD MEMBERS; REMOVAL FROM OFFICE.—The Commission may, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, remove

from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member—

(A) has willfully violated any provision of this Act, the rules of the Board, or the securities laws;

(B) has willfully abused the authority of that member; or

(C) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by any registered public accounting firm or any associated person thereof.

15 USC 7218.

SEC. 108. ACCOUNTING STANDARDS.

(a) AMENDMENT TO SECURITIES ACT OF 1933.—Section 19 of the Securities Act of 1933 (15 U.S.C. 77s) is amended—

(1) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively; and

(2) by inserting after subsection (a) the following:

"(b) RECOGNITION OF ACCOUNTING STANDARDS.—

"(1) IN GENERAL.—In carrying out its authority under subsection (a) and under section 13(b) of the Securities Exchange Act of 1934, the Commission may recognize, as 'generally accepted' for purposes of the securities laws, any accounting principles established by a standard setting body—

"(A) that—

"(i) is organized as a private entity;

"(ii) has, for administrative and operational purposes, a board of trustees (or equivalent body) serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the 2-year period preceding such service, associated persons of any registered public accounting firm;

"(iii) is funded as provided in section 109 of the Sarbanes-Oxley Act of 2002;

"(iv) has adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices; and

"(v) considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors; and

"(B) that the Commission determines has the capacity to assist the Commission in fulfilling the requirements of subsection (a) and section 13(b) of the Securities Exchange Act of 1934, because, at a minimum, the standard setting body is capable of improving the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws.

"(2) ANNUAL REPORT.—A standard setting body described in paragraph (1) shall submit an annual report to the Commission and the public, containing audited financial statements of that standard setting body.".

(b) COMMISSION AUTHORITY.—The Commission shall promulgate such rules and regulations to carry out section 19(b) of the Securities Act of 1933, as added by this section, as it deems necessary or appropriate in the public interest or for the protection of investors. Regulations.

(c) NO EFFECT ON COMMISSION POWERS.—Nothing in this Act, including this section and the amendment made by this section, shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.

(d) STUDY AND REPORT ON ADOPTING PRINCIPLES-BASED ACCOUNTING.—

(1) STUDY.—

(A) IN GENERAL.—The Commission shall conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

(B) STUDY TOPICS.—The study required by subparagraph (A) shall include an examination of—

(i) the extent to which principles-based accounting and financial reporting exists in the United States;

(ii) the length of time required for change from a rules-based to a principles-based financial reporting system;

(iii) the feasibility of and proposed methods by which a principles-based system may be implemented; and

(iv) a thorough economic analysis of the implementation of a principles-based system.

(2) REPORT.—Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required by paragraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 109. FUNDING. 15 USC 7219.

(a) IN GENERAL.—The Board, and the standard setting body designated pursuant to section 19(b) of the Securities Act of 1933, as amended by section 108, shall be funded as provided in this section.

(b) ANNUAL BUDGETS.—The Board and the standard setting body referred to in subsection (a) shall each establish a budget for each fiscal year, which shall be reviewed and approved according to their respective internal procedures not less than 1 month prior to the commencement of the fiscal year to which the budget pertains (or at the beginning of the Board's first fiscal year, which may be a short fiscal year). The budget of the Board shall be subject to approval by the Commission. The budget for the first fiscal year of the Board shall be prepared and approved promptly following the appointment of the initial five Board members, to permit action by the Board of the organizational tasks contemplated by section 101(d).

(c) SOURCES AND USES OF FUNDS.—

(1) RECOVERABLE BUDGET EXPENSES.—The budget of the Board (reduced by any registration or annual fees received under section 102(e) for the year preceding the year for which the budget is being computed), and all of the budget of the standard setting body referred to in subsection (a), for each fiscal year of each of those 2 entities, shall be payable from annual accounting support fees, in accordance with subsections (d) and (e). Accounting support fees and other receipts of the Board and of such standard-setting body shall not be considered public monies of the United States.

(2) FUNDS GENERATED FROM THE COLLECTION OF MONETARY PENALTIES.—Subject to the availability in advance in an appropriations Act, and notwithstanding subsection (i), all funds collected by the Board as a result of the assessment of monetary penalties shall be used to fund a merit scholarship program for undergraduate and graduate students enrolled in accredited accounting degree programs, which program is to be administered by the Board or by an entity or agent identified by the Board.

(d) ANNUAL ACCOUNTING SUPPORT FEE FOR THE BOARD.—

(1) ESTABLISHMENT OF FEE.—The Board shall establish, with the approval of the Commission, a reasonable annual accounting support fee (or a formula for the computation thereof), as may be necessary or appropriate to establish and maintain the Board. Such fee may also cover costs incurred in the Board's first fiscal year (which may be a short fiscal year), or may be levied separately with respect to such short fiscal year.

(2) ASSESSMENTS.—The rules of the Board under paragraph (1) shall provide for the equitable allocation, assessment, and collection by the Board (or an agent appointed by the Board) of the fee established under paragraph (1), among issuers, in accordance with subsection (g), allowing for differentiation among classes of issuers, as appropriate.

(e) ANNUAL ACCOUNTING SUPPORT FEE FOR STANDARD SETTING BODY.—The annual accounting support fee for the standard setting body referred to in subsection (a)—

(1) shall be allocated in accordance with subsection (g), and assessed and collected against each issuer, on behalf of the standard setting body, by 1 or more appropriate designated collection agents, as may be necessary or appropriate to pay for the budget and provide for the expenses of that standard setting body, and to provide for an independent, stable source of funding for such body, subject to review by the Commission; and

(2) may differentiate among different classes of issuers.

(f) LIMITATION ON FEE.—The amount of fees collected under this section for a fiscal year on behalf of the Board or the standards setting body, as the case may be, shall not exceed the recoverable budget expenses of the Board or body, respectively (which may include operating, capital, and accrued items), referred to in subsection (c)(1).

(g) ALLOCATION OF ACCOUNTING SUPPORT FEES AMONG ISSUERS.—Any amount due from issuers (or a particular class of issuers) under this section to fund the budget of the Board or the standard setting body referred to in subsection (a) shall be allocated among and payable by each issuer (or each issuer in a particular class, as applicable) in an amount equal to the total of such amount, multiplied by a fraction—

(1) the numerator of which is the average monthly equity market capitalization of the issuer for the 12-month period immediately preceding the beginning of the fiscal year to which such budget relates; and

(2) the denominator of which is the average monthly equity market capitalization of all such issuers for such 12-month period.

(h) CONFORMING AMENDMENTS.—Section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2)) is amended—

(1) in subparagraph (A), by striking "and" at the end; and

(2) in subparagraph (B), by striking the period at the end and inserting the following: "; and

"(C) notwithstanding any other provision of law, pay the allocable share of such issuer of a reasonable annual accounting support fee or fees, determined in accordance with section 109 of the Sarbanes-Oxley Act of 2002.".

(i) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to render either the Board, the standard setting body referred to in subsection (a), or both, subject to procedures in Congress to authorize or appropriate public funds, or to prevent such organization from utilizing additional sources of revenue for its activities, such as earnings from publication sales, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual and perceived independence of such organization.

(j) START-UP EXPENSES OF THE BOARD.—From the unexpended balances of the appropriations to the Commission for fiscal year 2003, the Secretary of the Treasury is authorized to advance to the Board not to exceed the amount necessary to cover the expenses of the Board during its first fiscal year (which may be a short fiscal year).

TITLE II—AUDITOR INDEPENDENCE

SEC. 201. SERVICES OUTSIDE THE SCOPE OF PRACTICE OF AUDITORS.

(a) PROHIBITED ACTIVITIES.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended by adding at the end the following:

"(g) PROHIBITED ACTIVITIES.—Except as provided in subsection (h), it shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit required by this title or the rules of the Commission under this title or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 101 of the Sarbanes-Oxley Act of 2002 (in this section referred to as the 'Board'), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including—

"(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

"(2) financial information systems design and implementation;

"(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

"(4) actuarial services;

"(5) internal audit outsourcing services;

"(6) management functions or human resources;

"(7) broker or dealer, investment adviser, or investment banking services;

"(8) legal services and expert services unrelated to the audit; and

"(9) any other service that the Board determines, by regulation, is impermissible.

"(h) PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES.—A registered public accounting firm may engage in any non-audit service, including tax services, that is not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i).".

15 USC 7231.

(b) EXEMPTION AUTHORITY.—The Board may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of services under section 10A(g) of the Securities Exchange Act of 1934 (as added by this section), to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, and subject to review by the Commission in the same manner as for rules of the Board under section 107.

SEC. 202. PREAPPROVAL REQUIREMENTS.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(i) PREAPPROVAL REQUIREMENTS.—

"(1) IN GENERAL.—

"(A) AUDIT COMMITTEE ACTION.—All auditing services (which may entail providing comfort letters in connection with securities underwritings or statutory audits required for insurance companies for purposes of State law) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.

"(B) DE MINIMUS EXCEPTION.—The preapproval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if—

"(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor during the fiscal year in which the nonaudit services are provided;

"(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

"(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved prior to the completion of the audit by the audit committee or by 1 or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

"(2) DISCLOSURE TO INVESTORS.—Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 13(a).

"(3) DELEGATION AUTHORITY.—The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to preapprove an activity under this subsection shall be presented to the full audit committee at each of its scheduled meetings.

"(4) APPROVAL OF AUDIT SERVICES FOR OTHER PURPOSES.—In carrying out its duties under subsection (m)(2), if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service shall be deemed to have been preapproved for purposes of this subsection.".

SEC. 203. AUDIT PARTNER ROTATION.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(j) AUDIT PARTNER ROTATION.—It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.".

SEC. 204. AUDITOR REPORTS TO AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(k) REPORTS TO AUDIT COMMITTEES.—Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer—

"(1) all critical accounting policies and practices to be used;

"(2) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and

"(3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.".

SEC. 205. CONFORMING AMENDMENTS.

(a) DEFINITIONS.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following:

"(58) AUDIT COMMITTEE.—The term 'audit committee' means—

"(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

"(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

"(59) REGISTERED PUBLIC ACCOUNTING FIRM.—The term 'registered public accounting firm' has the same meaning as in section 2 of the Sarbanes-Oxley Act of 2002.".

(b) AUDITOR REQUIREMENTS.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1) is amended—

(1) by striking "an independent public accountant" each place that term appears and inserting "a registered public accounting firm";

(2) by striking "the independent public accountant" each place that term appears and inserting "the registered public accounting firm";

(3) in subsection (c), by striking "No independent public accountant" and inserting "No registered public accounting firm"; and

(4) in subsection (b)—

(A) by striking "the accountant" each place that term appears and inserting "the firm";

(B) by striking "such accountant" each place that term appears and inserting "such firm"; and

(C) in paragraph (4), by striking "the accountant's report" and inserting "the report of the firm".

(c) OTHER REFERENCES.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 12(b)(1) (15 U.S.C. 78l(b)(1)), by striking "independent public accountants" each place that term appears and inserting "a registered public accounting firm"; and

(2) in subsections (e) and (i) of section 17 (15 U.S.C. 78q), by striking "an independent public accountant" each place that term appears and inserting "a registered public accounting firm".

(d) CONFORMING AMENDMENT.—Section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78k(f)) is amended—

15 USC 78j–1.

(1) by striking "DEFINITION" and inserting "DEFINITIONS"; and

(2) by adding at the end the following: "As used in this section, the term 'issuer' means an issuer (as defined in section 3), the securities of which are registered under section 12, or that is required to file reports pursuant to section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.".

SEC. 206. CONFLICTS OF INTEREST.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1), as amended by this Act, is amended by adding at the end the following:

"(l) CONFLICTS OF INTEREST.—It shall be unlawful for a registered public accounting firm to perform for an issuer any audit service required by this title, if a chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the issuer, was employed by that registered independent public accounting firm and participated in any capacity in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit.".

SEC. 207. STUDY OF MANDATORY ROTATION OF REGISTERED PUBLIC ACCOUNTING FIRMS. 15 USC 7232.

(a) STUDY AND REVIEW REQUIRED.—The Comptroller General of the United States shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms.

(b) REPORT REQUIRED.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study and review required by this section. Deadline.

(c) DEFINITION.—For purposes of this section, the term "mandatory rotation" refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer.

SEC. 208. COMMISSION AUTHORITY. 15 USC 7233.

(a) COMMISSION REGULATIONS.—Not later than 180 days after the date of enactment of this Act, the Commission shall issue final regulations to carry out each of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title. Deadline.

(b) AUDITOR INDEPENDENCE.—It shall be unlawful for any registered public accounting firm (or an associated person thereof, as applicable) to prepare or issue any audit report with respect to any issuer, if the firm or associated person engages in any activity with respect to that issuer prohibited by any of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title, or any rule or regulation of the Commission or of the Board issued thereunder.

SEC. 209. CONSIDERATIONS BY APPROPRIATE STATE REGULATORY AUTHORITIES. 15 USC 7234.

In supervising nonregistered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable, particularly taking into consideration the size and nature of the business of the accounting firms they supervise and the size and nature of the business of the clients of those firms. The standards applied by the Board under this Act should not be presumed to be applicable for purposes of this section for small and medium sized nonregistered public accounting firms.

TITLE III—CORPORATE RESPONSIBILITY

SEC. 301. PUBLIC COMPANY AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78f) is amended by adding at the end the following: 15 USC 78j–1.

"(m) STANDARDS RELATING TO AUDIT COMMITTEES.—

"(1) COMMISSION RULES.—

Deadline.

"(A) IN GENERAL.—Effective not later than 270 days after the date of enactment of this subsection, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of any portion of paragraphs (2) through (6).

"(B) OPPORTUNITY TO CURE DEFECTS.—The rules of the Commission under subparagraph (A) shall provide for appropriate procedures for an issuer to have an opportunity to cure any defects that would be the basis for a prohibition under subparagraph (A), before the imposition of such prohibition.

"(2) RESPONSIBILITIES RELATING TO REGISTERED PUBLIC ACCOUNTING FIRMS.—The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.

"(3) INDEPENDENCE.—

"(A) IN GENERAL.—Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer, and shall otherwise be independent.

"(B) CRITERIA.—In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee—

"(i) accept any consulting, advisory, or other compensatory fee from the issuer; or

"(ii) be an affiliated person of the issuer or any subsidiary thereof.

"(C) EXEMPTION AUTHORITY.—The Commission may exempt from the requirements of subparagraph (B) a particular relationship with respect to audit committee members, as the Commission determines appropriate in light of the circumstances.

"(4) COMPLAINTS.—Each audit committee shall establish procedures for—

"(A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

"(B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

"(5) AUTHORITY TO ENGAGE ADVISERS.—Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

"(6) FUNDING.—Each issuer shall provide for appropriate funding, as determined by the audit committee, in its capacity as a committee of the board of directors, for payment of compensation—

"(A) to the registered public accounting firm employed by the issuer for the purpose of rendering or issuing an audit report; and

"(B) to any advisers employed by the audit committee under paragraph (5).".

SEC. 302. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS. 15 USC 7241.

(a) REGULATIONS REQUIRED.—The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act that—

(1) the signing officer has reviewed the report;

(2) based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;

(3) based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;

(4) the signing officers—

(A) are responsible for establishing and maintaining internal controls;

(B) have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared;

(C) have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report; and

(D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;

(5) the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function)—

(A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and

(B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and

(6) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

(b) FOREIGN REINCORPORATIONS HAVE NO EFFECT.—Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302, by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.

(c) DEADLINE.—The rules required by subsection (a) shall be effective not later than 30 days after the date of enactment of this Act.

15 USC 7242.

SEC. 303. IMPROPER INFLUENCE ON CONDUCT OF AUDITS.

(a) RULES TO PROHIBIT.—It shall be unlawful, in contravention of such rules or regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

(b) ENFORCEMENT.—In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation issued under this section.

(c) NO PREEMPTION OF OTHER LAW.—The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation issued thereunder.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose the rules or regulations required by this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules or regulations required by this section, not later than 270 days after that date of enactment.

15 USC 7243.

SEC. 304. FORFEITURE OF CERTAIN BONUSES AND PROFITS.

(a) ADDITIONAL COMPENSATION PRIOR TO NONCOMPLIANCE WITH COMMISSION FINANCIAL REPORTING REQUIREMENTS.—If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(2) any profits realized from the sale of securities of the issuer during that 12-month period.

(b) COMMISSION EXEMPTION AUTHORITY.—The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.

SEC. 305. OFFICER AND DIRECTOR BARS AND PENALTIES.

(a) UNFITNESS STANDARD.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(2)) is amended by striking "substantial unfitness" and inserting "unfitness".

(2) SECURITIES ACT OF 1933.—Section 20(e) of the Securities Act of 1933 (15 U.S.C. 77t(e)) is amended by striking "substantial unfitness" and inserting "unfitness".

(b) EQUITABLE RELIEF.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended by adding at the end the following:

"(5) EQUITABLE RELIEF.—In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.".

SEC. 306. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS. 15 USC 7244.

(a) PROHIBITION OF INSIDER TRADING DURING PENSION FUND BLACKOUT PERIODS.—

(1) IN GENERAL.—Except to the extent otherwise provided by rule of the Commission pursuant to paragraph (3), it shall be unlawful for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer (other than an exempted security) during any blackout period with respect to such equity security if such director or officer acquires such equity security in connection with his or her service or employment as a director or executive officer.

(2) REMEDY.—

(A) IN GENERAL.—Any profit realized by a director or executive officer referred to in paragraph (1) from any purchase, sale, or other acquisition or transfer in violation of this subsection shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such director or executive officer in entering into the transaction.

(B) ACTIONS TO RECOVER PROFITS.—An action to recover profits in accordance with this subsection may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer fails or refuses to bring such action within 60 days after the date of request, or fails diligently to prosecute the action thereafter, except that no such suit shall be brought more than 2 years after the date on which such profit was realized.

(3) RULEMAKING AUTHORIZED.—The Commission shall, in consultation with the Secretary of Labor, issue rules to clarify the application of this subsection and to prevent evasion thereof. Such rules shall provide for the application of the requirements of paragraph (1) with respect to entities treated as a single employer with respect to an issuer under section 414(b), (c), (m), or (o) of the Internal Revenue Code of 1986 to the extent necessary to clarify the application of such requirements and to prevent evasion thereof. Such rules may also provide for

appropriate exceptions from the requirements of this subsection, including exceptions for purchases pursuant to an automatic dividend reinvestment program or purchases or sales made pursuant to an advance election.

(4) BLACKOUT PERIOD.—For purposes of this subsection, the term "blackout period", with respect to the equity securities of any issuer—

(A) means any period of more than 3 consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan; and

(B) does not include, under regulations which shall be prescribed by the Commission—

(i) a regularly scheduled period in which the participants and beneficiaries may not purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer, if such period is—

(I) incorporated into the individual account plan; and

(II) timely disclosed to employees before becoming participants under the individual account plan or as a subsequent amendment to the plan; or

(ii) any suspension described in subparagraph (A) that is imposed solely in connection with persons becoming participants or beneficiaries, or ceasing to be participants or beneficiaries, in an individual account plan by reason of a corporate merger, acquisition, divestiture, or similar transaction involving the plan or plan sponsor.

(5) INDIVIDUAL ACCOUNT PLAN.—For purposes of this subsection, the term "individual account plan" has the meaning provided in section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34), except that such term shall not include a one-participant retirement plan (within the meaning of section 101(i)(8)(B) of such Act (29 U.S.C. 1021(i)(8)(B))).

(6) NOTICE TO DIRECTORS, EXECUTIVE OFFICERS, AND THE COMMISSION.—In any case in which a director or executive officer is subject to the requirements of this subsection in connection with a blackout period (as defined in paragraph (4)) with respect to any equity securities, the issuer of such equity securities shall timely notify such director or officer and the Securities and Exchange Commission of such blackout period.

(b) NOTICE REQUIREMENTS TO PARTICIPANTS AND BENEFICIARIES UNDER ERISA.—

(1) IN GENERAL.—Section 101 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1021) is amended by redesignating the second subsection (h) as subsection (j), and by inserting after the first subsection (h) the following new subsection:

"(i) NOTICE OF BLACKOUT PERIODS TO PARTICIPANT OR BENEFICIARY UNDER INDIVIDUAL ACCOUNT PLAN.—

"(1) DUTIES OF PLAN ADMINISTRATOR.—In advance of the commencement of any blackout period with respect to an individual account plan, the plan administrator shall notify the plan participants and beneficiaries who are affected by such action in accordance with this subsection.

"(2) NOTICE REQUIREMENTS.—

"(A) IN GENERAL.—The notices described in paragraph (1) shall be written in a manner calculated to be understood by the average plan participant and shall include—

"(i) the reasons for the blackout period,

"(ii) an identification of the investments and other rights affected,

"(iii) the expected beginning date and length of the blackout period,

"(iv) in the case of investments affected, a statement that the participant or beneficiary should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts during the blackout period, and

"(v) such other matters as the Secretary may require by regulation.

"(B) NOTICE TO PARTICIPANTS AND BENEFICIARIES.—Except as otherwise provided in this subsection, notices described in paragraph (1) shall be furnished to all participants and beneficiaries under the plan to whom the blackout period applies at least 30 days in advance of the blackout period.

"(C) EXCEPTION TO 30-DAY NOTICE REQUIREMENT.—In any case in which—

"(i) a deferral of the blackout period would violate the requirements of subparagraph (A) or (B) of section 404(a)(1), and a fiduciary of the plan reasonably so determines in writing, or

"(ii) the inability to provide the 30-day advance notice is due to events that were unforeseeable or circumstances beyond the reasonable control of the plan administrator, and a fiduciary of the plan reasonably so determines in writing,

subparagraph (B) shall not apply, and the notice shall be furnished to all participants and beneficiaries under the plan to whom the blackout period applies as soon as reasonably possible under the circumstances unless such a notice in advance of the termination of the blackout period is impracticable.

"(D) WRITTEN NOTICE.—The notice required to be provided under this subsection shall be in writing, except that such notice may be in electronic or other form to the extent that such form is reasonably accessible to the recipient.

"(E) NOTICE TO ISSUERS OF EMPLOYER SECURITIES SUBJECT TO BLACKOUT PERIOD.—In the case of any blackout period in connection with an individual account plan, the plan administrator shall provide timely notice of such blackout period to the issuer of any employer securities subject to such blackout period.

"(3) EXCEPTION FOR BLACKOUT PERIODS WITH LIMITED APPLICABILITY.—In any case in which the blackout period applies only to 1 or more participants or beneficiaries in connection with a merger, acquisition, divestiture, or similar transaction involving the plan or plan sponsor and occurs solely in connection with becoming or ceasing to be a participant or beneficiary under the plan by reason of such merger, acquisition, divestiture, or transaction, the requirement of this subsection that the notice be provided to all participants and beneficiaries shall be treated as met if the notice required under paragraph (1) is provided to such participants or beneficiaries to whom the blackout period applies as soon as reasonably practicable.

"(4) CHANGES IN LENGTH OF BLACKOUT PERIOD.—If, following the furnishing of the notice pursuant to this subsection, there is a change in the beginning date or length of the blackout period (specified in such notice pursuant to paragraph (2)(A)(iii)), the administrator shall provide affected participants and beneficiaries notice of the change as soon as reasonably practicable. In relation to the extended blackout period, such notice shall meet the requirements of paragraph (2)(D) and shall specify any material change in the matters referred to in clauses (i) through (v) of paragraph (2)(A).

"(5) REGULATORY EXCEPTIONS.—The Secretary may provide by regulation for additional exceptions to the requirements of this subsection which the Secretary determines are in the interests of participants and beneficiaries.

"(6) GUIDANCE AND MODEL NOTICES.—The Secretary shall issue guidance and model notices which meet the requirements of this subsection.

"(7) BLACKOUT PERIOD.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'blackout period' means, in connection with an individual account plan, any period for which any ability of participants or beneficiaries under the plan, which is otherwise available under the terms of such plan, to direct or diversify assets credited to their accounts, to obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited, or restricted, if such suspension, limitation, or restriction is for any period of more than 3 consecutive business days.

"(B) EXCLUSIONS.—The term 'blackout period' does not include a suspension, limitation, or restriction—

"(i) which occurs by reason of the application of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934),

"(ii) which is a change to the plan which provides for a regularly scheduled suspension, limitation, or restriction which is disclosed to participants or beneficiaries through any summary of material modifications, any materials describing specific investment alternatives under the plan, or any changes thereto, or

"(iii) which applies only to 1 or more individuals, each of whom is the participant, an alternate payee (as defined in section 206(d)(3)(K)), or any other beneficiary pursuant to a qualified domestic relations order (as defined in section 206(d)(3)(B)(i)).

"(8) INDIVIDUAL ACCOUNT PLAN.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'individual account plan' shall have the meaning provided such term in section 3(34), except that such term shall not include a one-participant retirement plan.

"(B) ONE-PARTICIPANT RETIREMENT PLAN.—For purposes of subparagraph (A), the term 'one-participant retirement plan' means a retirement plan that—

"(i) on the first day of the plan year—

"(I) covered only the employer (and the employer's spouse) and the employer owned the entire business (whether or not incorporated), or

"(II) covered only one or more partners (and their spouses) in a business partnership (including partners in an S or C corporation (as defined in section 1361(a) of the Internal Revenue Code of 1986)),

"(ii) meets the minimum coverage requirements of section 410(b) of the Internal Revenue Code of 1986 (as in effect on the date of the enactment of this paragraph) without being combined with any other plan of the business that covers the employees of the business,

"(iii) does not provide benefits to anyone except the employer (and the employer's spouse) or the partners (and their spouses),

"(iv) does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of businesses under common control, and

"(v) does not cover a business that leases employees.".

(2) ISSUANCE OF INITIAL GUIDANCE AND MODEL NOTICE.— Deadlines.
The Secretary of Labor shall issue initial guidance and a model notice pursuant to section 101(i)(6) of the Employee Retirement Income Security Act of 1974 (as added by this subsection) not later than January 1, 2003. Not later than 75 days after Regulations. the date of the enactment of this Act, the Secretary shall promulgate interim final rules necessary to carry out the amendments made by this subsection.

(3) CIVIL PENALTIES FOR FAILURE TO PROVIDE NOTICE.— Section 502 of such Act (29 U.S.C. 1132) is amended—

(A) in subsection (a)(6), by striking "(5), or (6)" and inserting "(5), (6), or (7)";

(B) by redesignating paragraph (7) of subsection (c) as paragraph (8); and

(C) by inserting after paragraph (6) of subsection (c) the following new paragraph:

"(7) The Secretary may assess a civil penalty against a plan administrator of up to $100 a day from the date of the plan administrator's failure or refusal to provide notice to participants and beneficiaries in accordance with section 101(i). For purposes of this paragraph, each violation with respect to any single participant or beneficiary shall be treated as a separate violation.".

(3) PLAN AMENDMENTS.—If any amendment made by this subsection requires an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after the effective date of this section, if—

(A) during the period after such amendment made by this subsection takes effect and before such first plan year, the plan is operated in good faith compliance with the requirements of such amendment made by this subsection, and

(B) such plan amendment applies retroactively to the period after such amendment made by this subsection takes effect and before such first plan year.

(c) EFFECTIVE DATE.—The provisions of this section (including the amendments made thereby) shall take effect 180 days after the date of the enactment of this Act. Good faith compliance with the requirements of such provisions in advance of the issuance of applicable regulations thereunder shall be treated as compliance with such provisions.

15 USC 7245.

SEC. 307. RULES OF PROFESSIONAL RESPONSIBILITY FOR ATTORNEYS.

Deadline.

Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—

(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

15 USC 7246.

SEC. 308. FAIR FUNDS FOR INVESTORS.

(a) CIVIL PENALTIES ADDED TO DISGORGEMENT FUNDS FOR THE RELIEF OF VICTIMS.—If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.

(b) ACCEPTANCE OF ADDITIONAL DONATIONS.—The Commission is authorized to accept, hold, administer, and utilize gifts, bequests and devises of property, both real and personal, to the United

States for a disgorgement fund described in subsection (a). Such gifts, bequests, and devises of money and proceeds from sales of other property received as gifts, bequests, or devises shall be deposited in the disgorgement fund and shall be available for allocation in accordance with subsection (a).

(c) STUDY REQUIRED.—

(1) SUBJECT OF STUDY.—The Commission shall review and analyze—

(A) enforcement actions by the Commission over the five years preceding the date of the enactment of this Act that have included proceedings to obtain civil penalties or disgorgements to identify areas where such proceedings may be utilized to efficiently, effectively, and fairly provide restitution for injured investors; and

(B) other methods to more efficiently, effectively, and fairly provide restitution to injured investors, including methods to improve the collection rates for civil penalties and disgorgements.

(2) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days after of the date of the enactment of this Act, and shall use such findings to revise its rules and regulations as necessary. The report shall include a discussion of regulatory or legislative actions that are recommended or that may be necessary to address concerns identified in the study. Deadline.

(d) CONFORMING AMENDMENTS.—Each of the following provisions is amended by inserting ", except as otherwise provided in section 308 of the Sarbanes-Oxley Act of 2002" after "Treasury of the United States":

(1) Section 21(d)(3)(C)(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(3)(C)(i)).

(2) Section 21A(d)(1) of such Act (15 U.S.C. 78u-1(d)(1)).

(3) Section 20(d)(3)(A) of the Securities Act of 1933 (15 U.S.C. 77t(d)(3)(A)).

(4) Section 42(e)(3)(A) of the Investment Company Act of 1940 (15 U.S.C. 80a–41(e)(3)(A)).

(5) Section 209(e)(3)(A) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–9(e)(3)(A)).

(e) DEFINITION.—As used in this section, the term "disgorgement fund" means a fund established in any administrative or judicial proceeding described in subsection (a).

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

SEC. 401. DISCLOSURES IN PERIODIC REPORTS. 15 USC 7261.

(a) DISCLOSURES REQUIRED.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

"(i) ACCURACY OF FINANCIAL REPORTS.—Each financial report that contains financial statements, and that is required to be prepared in accordance with (or reconciled to) generally accepted accounting principles under this title and filed with the Commission shall reflect all material correcting adjustments that have been identified by a registered public accounting firm in accordance with generally accepted accounting principles and the rules and regulations of the Commission.

Deadline. Regulations.

"(j) OFF-BALANCE SHEET TRANSACTIONS.—Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002, the Commission shall issue final rules providing that each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.".

Deadline.

(b) COMMISSION RULES ON PRO FORMA FIGURES.—Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act fo 2002, the Commission shall issue final rules providing that pro forma financial information included in any periodic or other report filed with the Commission pursuant to the securities laws, or in any public disclosure or press or other release, shall be presented in a manner that—

(1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information, in light of the circumstances under which it is presented, not misleading; and

(2) reconciles it with the financial condition and results of operations of the issuer under generally accepted accounting principles.

(c) STUDY AND REPORT ON SPECIAL PURPOSE ENTITIES.—

Deadline.

(1) STUDY REQUIRED.—The Commission shall, not later than 1 year after the effective date of adoption of off-balance sheet disclosure rules required by section 13(j) of the Securities Exchange Act of 1934, as added by this section, complete a study of filings by issuers and their disclosures to determine—

(A) the extent of off-balance sheet transactions, including assets, liabilities, leases, losses, and the use of special purpose entities; and

(B) whether generally accepted accounting rules result in financial statements of issuers reflecting the economics of such off-balance sheet transactions to investors in a transparent fashion.

Deadline.

(2) REPORT AND RECOMMENDATIONS.—Not later than 6 months after the date of completion of the study required by paragraph (1), the Commission shall submit a report to the President, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, setting forth—

(A) the amount or an estimate of the amount of off-balance sheet transactions, including assets, liabilities, leases, and losses of, and the use of special purpose entities by, issuers filing periodic reports pursuant to section 13 or 15 of the Securities Exchange Act of 1934;

(B) the extent to which special purpose entities are used to facilitate off-balance sheet transactions;

(C) whether generally accepted accounting principles or the rules of the Commission result in financial statements of issuers reflecting the economics of such transactions to investors in a transparent fashion;

(D) whether generally accepted accounting principles specifically result in the consolidation of special purpose entities sponsored by an issuer in cases in which the issuer has the majority of the risks and rewards of the special purpose entity; and

(E) any recommendations of the Commission for improving the transparency and quality of reporting off-balance sheet transactions in the financial statements and disclosures required to be filed by an issuer with the Commission.

SEC. 402. ENHANCED CONFLICT OF INTEREST PROVISIONS.

(a) PROHIBITION ON PERSONAL LOANS TO EXECUTIVES.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

"(k) PROHIBITION ON PERSONAL LOANS TO EXECUTIVES.—

"(1) IN GENERAL.—It shall be unlawful for any issuer (as defined in section 2 of the Sarbanes-Oxley Act of 2002), directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer. An extension of credit maintained by the issuer on the date of enactment of this subsection shall not be subject to the provisions of this subsection, provided that there is no material modification to any term of any such extension of credit or any renewal of any such extension of credit on or after that date of enactment.

"(2) LIMITATION.—Paragraph (1) does not preclude any home improvement and manufactured home loans (as that term is defined in section 5 of the Home Owners' Loan Act (12 U.S.C. 1464)), consumer credit (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602)), or any extension of credit under an open end credit plan (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602)), or a charge card (as defined in section 127(c)(4)(e) of the Truth in Lending Act (15 U.S.C. 1637(c)(4)(e)), or any extension of credit by a broker or dealer registered under section 15 of this title to an employee of that broker or dealer to buy, trade, or carry securities, that is permitted under rules or regulations of the Board of Governors of the Federal Reserve System pursuant to section 7 of this title (other than an extension of credit that would be used to purchase the stock of that issuer), that is—

"(A) made or provided in the ordinary course of the consumer credit business of such issuer;

"(B) of a type that is generally made available by such issuer to the public; and

"(C) made by such issuer on market terms, or terms that are no more favorable than those offered by the issuer to the general public for such extensions of credit.

"(3) RULE OF CONSTRUCTION FOR CERTAIN LOANS.—Paragraph (1) does not apply to any loan made or maintained by an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), if the loan is subject to the insider lending restrictions of section 22(h) of the Federal Reserve Act (12 U.S.C. 375b).''.

SEC. 403. DISCLOSURES OF TRANSACTIONS INVOLVING MANAGEMENT AND PRINCIPAL STOCKHOLDERS.

(a) AMENDMENT.—Section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) is amended by striking the heading of such section and subsection (a) and inserting the following:

''SEC. 16. DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS.

''(a) DISCLOSURES REQUIRED.—

''(1) DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS REQUIRED TO FILE.—Every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to section 12, or who is a director or an officer of the issuer of such security, shall file the statements required by this subsection with the Commission (and, if such security is registered on a national securities exchange, also with the exchange).

''(2) TIME OF FILING.—The statements required by this subsection shall be filed—

''(A) at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g);

''(B) within 10 days after he or she becomes such beneficial owner, director, or officer;

''(C) if there has been a change in such ownership, or if such person shall have purchased or sold a security-based swap agreement (as defined in section 206(b) of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note)) involving such equity security, before the end of the second business day following the day on which the subject transaction has been executed, or at such other time as the Commission shall establish, by rule, in any case in which the Commission determines that such 2-day period is not feasible.

''(3) CONTENTS OF STATEMENTS.—A statement filed—

''(A) under subparagraph (A) or (B) of paragraph (2) shall contain a statement of the amount of all equity securities of such issuer of which the filing person is the beneficial owner; and

''(B) under subparagraph (C) of such paragraph shall indicate ownership by the filing person at the date of filing, any such changes in such ownership, and such purchases and sales of the security-based swap agreements as have occurred since the most recent such filing under such subparagraph.

Deadline.

''(4) ELECTRONIC FILING AND AVAILABILITY.—Beginning not later than 1 year after the date of enactment of the Sarbanes-Oxley Act of 2002—

''(A) a statement filed under subparagraph (C) of paragraph (2) shall be filed electronically;

Deadline.

''(B) the Commission shall provide each such statement on a publicly accessible Internet site not later than the end of the business day following that filing; and

"(C) the issuer (if the issuer maintains a corporate website) shall provide that statement on that corporate website, not later than the end of the business day following that filing.". Deadline.

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective 30 days after the date of the enactment of this Act. 15 USC 78p note.

SEC. 404. MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS. 15 USC 7262.

(a) RULES REQUIRED.—The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—

(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

(2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) INTERNAL CONTROL EVALUATION AND REPORTING.—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

SEC. 405. EXEMPTION. 15 USC 7263.

Nothing in section 401, 402, or 404, the amendments made by those sections, or the rules of the Commission under those sections shall apply to any investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8).

SEC. 406. CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS. 15 USC 7264.

(a) CODE OF ETHICS DISCLOSURE.—The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions. Regulations.

(b) CHANGES IN CODES OF ETHICS.—The Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8–K (or any successor thereto) to require the immediate disclosure, by means of the filing of such form, dissemination by the Internet or by other electronic means, by any issuer of any change in or waiver of the code of ethics for senior financial officers. Regulations.

(c) DEFINITION.—In this section, the term "code of ethics" means such standards as are reasonably necessary to promote—

(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

(2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3) compliance with applicable governmental rules and regulations.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

15 USC 7265.

SEC. 407. DISCLOSURE OF AUDIT COMMITTEE FINANCIAL EXPERT.

(a) RULES DEFINING "FINANCIAL EXPERT".—The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reasons therefor, the audit committee of that issuer is comprised of at least 1 member who is a financial expert, as such term is defined by the Commission.

(b) CONSIDERATIONS.—In defining the term "financial expert" for purposes of subsection (a), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions—

(1) an understanding of generally accepted accounting principles and financial statements;

(2) experience in—

(A) the preparation or auditing of financial statements of generally comparable issuers; and

(B) the application of such principles in connection with the accounting for estimates, accruals, and reserves;

(3) experience with internal accounting controls; and

(4) an understanding of audit committee functions.

(c) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

15 USC 7266.

SEC. 408. ENHANCED REVIEW OF PERIODIC DISCLOSURES BY ISSUERS.

(a) REGULAR AND SYSTEMATIC REVIEW.—The Commission shall review disclosures made by issuers reporting under section 13(a) of the Securities Exchange Act of 1934 (including reports filed on Form 10–K), and which have a class of securities listed on a national securities exchange or traded on an automated quotation facility of a national securities association, on a regular and systematic basis for the protection of investors. Such review shall include a review of an issuer's financial statement.

(b) REVIEW CRITERIA.—For purposes of scheduling the reviews required by subsection (a), the Commission shall consider, among other factors—

(1) issuers that have issued material restatements of financial results;

(2) issuers that experience significant volatility in their stock price as compared to other issuers;

(3) issuers with the largest market capitalization;

(4) emerging companies with disparities in price to earning ratios;

(5) issuers whose operations significantly affect any material sector of the economy; and

(6) any other factors that the Commission may consider relevant.

(c) MINIMUM REVIEW PERIOD.—In no event shall an issuer required to file reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 be reviewed under this section less frequently than once every 3 years.

SEC. 409. REAL TIME ISSUER DISCLOSURES.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

"(l) REAL TIME ISSUER DISCLOSURES.—Each issuer reporting under section 13(a) or 15(d) shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest.".

TITLE V—ANALYST CONFLICTS OF INTEREST

SEC. 501. TREATMENT OF SECURITIES ANALYSTS BY REGISTERED SECURITIES ASSOCIATIONS AND NATIONAL SECURITIES EXCHANGES.

(a) RULES REGARDING SECURITIES ANALYSTS.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 15C the following new section:

"SEC. 15D. SECURITIES ANALYSTS AND RESEARCH REPORTS. 15 USC 78*o*–6.

"(a) ANALYST PROTECTIONS.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this section, rules reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information, including rules designed— Deadline.

"(1) to foster greater public confidence in securities research, and to protect the objectivity and independence of securities analysts, by—

"(A) restricting the prepublication clearance or approval of research reports by persons employed by the broker or dealer who are engaged in investment banking activities, or persons not directly responsible for investment research, other than legal or compliance staff;

"(B) limiting the supervision and compensatory evaluation of securities analysts to officials employed by the broker or dealer who are not engaged in investment banking activities; and

"(C) requiring that a broker or dealer and persons employed by a broker or dealer who are involved with investment banking activities may not, directly or indirectly, retaliate against or threaten to retaliate against any securities analyst employed by that broker or dealer or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report that may adversely affect the present or prospective investment banking relationship of the broker or dealer with the issuer that is the subject of the research report, except that such rules may not limit the authority of a broker or dealer to discipline a securities analyst for causes other than such research report in accordance with the policies and procedures of the firm;

"(2) to define periods during which brokers or dealers who have participated, or are to participate, in a public offering of securities as underwriters or dealers should not publish or otherwise distribute research reports relating to such securities or to the issuer of such securities;

"(3) to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision; and

"(4) to address such other issues as the Commission, or such association or exchange, determines appropriate.

"(b) DISCLOSURE.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this section, rules reasonably designed to require each securities analyst to disclose in public appearances, and each registered broker or dealer to disclose in each research report, as applicable, conflicts of interest that are known or should have been known by the securities analyst or the broker or dealer, to exist at the time of the appearance or the date of distribution of the report, including—

"(1) the extent to which the securities analyst has debt or equity investments in the issuer that is the subject of the appearance or research report;

"(2) whether any compensation has been received by the registered broker or dealer, or any affiliate thereof, including the securities analyst, from the issuer that is the subject of the appearance or research report, subject to such exemptions as the Commission may determine appropriate and necessary to prevent disclosure by virtue of this paragraph of material non-public information regarding specific potential future investment banking transactions of such issuer, as is appropriate in the public interest and consistent with the protection of investors;

"(3) whether an issuer, the securities of which are recommended in the appearance or research report, currently is, or during the 1-year period preceding the date of the appearance or date of distribution of the report has been, a client of the registered broker or dealer, and if so, stating the types of services provided to the issuer;

"(4) whether the securities analyst received compensation with respect to a research report, based upon (among any other factors) the investment banking revenues (either generally or specifically earned from the issuer being analyzed) of the registered broker or dealer; and

"(5) such other disclosures of conflicts of interest that are material to investors, research analysts, or the broker or dealer as the Commission, or such association or exchange, determines appropriate.

"(c) DEFINITIONS.—In this section—

"(1) the term 'securities analyst' means any associated person of a registered broker or dealer that is principally responsible for, and any associated person who reports directly or indirectly to a securities analyst in connection with, the preparation of the substance of a research report, whether or not any such person has the job title of 'securities analyst'; and

"(2) the term 'research report' means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.".

(b) ENFORCEMENT.—Section 21B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–2(a)) is amended by inserting "15D," before "15B".

(c) COMMISSION AUTHORITY.—The Commission may promulgate and amend its regulations, or direct a registered securities association or national securities exchange to promulgate and amend its rules, to carry out section 15D of the Securities Exchange Act of 1934, as added by this section, as is necessary for the protection of investors and in the public interest. 15 USC 78*o*–6 note.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

SEC. 601. AUTHORIZATION OF APPROPRIATIONS.

Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

"SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

"In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission, $776,000,000 for fiscal year 2003, of which—

"(1) $102,700,000 shall be available to fund additional compensation, including salaries and benefits, as authorized in the Investor and Capital Markets Fee Relief Act (Public Law 107–123; 115 Stat. 2390 et seq.);

"(2) $108,400,000 shall be available for information technology, security enhancements, and recovery and mitigation activities in light of the terrorist attacks of September 11, 2001; and

"(3) $98,000,000 shall be available to add not fewer than an additional 200 qualified professionals to provide enhanced oversight of auditors and audit services required by the Federal securities laws, and to improve Commission investigative and disciplinary efforts with respect to such auditors and services, as well as for additional professional support staff necessary to strengthen the programs of the Commission involving Full Disclosure and Prevention and Suppression of Fraud, risk management, industry technology review, compliance, inspections, examinations, market regulation, and investment management.''.

SEC. 602. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 4B the following:

15 USC 78d–3.

''SEC. 4C. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

''(a) AUTHORITY TO CENSURE.—The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission, after notice and opportunity for hearing in the matter—

''(1) not to possess the requisite qualifications to represent others;

''(2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or

''(3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder.

''(b) DEFINITION.—With respect to any registered public accounting firm or associated person, for purposes of this section, the term 'improper professional conduct' means—

''(1) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; and

''(2) negligent conduct in the form of—

''(A) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted; or

''(B) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.''.

SEC. 603. FEDERAL COURT AUTHORITY TO IMPOSE PENNY STOCK BARS.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)), as amended by this Act, is amended by adding at the end the following:

''(6) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

''(A) IN GENERAL.—In any proceeding under paragraph (1) against any person participating in, or, at the time of the alleged misconduct who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

''(B) DEFINITION.—For purposes of this paragraph, the term 'person participating in an offering of penny stock' includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.".

(b) SECURITIES ACT OF 1933.—Section 20 of the Securities Act of 1933 (15 U.S.C. 77t) is amended by adding at the end the following:

"(g) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

"(1) IN GENERAL.—In any proceeding under subsection (a) against any person participating in, or, at the time of the alleged misconduct, who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

"(2) DEFINITION.—For purposes of this subsection, the term 'person participating in an offering of penny stock' includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.".

SEC. 604. QUALIFICATIONS OF ASSOCIATED PERSONS OF BROKERS AND DEALERS.

(a) BROKERS AND DEALERS.—Section 15(b)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended—

(1) by striking subparagraph (F) and inserting the following:

"(F) is subject to any order of the Commission barring or suspending the right of the person to be associated with a broker or dealer;"; and

(2) in subparagraph (G), by striking the period at the end and inserting the following: "; or

"(H) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

"(i) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or "(ii) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.".

(b) INVESTMENT ADVISERS.—Section 203(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(e)) is amended—

(1) by striking paragraph (7) and inserting the following:

"(7) is subject to any order of the Commission barring or suspending the right of the person to be associated with an investment adviser;";

(2) in paragraph (8), by striking the period at the end and inserting "; or"; and

(3) by adding at the end the following:

"(9) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

"(A) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

"(B) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.".

(c) CONFORMING AMENDMENTS.—

(1) SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(A) in section 3(a)(39)(F) (15 U.S.C. 78c(a)(39)(F))—

(i) by striking "or (G)" and inserting "(H), or (G)"; and

(ii) by inserting ", or is subject to an order or finding," before "enumerated";

(B) in each of section 15(b)(6)(A)(i) (15 U.S.C. 78o(b)(6)(A)(i)), paragraphs (2) and (4) of section 15B(c) (15 U.S.C. 78o–4(c)), and subparagraphs (A) and (C) of section 15C(c)(1) (15 U.S.C. 78o–5(c)(1))—

(i) by striking "or (G)" each place that term appears and inserting "(H), or (G)"; and

(ii) by striking "or omission" each place that term appears, and inserting ", or is subject to an order or finding,"; and

(C) in each of paragraphs (3)(A) and (4)(C) of section 17A(c) (15 U.S.C. 78q–1(c))—

(i) by striking "or (G)" each place that term appears and inserting "(H), or (G)"; and

(ii) by inserting ", or is subject to an order or finding," before "enumerated" each place that term appears.

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 203(f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(f)) is amended—

(A) by striking "or (8)" and inserting "(8), or (9)"; and

(B) by inserting "or (3)" after "paragraph (2)".

TITLE VII—STUDIES AND REPORTS

SEC. 701. GAO STUDY AND REPORT REGARDING CONSOLIDATION OF PUBLIC ACCOUNTING FIRMS.

15 USC 7201 note.

(a) STUDY REQUIRED.—The Comptroller General of the United States shall conduct a study—

(1) to identify—

(A) the factors that have led to the consolidation of public accounting firms since 1989 and the consequent reduction in the number of firms capable of providing audit services to large national and multi-national business organizations that are subject to the securities laws;

(B) the present and future impact of the condition described in subparagraph (A) on capital formation and securities markets, both domestic and international; and

(C) solutions to any problems identified under subparagraph (B), including ways to increase competition and the number of firms capable of providing audit services to large national and multinational business organizations that are subject to the securities laws;

(2) of the problems, if any, faced by business organizations that have resulted from limited competition among public accounting firms, including—

(A) higher costs;

(B) lower quality of services;

(C) impairment of auditor independence; or

(D) lack of choice; and

(3) whether and to what extent Federal or State regulations impede competition among public accounting firms.

(b) CONSULTATION.—In planning and conducting the study under this section, the Comptroller General shall consult with—

(1) the Commission;

(2) the regulatory agencies that perform functions similar to the Commission within the other member countries of the Group of Seven Industrialized Nations;

(3) the Department of Justice; and

(4) any other public or private sector organization that the Comptroller General considers appropriate.

(c) REPORT REQUIRED.—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report on the results of the study required by this section to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives. Deadline.

SEC. 702. COMMISSION STUDY AND REPORT REGARDING CREDIT RATING AGENCIES.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—The Commission shall conduct a study of the role and function of credit rating agencies in the operation of the securities market.

(2) AREAS OF CONSIDERATION.—The study required by this subsection shall examine—

(A) the role of credit rating agencies in the evaluation of issuers of securities;

(B) the importance of that role to investors and the functioning of the securities markets;

(C) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

(D) any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers;

(E) any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings; and

(F) any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate the consequences of such conflicts.

Deadline.

(b) REPORT REQUIRED.—The Commission shall submit a report on the study required by subsection (a) to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate not later than 180 days after the date of enactment of this Act.

SEC. 703. STUDY AND REPORT ON VIOLATORS AND VIOLATIONS.

(a) STUDY.—The Commission shall conduct a study to determine, based upon information for the period from January 1, 1998, to December 31, 2001—

(1) the number of securities professionals, defined as public accountants, public accounting firms, investment bankers, investment advisers, brokers, dealers, attorneys, and other securities professionals practicing before the Commission—

(A) who have been found to have aided and abetted a violation of the Federal securities laws, including rules or regulations promulgated thereunder (collectively referred to in this section as "Federal securities laws"), but who have not been sanctioned, disciplined, or otherwise penalized as a primary violator in any administrative action or civil proceeding, including in any settlement of such an action or proceeding (referred to in this section as "aiders and abettors"); and

(B) who have been found to have been primary violators of the Federal securities laws;

(2) a description of the Federal securities laws violations committed by aiders and abettors and by primary violators, including—

(A) the specific provision of the Federal securities laws violated;

(B) the specific sanctions and penalties imposed upon such aiders and abettors and primary violators, including the amount of any monetary penalties assessed upon and collected from such persons;

(C) the occurrence of multiple violations by the same person or persons, either as an aider or abettor or as a primary violator; and

(D) whether, as to each such violator, disciplinary sanctions have been imposed, including any censure, suspension, temporary bar, or permanent bar to practice before the Commission; and

(3) the amount of disgorgement, restitution, or any other fines or payments that the Commission has assessed upon and collected from, aiders and abettors and from primary violators.

(b) REPORT.—A report based upon the study conducted pursuant to subsection (a) shall be submitted to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives not later than 6 months after the date of enactment of this Act.

SEC. 704. STUDY OF ENFORCEMENT ACTIONS.

(a) STUDY REQUIRED.—The Commission shall review and analyze all enforcement actions by the Commission involving violations of reporting requirements imposed under the securities laws, and restatements of financial statements, over the 5-year period preceding the date of enactment of this Act, to identify areas of reporting that are most susceptible to fraud, inappropriate manipulation, or inappropriate earnings management, such as revenue recognition and the accounting treatment of off-balance sheet special purpose entities.

(b) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, not later than 180 days after the date of enactment of this Act, and shall use such findings to revise its rules and regulations, as necessary. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study. Deadline.

SEC. 705. STUDY OF INVESTMENT BANKS.

(a) GAO STUDY.—The Comptroller General of the United States shall conduct a study on whether investment banks and financial advisers assisted public companies in manipulating their earnings and obfuscating their true financial condition. The study should address the rule of investment banks and financial advisers—

(1) in the collapse of the Enron Corporation, including with respect to the design and implementation of derivatives transactions, transactions involving special purpose vehicles, and other financial arrangements that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company;

(2) in the failure of Global Crossing, including with respect to transactions involving swaps of fiberoptic cable capacity, in the designing transactions that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company; and

(3) generally, in creating and marketing transactions which may have been designed solely to enable companies to manipulate revenue streams, obtain loans, or move liabilities off balance sheets without altering the economic and business risks faced by the companies or any other mechanism to obscure a company's financial picture.

(b) REPORT.—The Comptroller General shall report to Congress not later than 180 days after the date of enactment of this Act on the results of the study required by this section. The report shall include a discussion of regulatory or legislative steps that Deadline.

are recommended or that may be necessary to address concerns identified in the study.

Corporate and Criminal Fraud Accountability Act of 2002.

TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

18 USC 1501 note.

SEC. 801. SHORT TITLE.

This title may be cited as the "Corporate and Criminal Fraud Accountability Act of 2002".

SEC. 802. CRIMINAL PENALTIES FOR ALTERING DOCUMENTS.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by adding at the end the following:

"§ 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy

"Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

"§ 1520. Destruction of corporate audit records

"(a)(1) Any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies, shall maintain all audit or review workpapers for a period of 5 years from the end of the fiscal period in which the audit or review was concluded.

Regulations.

"(2) The Securities and Exchange Commission shall promulgate, within 180 days, after adequate notice and an opportunity for comment, such rules and regulations, as are reasonably necessary, relating to the retention of relevant records such as workpapers, documents that form the basis of an audit or review, memoranda, correspondence, communications, other documents, and records (including electronic records) which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review, which is conducted by any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(a)) applies. The Commission may, from time to time, amend or supplement the rules and regulations that it is required to promulgate under this section, after adequate notice and an opportunity for comment, in order to ensure that such rules and regulations adequately comport with the purposes of this section.

"(b) Whoever knowingly and willfully violates subsection (a)(1), or any rule or regulation promulgated by the Securities and Exchange Commission under subsection (a)(2), shall be fined under this title, imprisoned not more than 10 years, or both.

"(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation imposed by Federal or State law or regulation to maintain, or refrain from destroying, any document.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by adding at the end the following new items:

"1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.

"1520. Destruction of corporate audit records.".

SEC. 803. DEBTS NONDISCHARGEABLE IF INCURRED IN VIOLATION OF SECURITIES FRAUD LAWS.

Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (17), by striking "or" after the semicolon;

(2) in paragraph (18), by striking the period at the end and inserting "; or"; and

(3) by adding at the end, the following:

"(19) that—

"(A) is for—

"(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

"(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

"(B) results from—

"(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

"(ii) any settlement agreement entered into by the debtor; or

"(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.".

SEC. 804. STATUTE OF LIMITATIONS FOR SECURITIES FRAUD.

(a) IN GENERAL.—Section 1658 of title 28, United States Code, is amended—

(1) by inserting "(a)" before "Except"; and

(2) by adding at the end the following:

"(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of—

"(1) 2 years after the discovery of the facts constituting the violation; or

"(2) 5 years after such violation.".

(b) EFFECTIVE DATE.—The limitations period provided by section 1658(b) of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act. 28 USC 1658 note.

(c) NO CREATION OF ACTIONS.—Nothing in this section shall create a new, private right of action. 28 USC 1658 note.

28 USC 994 note.

SEC. 805. REVIEW OF FEDERAL SENTENCING GUIDELINES FOR OBSTRUCTION OF JUSTICE AND EXTENSIVE CRIMINAL FRAUD.

(a) ENHANCEMENT OF FRAUD AND OBSTRUCTION OF JUSTICE SENTENCES.—Pursuant to section 994 of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that—

(1) the base offense level and existing enhancements contained in United States Sentencing Guideline 2J1.2 relating to obstruction of justice are sufficient to deter and punish that activity;

(2) the enhancements and specific offense characteristics relating to obstruction of justice are adequate in cases where—

(A) the destruction, alteration, or fabrication of evidence involves—

(i) a large amount of evidence, a large number of participants, or is otherwise extensive;

(ii) the selection of evidence that is particularly probative or essential to the investigation; or

(iii) more than minimal planning; or

(B) the offense involved abuse of a special skill or a position of trust;

(3) the guideline offense levels and enhancements for violations of section 1519 or 1520 of title 18, United States Code, as added by this title, are sufficient to deter and punish that activity;

(4) a specific offense characteristic enhancing sentencing is provided under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) for a fraud offense that endangers the solvency or financial security of a substantial number of victims; and

(5) the guidelines that apply to organizations in United States Sentencing Guidelines, chapter 8, are sufficient to deter and punish organizational criminal misconduct.

Deadline.

(b) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than 180 days after the date of enactment of this Act, in accordance with the prcedures set forth in section 219(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

SEC. 806. PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES WHO PROVIDE EVIDENCE OF FRAUD.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by inserting after section 1514 the following:

"§ 1514A. Civil action to protect against retaliation in fraud cases

"(a) WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES.—No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

"(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—

"(A) a Federal regulatory or law enforcement agency;

"(B) any Member of Congress or any committee of Congress; or

"(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

"(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

"(b) ENFORCEMENT ACTION.—

"(1) IN GENERAL.—A person who alleges discharge or other discrimination by any person in violation of subsection (a) may seek relief under subsection (c), by—

"(A) filing a complaint with the Secretary of Labor; or

"(B) if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, bringing an action at law or equity for de novo review in the appropriate district court of the United States, which shall have jurisdiction over such an action without regard to the amount in controversy.

"(2) PROCEDURE.—

"(A) IN GENERAL.—An action under paragraph (1)(A) shall be governed under the rules and procedures set forth in section 42121(b) of title 49, United States Code.

"(B) EXCEPTION.—Notification made under section 42121(b)(1) of title 49, United States Code, shall be made to the person named in the complaint and to the employer.

"(C) BURDENS OF PROOF.—An action brought under paragraph (1)(B) shall be governed by the legal burdens of proof set forth in section 42121(b) of title 49, United States Code.

"(D) STATUTE OF LIMITATIONS.—An action under paragraph (1) shall be commenced not later than 90 days after the date on which the violation occurs. Deadline.

"(c) REMEDIES.—

"(1) IN GENERAL.—An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

"(2) COMPENSATORY DAMAGES.—Relief for any action under paragraph (1) shall include—

"(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

"(B) the amount of back pay, with interest; and

"(C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.

"(d) RIGHTS RETAINED BY EMPLOYEE.—Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any employee under any Federal or State law, or under any collective bargaining agreement.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by inserting after the item relating to section 1514 the following new item:

"1514A. Civil action to protect against retaliation in fraud cases.".

SEC. 807. CRIMINAL PENALTIES FOR DEFRAUDING SHAREHOLDERS OF PUBLICLY TRADED COMPANIES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"§ 1348. Securities fraud

"Whoever knowingly executes, or attempts to execute, a scheme or artifice—

"(1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or

"(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d));

shall be fined under this title, or imprisoned not more than 25 years, or both.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new item:

"1348. Securities fraud.".

White-Collar Crime Penalty Enhancement Act of 2002.

TITLE IX—WHITE-COLLAR CRIME PENALTY ENHANCEMENTS

18 USC 1341 note.

SEC. 901. SHORT TITLE.

This title may be cited as the "White-Collar Crime Penalty Enhancement Act of 2002".

SEC. 902. ATTEMPTS AND CONSPIRACIES TO COMMIT CRIMINAL FRAUD OFFENSES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by inserting after section 1348 as added by this Act the following:

"§ 1349. Attempt and conspiracy

"Any person who attempts or conspires to commit any offense under this chapter shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new item:

"1349. Attempt and conspiracy.".

SEC. 903. CRIMINAL PENALTIES FOR MAIL AND WIRE FRAUD.

(a) MAIL FRAUD.—Section 1341 of title 18, United States Code, is amended by striking "five" and inserting "20".

(b) WIRE FRAUD.—Section 1343 of title 18, United States Code, is amended by striking "five" and inserting "20".

SEC. 904. CRIMINAL PENALTIES FOR VIOLATIONS OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.

Section 501 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1131) is amended—

(1) by striking "$5,000" and inserting "$100,000";

(2) by striking "one year" and inserting "10 years"; and

(3) by striking "$100,000" and inserting "$500,000".

SEC. 905. AMENDMENT TO SENTENCING GUIDELINES RELATING TO CERTAIN WHITE-COLLAR OFFENSES. 28 USC 994 note.

(a) DIRECTIVE TO THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 18, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and, as appropriate, amend the Federal Sentencing Guidelines and related policy statements to implement the provisions of this Act.

(b) REQUIREMENTS.—In carrying out this section, the Sentencing Commission shall—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of the offenses and the penalties set forth in this Act, the growing incidence of serious fraud offenses which are identified above, and the need to modify the sentencing guidelines and policy statements to deter, prevent, and punish such offenses;

(2) consider the extent to which the guidelines and policy statements adequately address whether the guideline offense levels and enhancements for violations of the sections amended by this Act are sufficient to deter and punish such offenses, and specifically, are adequate in view of the statutory increases in penalties contained in this Act;

(3) assure reasonable consistency with other relevant directives and sentencing guidelines;

(4) account for any additional aggravating or mitigating circumstances that might justify exceptions to the generally applicable sentencing ranges;

(5) make any necessary conforming changes to the sentencing guidelines; and

(6) assure that the guidelines adequately meet the purposes of sentencing, as set forth in section 3553(a)(2) of title 18, United States Code.

(c) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than 180 days after the date of enactment of this Act, in accordance with the procedures set forth in section 219(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

SEC. 906. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by inserting after section 1349, as created by this Act, the following:

"§ 1350. Failure of corporate officers to certify financial reports

(a) CERTIFICATION OF PERIODIC FINANCIAL REPORTS.—Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.

"(b) CONTENT.—The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act pf 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

"(c) CRIMINAL PENALTIES.—Whoever—

"(1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $1,000,000 or imprisoned not more than 10 years, or both; or

"(2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $5,000,000, or imprisoned not more than 20 years, or both.".

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following:

"1350. Failure of corporate officers to certify financial reports.".

TITLE X—CORPORATE TAX RETURNS

SEC. 1001. SENSE OF THE SENATE REGARDING THE SIGNING OF CORPORATE TAX RETURNS BY CHIEF EXECUTIVE OFFICERS.

It is the sense of the Senate that the Federal income tax return of a corporation should be signed by the chief executive officer of such corporation.

TITLE XI—CORPORATE FRAUD ACCOUNTABILITY

Corporate Fraud Accountability Act of 2002.

SEC. 1101. SHORT TITLE.

15 USC 78a note.

This title may be cited as the "Corporate Fraud Accountability Act of 2002".

SEC. 1102. TAMPERING WITH A RECORD OR OTHERWISE IMPEDING AN OFFICIAL PROCEEDING.

Section 1512 of title 18, United States Code, is amended—

(1) by redesignating subsections (c) through (i) as subsections (d) through (j), respectively; and

(2) by inserting after subsection (b) the following new subsection:

"(c) Whoever corruptly—

"(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or

"(2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so,

shall be fined under this title or imprisoned not more than 20 years, or both.".

SEC. 1103. TEMPORARY FREEZE AUTHORITY FOR THE SECURITIES AND EXCHANGE COMMISSION.

(a) IN GENERAL.—Section 21C(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)) is amended by adding at the end the following:

"(3) TEMPORARY FREEZE.—

"(A) IN GENERAL.—

"(i) ISSUANCE OF TEMPORARY ORDER.—Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

"(ii) STANDARD.—A temporary order shall be entered under clause (i), only after notice and opportunity for a hearing, unless the court determines that notice and hearing prior to entry of the order would be impracticable or contrary to the public interest.

"(iii) EFFECTIVE PERIOD.—A temporary order issued under clause (i) shall—

"(I) become effective immediately;

"(II) be served upon the parties subject to it; and

"(III) unless set aside, limited or suspended by a court of competent jurisdiction, shall remain effective and enforceable for 45 days.

"(iv) EXTENSIONS AUTHORIZED.—The effective period of an order under this subparagraph may be extended by the court upon good cause shown for not longer than 45 additional days, provided that the combined period of the order shall not exceed 90 days.

"(B) PROCESS ON DETERMINATION OF VIOLATIONS.—

"(i) VIOLATIONS CHARGED.—If the issuer or other person described in subparagraph (A) is charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the order shall remain in effect, subject to court approval, until the conclusion of any legal proceedings related thereto, and the affected issuer or other person, shall have the right to petition the court for review of the order.

"(ii) VIOLATIONS NOT CHARGED.—If the issuer or other person described in subparagraph (A) is not charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the escrow shall terminate at the expiration of the 45-day effective period (or the expiration of any extension period, as applicable), and the disputed payments (with accrued interest) shall be returned to the issuer or other affected person.".

(b) TECHNICAL AMENDMENT.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3(c)(2)) is amended by striking "This" and inserting "paragraph (1)".

28 USC 994 note.

SEC. 1104. AMENDMENT TO THE FEDERAL SENTENCING GUIDELINES.

(a) REQUEST FOR IMMEDIATE CONSIDERATION BY THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission is requested to—

(1) promptly review the sentencing guidelines applicable to securities and accounting fraud and related offenses;

(2) expeditiously consider the promulgation of new sentencing guidelines or amendments to existing sentencing guidelines to provide an enhancement for officers or directors of publicly traded corporations who commit fraud and related offenses; and

(3) submit to Congress an explanation of actions taken by the Sentencing Commission pursuant to paragraph (2) and

any additional policy recommendations the Sentencing Commission may have for combating offenses described in paragraph (1).

(b) CONSIDERATIONS IN REVIEW.—In carrying out this section, the Sentencing Commission is requested to—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of securities, pension, and accounting fraud and the need for aggressive and appropriate law enforcement action to prevent such offenses;

(2) assure reasonable consistency with other relevant directives and with other guidelines;

(3) account for any aggravating or mitigating circumstances that might justify exceptions, including circumstances for which the sentencing guidelines currently provide sentencing enhancements;

(4) ensure that guideline offense levels and enhancements for an obstruction of justice offense are adequate in cases where documents or other physical evidence are actually destroyed or fabricated;

(5) ensure that the guideline offense levels and enhancements under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) are sufficient for a fraud offense when the number of victims adversely involved is significantly greater than 50;

(6) make any necessary conforming changes to the sentencing guidelines; and

(7) assure that the guidelines adequately meet the purposes of sentencing as set forth in section 3553 (a)(2) of title 18, United States Code.

(c) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than the 180 days after the date of enactment of this Act, in accordance with the procedures sent forth in section 21(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired. Deadline.

SEC. 1105. AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 21C of the Securities Exchange Act of 1934 (15 U.S.C. 78u–3) is amended by adding at the end the following:

"(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 10(b) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12, or that is required to file reports pursuant to section 15(d), if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.".

(b) SECURITIES ACT OF 1933.—Section 8A of the Securities Act of 1933 (15 U.S.C. 77h–1) is amended by adding at the end of the following:

"(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 17(a)(1) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934, or that is required to file reports pursuant to section 15(d) of that Act, if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.".

SEC. 1106. INCREASED CRIMINAL PENALTIES UNDER SECURITIES EXCHANGE ACT OF 1934.

Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(a)) is amended—

(1) by striking "$1,000,000, or imprisoned not more than 10 years" and inserting "$5,000,000, or imprisoned not more than 20 years"; and

(2) by striking "$2,500,000" and inserting "$25,000,000".

SEC. 1107. RETALIATION AGAINST INFORMANTS.

(a) IN GENERAL.—Section 1513 of title 18, United States Code, is amended by adding at the end the following:

Penalties.

"(e) Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.".

Approved July 30, 2002.

LEGISLATIVE HISTORY—H.R. 3763 (S. 2673):

HOUSE REPORTS: Nos. 107–414 (Comm. on Financial Services) and 107–610 (Comm. of Conference).
SENATE REPORTS: No. 107–205 accompanying S. 2673 (Comm. on Banking, Housing, and Urban Affairs).
CONGRESSIONAL RECORD, Vol. 148 (2002):
Apr. 24, considered and passed House.
July 15, considered and passed Senate, amended, in lieu of S. 2673.
July 25, House and Senate agreed to conference report.
WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 38 (2002):
July 30, Presidential remarks and statement.

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COMMITTEE ON

IMF GOVERNANCE REFORM

Final Report

March 24, 2009

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EXECUTIVE SUMMARY

The global economy has entered a period of unprecedented turmoil, with the prospect of a prolonged economic downturn, heightened financial volatility, and social instability. Weakly coordinated macroeconomic policies among major world economies, deficient financial regulation, and insufficient commitment to financial stability as a public good have each contributed to the current global economic conditions.

The world needs a multilateral institution at the center of the world economy to help anchor global financial stability. Achieving that aim depends on the monitoring of risks, coordinated policy responses, and agreed norms and standards to which all countries subscribe. To be effective, the institution requires a strong and respected voice, human and financial resources appropriate to its mission, and it must be accountable to its members. It must also work closely with other international organizations and standard setters, and provide a focal point for discussions on crisis management and the macroeconomics of financial regulation.

The International Monetary Fund is well placed to be this institution, but it needs a re-energized multilateral mandate to reflect the evolution of the world economy and to increase its legitimacy and effectiveness in addressing today's global challenges. Few of the conditions outlined above are currently being met.

This report puts forth recommendations for governance reforms. A recomposition of the Executive Board to reflect economic realities by allowing greater representation of emerging market economies, more timely and effective decision-making by a ministerial-level body, and a more precise delineation of responsibilities between management and the Executive Board are central objectives.

We recommend a series of governance reform measures that should be agreed as a single package. That package comprises the following:

- An accelerated quota revision process, to be concluded by April 2010, and an amendment to the Articles of Agreement that would eliminate appointed chairs, thereby allowing for the needed consolidation of chairs, including those of EU countries. This is critical to facilitate the rapid reconfiguration of the composition of the Council (see below) and the Executive Board to reflect current economic realities;

- The activation of a Council of ministers and governors to provide a forum for coordination and to take strategic decisions critical to global stability, as provided for in the Articles of Agreement;

- The expansion of the Fund's surveillance mandate beyond exchange rates to provide appropriate coverage of macroeconomic policies, prudential issues and financial spillovers. The capital account would fall within the mandate;

- The adoption of a troika leadership model for the Council, with regular rotation, and agenda-setting by the leadership, with input from the Executive Board and management;

- The giving of most authority for conducting and completing member-specific surveillance to Fund management, together with strengthened accountability;

- The elevation of the Executive Board from day-to-day operational decisions to giving advice on strategic issues to the Council and to delivering a critical supervisory function, including oversight and review of surveillance. The Board would retain responsibility over lending and financial decisions, and with greater accountability;

- The lowering of the voting threshold on critical decisions from 85 percent to 70–75 percent, and consideration given to extending double majorities to a wider range of decisions, thus ensuring that decisions affecting key aspects of the institution command the support of the majority of members; and

- The introduction of an open, transparent and merit-based system for the appointment of the Managing Director and Deputy Managing Directors.

Governance reforms are necessary but not sufficient to enhance the Fund's legitimacy, effectiveness and accountability. Achieving the aim of a multilateral institution that is able to secure global financial stability needs to be supported with complementary measures. These include steps to progress rapidly on adjustments to quota and voice of members, additions to the Fund's available financial resources, and enhancing its expertise, capabilities and role in macroeconomic coordination, financial and capital account issues. These measures are as important as our governance reform recommendations.

I. INTRODUCTION

This section summarizes the Committee's point of departure on Fund governance.

1. ***Global financial stability***. The world needs a strong multilateral institution at the center of the global financial system that with the support of various groupings and standard setters secures a critical public good, namely, global financial stability, with the benefits of smoothly functioning financial markets accruing to the entire global community.[1] This good could be attained through effective action addressing macroeconomic policy and its coordination, financial regulation, and provision of liquidity.

2. ***Fragmented responsibility***. In recent years, the responsibility for securing global financial stability has become fragmented and the Fund's advice has lost traction and influence.

- Some advanced countries have preferred to seek resolution of monetary and financial issues in other, smaller international fora implying a diminished commitment to multilateral solutions to international economic and financial challenges.

- Emerging markets and developing countries have perceived their voice and quota shares at the Fund to be far short of their role in the global economy, and believe they receive unfair treatment (more intensive surveillance and heavy conditionality) and insufficient attention to their needs (loan size and instruments, policy advice).

- Their engagement at the Fund has been further diminished by the failure of the Fund's financial resources to keep pace with private capital flows; many economies are simply too large to benefit greatly from the financial support that is presently available.

- At the same time, the Fund's powers and advice in areas of increasing importance to the sustainability of economic growth such as the capital account have not kept up with members' needs. The lack of an explicit mandate to oversee global financial stability in all its dimensions—financial sector, domestic macroeconomic policies, and currency arrangements—has reduced the effectiveness of Fund surveillance.

The result has been a Fund that is ineffective in critical areas and struggles with a lack of ownership by the main actors in the global economy. This has reduced the Fund's relevance, and resulted in a de facto delegation of core financial sector work to a range of narrower and specialized agencies, networks, and working groups—all of which can claim expertise on selected issues, but no recognized responsibility for the overall stability of the global system. Naturally, all these bodies should play a fundamental role in a new

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[1] The International Task Force on Global Public Goods defines global public goods as "issues that are broadly conceived as important to the international community, that for the most part cannot or will not be adequately addressed by individual countries acting alone and that are defined through a broad international consensus or a legitimate process of decision-making" (p. 13 of the Final Report).

international financial architecture. However, a stronger IMF and greater collaboration with these bodies would be helpful for the discharge of the obligations of both.

3. ***Need for a multilateral solution***. The upheaval in the world economy is a reminder of two stark realities. First, financial and macroeconomic instability is not limited to just emerging market and developing countries, but a risk to all countries, with today's crisis originating in the most advanced part of the world economy and spreading to its various corners. Second, an effective mechanism for discussing risks to global financial and macroeconomic stability irrespective of their sources, and for coordinating policy responses, has been lacking. The need for greater coordination demonstrates the importance of multilateral solutions and assistance – both technical and financial – to countries in an integrated world. A multilateral institution at the center of the global financial system would have responsibility for the overall stability of the system, providing a forum for discussion, analysis and action on macroeconomic policy, financial regulation, and liquidity provision.

4. ***Global role***. Fulfilling the global role we have in mind requires a set of basic criteria:

a) Such an institution must have a global membership and an agreed set of norms and standards to which all countries subscribe.

b) It must have a legitimate and effective voice to establish and defend the norms and standards needed to deliver financial stability.

c) It needs to articulate a clear view of the global situation and play a guardian role, providing a platform for those countries less represented, but deeply affected by problems at the core.

d) It should seek to ensure compliance with norms to prevent financial instability, and have the courage to speak truth to power.

e) It should work in cooperation with other international bodies and standard setters (e.g. the Financial Stability Forum).

f) It must be respected for its expertise and capable of adjusting its skill mix in line with changes in the global financial markets.

g) It should have the financial resources appropriate to its mission of delivering global financial stability over time.

5. ***Role of governance reform***. The Fund has structural strengths that make it well-placed to play this multilateral role. First, its universal membership is the basis of the multilateral framework currently in place and could provide an effective global forum for the resolution of global problems. Second, its professional staff and management are able to provide high quality technical advice. However, until the Fund is viewed as legitimate and appropriate for the discussion and resolution of global macroeconomic issues, it will remain peripheral and unable to achieve the overall stability mandate envisaged by its founders and shareholders.

6. Having an effective voice, articulating a clear view of the global situation and playing a guardian role, monitoring compliance with norms to prevent financial instability, and working with other inter-governmental institutions involves having an appropriate governance framework. With higher-level and more balanced political representation, better strategic guidance and policy direction, clearer executive authority, as well as an expanded mandate to cover issues beyond a narrow conception of external stability, the Fund's strengths could be enhanced to enable the institution to deliver effective multilateral solutions to global financial, monetary and economic problems.

II. Drawbacks in the Fund's Current Governance Framework

The world has changed dramatically since the Fund's founding, yet the key features of the Fund's governance structures have not.

7. ***Legitimacy and Effectiveness***. The governance of the Fund has two dimensions.

- The first is that pertaining to power-sharing ("chairs and shares"). The Resolution on Quota and Voice Reform approved by the Board of Governors on April 28, 2008 reflected some adjustment to the current dispensation, with a commitment to adjust shares further over time as part of an ongoing process. However, the changes in voting power have thus far been marginal compared with the changes that have occurred globally, and the process of periodic adjustments is painfully slow—the next installment is not until 2013!

- This process needs to be accelerated and brought forward. Given the time commitments involved for negotiations, we urge that the current agreement be ratified immediately, and that members build on their pledge of last April to make quota reform an ongoing dynamic process by bringing forward the next quota exercise for completion by the Spring Meetings in 2010.

- The second dimension of governance covers the decision-making process itself; i.e. how members actually exercise their voting power (Box 1 provides an overview of the existing decision-making structure of the Fund).

- While this dimension of governance of the Fund has received less attention than the quota and voice issues, it is equally important. Current decision making structures have not helped build trust, confidence or legitimacy across the membership. Some shareholders, particularly advanced economies, have avoided some of the responsibilities and standards that others have found important. As part of a multilateral system, external evaluation and peer review should not be optional for any member.

- Existing governance bodies and formalistic procedures have impeded timely and effective responses, and have generated the systematic use of more informal processes that undermines good governance.

Box 1: An Overview of the Existing Decision-Making Framework of the IMF

A resident Executive Board, comprising of civil servants appointed or elected by member countries, currently takes many key decisions of the Fund, whether they are of a strategic or operational nature. These decisions are normally taken up by the Executive Board at the initiative of the Managing Director, based on the recommendations of staff and the institution's work program. The IMFC formed of the most senior political authorities in the areas of finance and monetary policy provides broad guidance to the institution through meetings and communiqués issued twice yearly.

As a financial institution, with resources derived from subscriptions, members control decisions regarding the use of resources, in proportion to their subscription. *As a regulatory institution*, the concept of "peer review" has been an important feature of the Fund's assessment of members' observance of their economic policy obligations under the Articles of Agreement.

For the most part, members exercise control over the decision-making process through the Fund's Executive Board. The Executive Board currently consists of 24 Executive Directors, who are either elected or appointed by members, and is in continuous session at Fund headquarters. With some exceptions, it is responsible for taking both strategic and operational decisions of the Fund – and therefore performs both a legislative and executive role.[2]

Strategic decisions cover broad financial issues (e.g., approval of general terms of credit facilities, such as access limits and repayment periods) and regulatory issues (e.g., the 2007 Surveillance decision that guides Fund assessments of member country policies).

Operational decisions cover the day-to-day application of strategic decisions, be it in the financial area (e.g. the approval of a specific credit arrangement for a member) or on the regulatory side (e.g. the Fund's assessment of a particular member's policies under the Article IV Consultation).

As a general matter, the Managing Director exercises the power of initiative. Most decisions taken by the Executive Board are proposed by the Managing Director and supported by the staff's technical analysis. Similar initiative is exercised in terms of individual Fund programs and the technical discussions that provide the basis for Article IV Consultations.

The Managing Director also has the authority to take a limited number of operational decisions. The allocation of authority between the Executive Board and the Managing Director with respect to operational decisions has been fluid in some respects, reflecting the changing needs and priorities of the Fund. In some circumstances, the Executive Board has ceded authority to the Managing Director (since 1991, for example, requests for technical assistance from members no longer require Executive Board approval). In other cases, the Board has placed additional limitations on the authority of the Managing Director (e.g. requiring consultation with the Board while negotiating a financial arrangement with a member that exceed the access limits prescribed by policies on the use of Fund resources).

[2] The exceptions relate to powers reserved for the Board of Governors, the supreme decision-making organ of the Fund—such as decisions on changes to members' quota subscriptions—and certain operational decisions taken by the Managing Director.

8. ***Political voice***. High-level political representation on a decision-making body that provides strategic and policy direction, and discusses macroeconomic and financial policy coordination, is needed.[3] The absence of such a body not only contributes to the perception of a "democratic deficit" but also limits engagement of senior policymakers on critical and systemic issues. These shortcomings are not entirely corrected for by the current International Monetary and Financial Committee (IMFC), which is an advisory body. In the absence of any institutional imperative to take concrete decisions, the outcome of high-level global deliberations are of too general a nature to come to grips with emerging systemic problems.

9. ***Executive Board***. The Executive Board is a body with high technical and professional capacity, but its members have tended to be viewed as international civil servants, rather than political representatives, and are often removed from actual policy-making at the national level. The Board is also not always well-placed to exercise genuine oversight over management. In practice, the Board's mandate conflates too many governance objectives (political voice, day-to-day operational decisions, broad oversight of the institution, and strategic vision), diluting its ability to give strategic direction and undermining the technical value of its operational decisions.[4]

10. ***Overlaps and gaps***. Best practice in corporate governance requires clarity of roles and responsibilities, which the Fund's current governance framework does not accomplish. Components of institutional decision-making—namely, the legislative function, the executive function, and a means of measuring performance and holding the executive accountable—are insufficiently delineated and assigned. The IMFC lacks the mandate to take strategic decisions; the Board is too stretched in day-to-day operational decisions to be able to set broad strategic directions; and there are few explicit systems for measuring management and board performance and holding them accountable.

11. ***Mandate***. Governance reforms to address the above drawbacks need to be complemented with other measures. The ongoing crisis confirms the extent to which financial stability has become a global public good and the need for updating the Fund's mandate. While the Fund is mandated to exercise firm surveillance over exchange rates, addressing this crisis and future ones also implies more attention to financial sector issues and how they intersect with macroeconomic policies (see Box 2). The Fund's relationship

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[3] The need for a decision-making body made up of senior policy makers was recognized when the Fund's Articles were amended in 1978. The amended Articles allow for the activation of a Council made up of governors, ministers, or "persons of comparable rank" that would be appointed on the same basis as Executive Directors are appointed or elected. Since 1978, calls have been made—notably after the Mexican and Asian crisis of the 90s—for the creation of the Council. Most recently, the Independent Evaluation Office of the IMF also recommended activating the Council in its evaluation of corporate governance of the Fund (Independent Evaluation Office, 2008, "Governance of the IMF: An Evaluation," IMF, Washington, DC).

[4] As noted in the IMF's IEO report on corporate governance, "the Board has played only a reactive role in strategy formulation and it has not been effective in monitoring policy implementation. The Board's involvement in day-to-day operations has deflected its attention from these needed oversight functions and constrained its ability to perform them in an independent manner." (IEO, 2008, "Governance of the IMF: An Evaluation," IMF.)

with the Financial Stability Forum (FSF) as central regulatory standard setter will be crucially important, and we welcome the enhanced collaboration already embarked on, especially on early warning.

Box 2. The IMF's Mandate

According to Article IV of the Articles of Agreement, members have a general obligation "to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates". To that end, the Fund is charged with exercising firm surveillance over the exchange rate policies of its members. As a result, domestic and financial sector policies are, in large measure, assessed in as much as they impinge upon the external account.

Domestic policies

The current global financial crisis shows that domestic policies, and in particular financial sector policies, cannot be assessed only in terms of the balance of payments impact. In this crisis, the hit to the financial sector was not transmitted to the rest of the world through a collapse in currencies and forced adjustments of the global imbalances. For example, while the U.S. had been one of the largest deficit countries entering the crisis, the U.S. dollar strengthened in a global flight to safety; and the U.S. deleveraging process prompted a "sudden stop" of capital flows from major money centers to emerging market and developing countries. Thus, a narrow focus on external stability can be highly misleading. An amendment of the Articles that would provide the Fund with a broader mandate for effective surveillance would give equal importance to macroeconomic and prudential policies and financial spillovers.

Capital account

Our Committee considered the issue of oversight of cross-border financial policies and spillovers. A way forward would be to extend the Fund's jurisdiction over the current account to also cover international capital movements by amending the Articles; a recommendation made by the advisory Interim Committee urged the Executive Board to do so in 1997/98. The objective was to ensure that changes to capital account policies were pursued within a multilateral framework in a manner that took into account macroeconomic stability and the regulatory capacity of members. The objective was never to champion the liberalization of capital movements per se, but rather to ensure that countries adequately assess domestic macroeconomic and financial risks ahead of liberalization. If the proposal were taken up now, it would require the Fund to establish the capacity to effectively monitor capital account policies of members and ensure that restrictions imposed (as allowed under Article VI, Section 3) are non-discriminatory.

Article IV reports should in any event take up capital account issues where they are relevant, and address spillovers and linkages across borders. Multilateral surveillance, exercised principally through the WEO and the GFSR, should also take up these issues in greater depth than has been the case so far.

III. TOWARDS A NEW GOVERNANCE FRAMEWORK

12. ***Key recommendation***. We propose a new governance framework to harness the Fund's strengths to work effectively in pursuit of the overall aims of the institution. The central objectives of governance reforms must be to enhance clear leadership, enable effective executive decision making, and increase accountability to the membership.

13. ***Approach***. Each of the main governance bodies needs change with a view to enhancing its effectiveness. A major impact on governance comes from activating the Council and amending the remit of the Executive Board. Freeing the Board from day-to-day and routine decisions would not only be consistent with best practices in the corporate context, but would create the basis for truly effective oversight and the capacity to provide more substantive strategic advice to the Council and Management. A refocusing of the Board would also facilitate greater focus by Management on outputs and create greater efficiencies and accountability in the overall operation of the Fund.

- Political representation at the strategic level—a ministerial-level Council to provide more direct political voice to the Fund's decisions. Representation on the Council would be enhanced by "direct" voting that enables splitting of constituency votes, which is allowed under the Articles of Agreement.

- Since the Council would have legal powers, it should take strategic decisions, which would constitute the general "legislative" decisions; e.g. the adoption of the Surveillance Decision and the establishment of new financial facilities. It should also among other functions engage in policy coordination and react to emerging risks.

- The Managing Director would be responsible for operational decisions, notably the application of the surveillance "legislation" in country-specific cases.

- The Executive Board would have four functions: (i) it would oversee the work of the Managing Director and staff, including surveillance, thus enforcing accountability; (ii) it would advise the Council on strategic decisions and prepare its work; (iii) it would be responsible for decisions on use of Fund resources; and (iv) it would take decisions on internal matters with major financial implications, including setting the medium-term budget and the staff compensation framework.

14. ***Fundamental leadership reform***. We want to be clear that we are calling for a fundamental reform of the IMF's governance structures, not a mere re-labeling of existing ones. Changing the name of the IMFC to the IMF Council and giving it *de jure* decision making authority is unlikely to accomplish much. As discussed below, changing the composition of the Council, with a membership that reflects global economic realities, is essential for legitimacy. As recognized under the Articles, the members of the Council must be at a sufficiently high level of authority, namely, the finance ministerial level, to discuss core global macroeconomic and financial issues, if there is to be traction. Furthermore, devolving responsibilities (e.g., the surveillance function) to management and staff, must lead to greater agility and accountability, not a weakening of peer review.

15. ***Engagement***. The reform package is far reaching and requires the personal involvement of Ministers and Governors, preserving as much as possible consensus as the predominant pattern of decision making. This will require from all a spirit of multilateralism, leadership, and ownership. The reforms will improve decision-making in the Fund, enhance capacity to engage in critical economic and financial issues of the day, and improve the effectiveness of the institution's advice and financial support to its members.

IV. Enhancing Political Voice in Decision Making

Since the management of globalization demands a strong multilateral framework, one core element of a governance reform package should be a high-level political voice in the Fund's decision making. The Fund's Articles of Agreement already provide for such a voice.

16. ***A Council***. The Articles of Agreement empower the Fund's Board of Governors to establish, by an eighty five percent voting majority, a Council to be composed of ministers, governors, or "persons of comparable rank". This Council would be responsible for strategic issues, namely, to "supervise the management and adaptation of the international monetary system, including the continuing operation of the adjustment process and developments in global liquidity."

17. ***Scope***. The Articles provide for flexibility in determining the scope of the Council's functions, which can be determined by the Board of Governors on an ongoing basis and should be responsive to changing circumstances. It seems critical to us that the Council should embody and practice a reinvigorated spirit of multilateralism, realized by an explicitly forward-looking agenda covering global and regional macroeconomic and financial issues.

18. ***Weight***. A Council would enhance the gravitas of decisions made and the speed of response so addressing two common sets of complaints about Fund decision making.

19. ***Functions***. Given that a high-level Council would take decisions on issues that are strategic in nature, it should be composed of ministers and governors. We propose that the functions include:

a) Discussing when needed policy coordination;

b) Establishing new financing facilities and other decisions of general application (i.e., the legislative function; see Box 2 for an example);

c) Building consensus on the set of norms and standards to which all members subscribe and providing for their adoption;

d) Launching and completing new rounds of multilateral consultations, including regional surveillance;

e) Reviewing developments, identifying emerging risks, and providing a forum for discussing and coordinating systemic macro and financial policies;

f) Reviewing key Management and Board decisions, particularly surveillance of systemically important issues or countries, and increased accountability (Box 3); and

g) Appointing the Managing Director through an open, transparent and merit-based selection process.

20. ***Operations***. The Council needs to operate with a high degree of peer review, mutual accountability, and consensus. This would be facilitated by the following proposals for deciding its leadership and agenda.

- ***Leadership and participation***. The adoption of informal understandings or conventions concerning its leadership would enhance further the legitimacy of the Council, both in terms of securing broader regional representation in its leadership and ensuring systematic turnover. The chairperson, selected every two years, should be assisted by two additional Councillors in a "troika"-type arrangement—i.e., the former chair and the following chair, which has the benefit of enhancing ownership and allowing for sufficient continuity.

- ***Agenda***. The leadership should set the agenda, taking input from Fund management and the Board. The Board in particular should assist in distilling research and policy discussions into actionable format for the Council's deliberations. This would enable the Council to hold meetings focused on a specific set of systemic, strategic or policy issues, on the basis of brief background notes.

- ***Meetings***. The Council should meet at least twice a year, during the Annual and Spring meetings, with ad hoc meetings as needed. Such flexibility would allow the Council to act rapidly and effectively. In addition to receiving input from the Executive Board, management would be expected to make periodic reports to the Council, as is the case with the IMFC.

21. ***Configuration***. Getting right the composition and size of the Council and Board is critical to the governance reform project. The Council must be of the highest possible legitimacy and representation, and aimed at enhancing the role and effectiveness of the Fund. It must, thanks to an appropriate and effective system of constituency, represent all 185 Fund members. Representation in the Council should reflect current economic realities and be adjustable over time.

22. ***Size and composition***. The Council and the Board need to be small enough to be workable but large enough to be representative. The Fund's Board of 24 warrants consolidation. The easiest approach is to move to 20 seats, as envisaged in the Articles of Agreement, to ensure effective representation without loss of efficiency. Since the size and composition of the Council and Board, according to the Articles, need to mirror each other, steps will need to be taken in the near term to allow for greater representation of emerging and developing economies at the Board, so that the Council is established with as much legitimacy as possible right from the beginning.

23. ***Relationship to quotas***. Bringing forward the quota review to realign existing shares with members' global economic weights is fundamental to achieve the optimal composition. The current quota and voice reform will lead to a realignment of existing shares, primarily through redistribution among the group of emerging market and developing economies. Further realignments of shares are expected in the context of future general quota reviews, beginning with the 14th general review currently scheduled for 2013. This process is far too gradual. A more thorough and far-reaching revision to the quota formula will help to improve

the political legitimacy of the Council. As noted earlier, we recognize that quota negotiations are difficult and time consuming, and recommend approving the current reform resolution and bringing forward the next quota review to 2010.

24. ***Appointed chairs***. Additionally, achieving the right composition can be facilitated by eliminating the requirement of appointing five chairs for the largest quota-holders. Instead, all chairs should be elected, which would also help consolidate European Union member countries and so achieve a better balance between advanced and emerging market/developing countries.[5]

25. ***Voting***. Voting in the Council provides for a more direct political voice and representation. According to the Articles, the Councillor appointed by a group of members *may* cast separately the votes allotted to each member in the group, unlike at the Executive Board, where Executive Directors elected by multi-country constituencies must cast the votes of their constituencies as a block. Votes at the Council do not have to be split, and the rules for each constituency could make clear when splitting would occur. This is an important safeguard for countries that by virtue of their constituency rules, size, or interests will not be present on the Council.

26. ***Broad majority***. We believe nevertheless that it is important for the Council to operate as fully as possible by consensus, as it is with the Board and the present IMFC. In this respect, voting rules have a way of helping participants move towards consensus by maintaining the underlying prospect of moving to a vote. To strengthen the democratic process, we suggest lowering the voting threshold on critical decisions from 85 percent to 70–75 percent. Additionally, consideration could be given to extending double majorities to a wider range of decisions thus ensuring that those decisions affecting key aspects of the institution command the support of the majority of members of the organization. [6]

[5] Providing for the election of all Executive Directors would require an amendment of the Fund's Articles. Currently, there are 10 European Directors on the Board, 8 of whom are from EU countries. Consolidating European chairs—8 EU chairs going for instance to 2 or 3—would enhance the voice of the region while making more space for emerging market and developing country directors and allowing for a reduction in the total number of chairs.

[6] We recognize that these changes would involve amendments to the Fund's Articles. A double majority is used already at the Fund – Article XXVIII, Section A provides that an amendment of the Articles requires support by three-fifths of the members, having 85 percent of the total voting power.

Box 3. Increased Accountability

An important advantage of our proposed delineation of responsibilities is enhanced accountability of Management and the Executive Board. The Council would be able to identify more clearly successes and failures in the fulfillment of the Fund's mandate and the meeting of strategic priorities. For instance, if important IMF programs fail to deliver results, Councillors may want to ask what role Fund advice and conditionality played—or failed to play—in this outcome.

Management would be held accountable by the Board through ex ante goal setting and ex post performance assessments. The Board in turn would be held accountable by the Council, who may commission reports on the Board's performance as and when desired.

V. RECONFIGURING GOVERNANCE RESPONSIBILITIES

The clear demarcation of responsibilities between the Board and Management is a central objective of governance reforms. Should the Board continue to take the vast majority of day-to-day operational decisions with Fund management, should Fund management be responsible for operational decisions and the Board have mainly a supervisory and an advisory function, or should there be a blend of responsibilities with some delegation of operational responsibilities to management? We recommend the blended option.

27. ***The Board as an executive body***. With the Council making key strategic decisions, one option is for the Board to be responsible for applying these decisions in individual cases and retaining a far-reaching executive function with respect to key operational matters. While this governance framework would ensure that members maintain close political control over the key operational decisions of the Fund, such as the approval of Fund financing to individual member countries, it would not establish a clear delineation of responsibilities between the Executive Board and the Managing Director that is critical to enhancing accountability. Moreover, once the responsibility for taking strategic decisions is transferred to the Council, it is likely that the Executive Board's involvement in the day-to-day management of the Fund will increase. This form of Board operation would involve high costs, reduce accountability, and generally slow decision making. It would also do little to improve representation of emerging markets and developing countries in the Fund's operational decisions.

28. ***Clear delineation of responsibilities***. An alternative framework is to give the responsibility for all operational decisions to the Managing Director. In this conception, the Board would be responsible for (a) exercising independent oversight over the Managing Director, and (b) making recommendations with respect to the strategic decisions to be made by the Council. This option delineates responsibilities clearly and enables the exercise of oversight in an independent manner, consistent with the best practices in the corporate governance context. The Board would perform ex post oversight as opposed to ex ante checks and balances. The main drawback, however, is that there would be limited member involvement in programs and the use of Fund resources.

29. ***A blend***. Our recommendation is a blended approach, wherein operational decisions involving Fund financing are retained by the Executive Board. It is only natural that members control decisions regarding the use of the Fund's resources. In this vein, the Board would also be responsible for internal decisions with major financial implications, including setting the medium-term budget and general compensation framework. Management would conduct surveillance, continue to have the responsibility to make staff appointments, and would have the discretion—within the framework of strategic priorities, Fund policies and the medium-term budget—to conduct surveillance and allocate resources to achieve the given priorities. Table 1 summarizes our proposed delineation of responsibilities. This greater delineation of responsibilities would permit increased accountability of management and the Board, which in turn would allow members to clearly identify successes as well as failures.

Table 1. Delineation of Responsibilities among the Council, Board, and Management

Council	**Board**	**Management**
Legislative functions in "critical" areas (which are defined responsively over time) - e.g. surveillance mandate, establishment of financing instruments and facilities	*Legislative functions in "non-critical" areas*, such as: - Routine reviews of and non-critical amendments to existing Fund policies and lending instruments - e.g. review of data provision to the Fund	Exercises initiative (status quo)
	Advisory role to Council: - provides input on preliminary policy papers on the critical legislative issues	Exercises initiative (status quo)
Regulatory function—surveillance: - early warnings and policy responses - concludes multilateral consultations	*Regulatory Function – Surveillance* - quarterly review of themes from Articles IVs	*Surveillance:* - concludes all Article IVs - however, the concerned ED/ group of EDs (at least 5) could ask for discussion - WEO/GFSR/early warnings
Financing decisions Legislative function for key financial policies and instruments	*Financing Function #1 Arrangements* - approval of arrangements - completion of reviews - waivers of PCs Advisory role in recommending new policies and instruments to the Council	Exercises initiative (status quo)

Strategic Priorities : - defines medium-term priorities	*Financing function #2: Budget* Sets medium-term budget and general compensation framework	*Operational autonomy on allocating resources to achieve priorities:* - develops and implements annual budget consistent with medium-term priorities and framework - free to appoint, organize, and dismiss staff (status quo)
Selection of MD: Sets out criteria for MD selection and conducts open, transparent, and merit-based selection process. MD remains Chair of the Board.		- MD appoints DMDs on approval of the Board (status quo)
	Supervision over management: - Review of management's performance including ex post assessment (on Article IVs and meeting medium term priorities)	- In matters of oversight over the MD, the dean (or another Board member) chairs the Board (status quo)
Supervision/accountability of Board: - reviews report on Board, prepared by the Council or by a subset of Councillors (as and when desired)		

VI. Delegating Responsibilities to Management

Responsibilities given to management include the authority to ordinarily conclude Article IV consultations with members and develop and implement annual budgets to meet the institution's strategic priorities. An open, transparent, and merit-based system for the selection of the Managing Director is essential.

30. ***Devolve some decision making***. A more modern structure of the Fund, with a more accountable Managing Director to oversee the work of a professional staff, is sorely needed. Our sense is that the Board is too involved in the day-to-day running of the institution. Accordingly, we propose a devolution of decision-making authority to management from the Board in the areas of surveillance and resource allocation:

31. ***Surveillance***. As reported in the recent Triennial Surveillance Review of the IMF, most country authorities note that IMF surveillance adds significant value, as an integrated macroeconomic assessment from a global perspective, as a test against the authorities' own judgments, as a transparent source of standardized information, and as a source of specific

policy advice. However, this added value tends to come at the conclusion of the Article IV consultation missions during briefings of senior officials.

32. ***Candor***. A greater measure of devolution, moreover, would help to alleviate political constraints imposed on staff's technical analysis. Where surveillance includes advice on multilateral issues, the candor and value of staff's assessments and early warnings could be significantly enhanced.

33. ***Functions***. Management should continue to exercise the power of initiative in the legislative and financing areas. It should also continue to have autonomy in the appointment, organization, and dismissal of staff. In addition, management should conduct surveillance under Article IV. The Board should have the option of requesting a discussion if asked for by the relevant ED or a group of EDs (at least five). Management should have the flexibility to allocate resources—within the overarching policy framework and strategic decisions—to best achieve the surveillance mandate. Accordingly, management should be given the authority to develop and implement annual budgets, within the medium-term budgetary and general compensation framework set by the Board.

34. ***Selection of the MD***. If the Fund is to provide leadership in the global financial system, then the Managing Director must be a world figure or symbol representing global financial stability and a credible and effective spokesman for these values. As such, the selection of the MD should occur through a transparent, open, and merit-based system.[7] The participation of the Council in the MD's selection process is essential. According to the Articles, the Board selects the MD, who serves as its chair. We propose that the MD be appointed by the Council and continue to serve as the chair of the Executive Board. The Articles would need to be amended accordingly.

35. ***Selection of the DMDs***. Although the three Deputy Managing Directors (DMDs) are members of the staff and chosen by the MD, there is a clear perception—confirmed by practice—of reserving the position of first DMD to the U.S. The selection of the DMDs should occur through a transparent, open, and merit-based system.

36. ***Accountability***. As the scope of responsibilities of management increases, so too does the need for effective accountability. A key function of the Board will be to review management's performance and hold it responsible for the conduct of surveillance and fulfillment of strategic priorities and for the effectiveness of the Fund's technical assistance to countries. All members of the management team should be subject to an assessment of their performance by the Board according to clear benchmarks, including taking into consideration the opinion of the staff.[8]

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[7] A selection process for the Managing Director was adopted by the Executive Board in July 2007; see Press Release No. 07/159 (http://www.imf.org/external/np/sec/pr/2007/pr07159.htm).

[8] A Working Group of Executive Directors on the Framework of the Managing Director's Performance Evaluation, chaired by the Dean of the Executive Board, was established in January 2008 to establish an accountability framework for the Managing Director.

VII. STRENGTHENING THE EXECUTIVE BOARD

The role of the Board needs to adjust to the institution's evolving needs. It is too "in the weeds" of day-to-day operations and pro-forma commentary to provide meaningful oversight of the Fund.[9] *It should be strengthened to serve as advisor to the Council, given its intimate knowledge of the institution; becoming more supervisory—as Fund management takes on more operational duties—but also retaining fiduciary/financing responsibilities. The Board should be made more representative of the membership.*[10]

37. ***Functions***. A new role for the Board is essential to the success of the Fund. With an intimate knowledge of the institution, the Board can assist the Council on strategy by providing perspective and advice and in taking policy decisions in areas of a lesser systemic importance. It should continue to decide on the use of Fund resources, with streamlined work practices, and it should perform a more supervisory role over Management.

- *Advising the Council*: the Board should advise the Council on emerging issues and decisions, and provide input in the preparatory stages of new Fund policies in critical areas. It should also provide quarterly or semi-annual reports to the Council on cross-cutting themes that emerge during Article IV consultations.

- *Legislative*: the Board should legislate in ordinary areas of Fund policy review and formulation, such as reviews of access policies.

- *Financial*: the Board should continue to decide on the financing arrangements. It should formulate the medium-term budget and compensation framework.

- *Oversight*: clearly delineating the responsibilities of the Board and management in the area of surveillance allows the Board to supervise management's performance, without a conflict of interest. This oversight function is critical to ensure that the Council's strategic priorities and the surveillance mandate are being fulfilled. The Board could conduct select ex post reviews of surveillance reports, and construct and implement a framework for management accountability, providing an overall assessment every 12 months.

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[9] The Board currently reviews over 80,000 pages of paper annually. Board offices are about 10 percent of total Fund personnel, taking up 8 percent of the budget—over $57 million for the Board offices, and nearly $12 million for the Secretary's Department to service the Board.

[10] In its evaluation of IMF governance reform, the IEO recommended that the Board take on more supervisory responsibilities, with improved representation to ensure a more equal voice of members in strategy formulation. It also recommended delegating authority to management on "certain non-systemic" country issues such as program reviews and some Article IV consultations. The IEO considered the merits of a non-resident Board, though it concluded that the IMF Board should remain resident. See "Governance of the IMF: An Evaluation"; Martinez-Diaz, Leonardo, "Executive Boards in International Organizations: Lessons for Strengthening IMF Governance," IEO, BP/08/08; and Chelsky, Jeff, "The Role and Evolution of Executive Board Standing Committees in IMF Corporate Governance," BP/08/04.

38. ***Structure and staffing***. The functional reform of the Board implies changes to its structure, meetings, and staffing. A lower day-to-day workload from a reduced surveillance function could help to lower overhead costs as offices are made smaller. Lower costs would also derive from less frequent meetings implied by a more supervisory and advisory role.

39. ***Resident or non-resident Board?*** The current practice of meeting thrice a week increases the tendency to micromanage, blunting the Board's efficiency and effectiveness. While a non-resident Board could be considered, it may be preferable to maintain a resident Board, but with fewer meetings and a lighter presence.

- A restructured workload for the Board has implications for the frequency of meetings and the need to delve into minutiae. A non-resident Board would create even greater scope for the Board to provide Management and the Council with the strategic advice that we believe is an important function for the Board.[11]

- A resident Board, however, allows members' concerns to be heard at an early stage, and allows for members to build specific human capital on the institution's complexity and advise Councillors. It enables it to take decisions in a timely manner that relate to the use of the Fund's resources. For these reasons, we recommend maintaining a resident Board, albeit with significantly smaller offices.

- Consideration could also be given to another configuration based on the appointment of a high-level, non-resident Executive Director, such as a minister's deputy or sherpa, who attends meetings in the Fund's headquarters for a week every two months and participates via video/teleconference as necessary. This would have the effect of upgrading the Board. A resident alternate Executive Director would then take decisions in the Executive Director's absence and would handle only urgent or unexpected business. Key to the success of this configuration would be the determination of the highest national authority to preserve the seniority of the appointed Directors, avoiding the practice of delegating downward.

40. ***Composition***. The composition of the Board should be improved to reflect the current economic realities. [12] This is a fundamental issue to enhance Fund legitimacy. Emerging market economies are clearly underrepresented at the Board. Furthermore, we

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[11] Both Bank of England Governor Mervyn King and US Treasury Secretary Henry Paulson recommended consideration of a non-resident board. Governor King said, "serious consideration should be given to a non-resident Board, meeting some six to eight times a year with directors comprising senior finance ministry or central bank officials" (speech on the "Reform of the International Monetary Fund," Indian Council for Research on International Economic Relations, New Delhi, India, February 20, 2006). Secretary Paulson remarked, "a non-resident board could free-up resources and enable management to focus on issues of more strategic importance" (http://www.treas.gov/press/releases/hp1285.htm).

[12] The Articles provide that the minimum number of Executive Directors must be 20 (5 appointed plus 15 elected). The Board of Governors may, by an 85 percent majority, increase the number of elected Executive Directors (and has done so over the years) or decrease the number.

recommend moving towards electing all chairs, which would allow for consolidation. Constituencies at the Board could make their own rules, within reasonable bounds.

VIII. Implementing the Reform Package

41. ***Package***. Restoring the Fund to the center of the international financial system is a daunting yet urgent task involving issues that have been left to the side for too long. Fortunately, there is a considerable amount of work underway, both within the Fund and in the G-20. We believe that immediate changes to the mandate of the Fund and its governance present the approach most likely to result in significant benefits for the effectiveness of the Fund. The required amendments to the Articles of Agreement and a new timetable for quota reform need to be set in motion in the very near future to facilitate the establishment of the Council and associated governance reforms as soon as possible. We believe that an explicit package should be composed of the following actions:

a) That a revised timetable be set out as soon as possible for further quota and voice reform, with the intention of completing a new round of revisions no later than the 2010 Spring Meetings.

b) That the composition of the Executive Board be adjusted to reflect economic realities and allow for greater representation of emerging market economies.

c) That the Council be activated through a vote of the Board of Governors and its composition adjusted in line with quota revisions proposed above.

d) That the Articles of Agreement be amended to remove the requirement that the five countries with the largest quotas are required to appoint their own Executive Directors, and that constituency reforms be made to achieve the needed consolidation of chairs, including of European countries, and for whatever other adjustment which could be seen as appropriate.

e) That the Articles be amended to expand the Fund's surveillance mandate beyond exchange rates to provide equal coverage of macroeconomic policies, prudential issues and financial spillovers. The capital account would also fall within the mandate.

f) That decision-making authority on surveillance and resource allocation be devolved as suggested to Fund management shortly after the creation of the Council, while the Board take on advisory responsibility to the Council and oversight responsibilities over management.

g) That the Articles be amended to lower the voting threshold on critical decisions from 85 percent to 70–75 percent, and consideration given to extending double majorities to a wider range of decisions, thus ensuring that decisions affecting key aspects of the institution command the support of the majority of members.

h) That the Articles be amended to provide for the appointment of the MD by the Council, and that the criteria for selecting the Managing Director and the Deputy Managing Directors be modified to allow for an open, transparent and merit based selection process.

42. ***Preferred timing***. Deferring this package of reforms at a critical time for the global economy has major drawbacks. The best way forward would be to implement the package as a whole in 2010, requiring speedy implementation of all measures. The Board of Governors would need to approve resolutions to amend the Articles by fall 2009.[13] The next round of quota revisions would need to be concluded by Spring 2010, and all necessary amendments to the Articles (for example, eliminating appointed chairs) ratified. The Council would be activated by mid 2010 by a resolution of the Board of Governors.[14]

43. ***Logistical support for Council***. The Council would require a support mechanism. The Fund's Secretary would be well placed to provide this support, to help ensure consistency and coherence among the different organs of the Fund.

IX. Conclusions

44. ***Defining moment***. We are at a defining moment for the global financial system and, by implication, for the relationships among countries. The institutional and policy-making landscape is changing in a rapid and unpredictable manner, driven not by a coherent global approach, but instead by separate reactions to the global financial crisis. As a result, the inadequacy of today's multilateral coordination is evident, multiplying the market accidents and policy mistakes.

45. ***Need for urgent and bold modernization***. Crises provide the opportunity and momentum for reform and radical change. We need to grasp this moment to put in place arrangements that forestall their recurrence. There is no decision-making body with the requisite political heft, national policy-making authority, flexibility, and widely acknowledged legitimacy to provide an effective mechanism for collaboration and response to early warnings and global financial problems.

46. ***Fundamental reforms***. To sustainably deliver the much needed public good of global financial stability, a broad package of IMF reforms is needed to its governance framework. This needs to be supported by adjustment to the Fund's mandate. Strategic direction and oversight of the global financial and monetary system needs to be imparted by a high-level political body that reflects global economic realities. A process for the

[13] Including but not necessarily limited to: eliminating appointed chairs; expanding the surveillance mandate including over domestic macroeconomic policies, financial spillovers and the capital account; lowering the voting threshold and possibly extending double majorities; and the appointing of the MD.

[14] In addition, the IMFC would need to be abolished through a vote of the Board of Governors. The By-Laws, Rules, and Regulations would need to be amended.

adjustment of quotas to facilitate better representation of emerging and developing economies should be set out, the composition of the Executive Board modified accordingly, and the decision-making Council of ministers and governors provided for in the Articles of Agreement activated. The Council must be small enough to be effective and representative, in addition to being highly representative of the world as we know it. All other governance tasks should be delegated to the Executive Board and Management, with greater delineation of responsibilities to further enhance the efficiency and effectiveness of decision making at the Fund. And while these reforms form a coherent package, it is necessary to bear in mind that implementation of some reforms will necessarily take longer than others. We urge members of the Fund to accept them as a package of reforms at this time, and to move speedily to implementation.

47. ***Fund resources***. The question of the adequacy of Fund resources remains a central concern of the Committee, although not strictly within its mandate. We appreciate the readiness of Japan to provide the IMF with an important bilateral loan, providing fresh and much needed resources at a critical time. This contribution and others that may be forthcoming may not suffice in the current global crisis, and so we conclude this report with an appeal for a substantial SDR allocation to be considered urgently.

APPENDIX I. COMMITTEE MEMBERS

- Trevor Manuel (Chairman), Minister of Finance, Republic of South Africa
- Michel Camdessus, Former Managing Director of the IMF and Honorary Governor, Banque de France
- Kenneth Dam, Professor of Law, University of Chicago
- Mohamed El-Erian, CEO, Pacific Investment Management Company
- Sri Mulyani Indrawati, Minister of Finance and Coordinating Minister of the Economy, Republic of Indonesia
- Guillermo Ortiz, Governor, Banco de Mexico
- Robert Rubin, Council on Foreign Relations
- Amartya Sen, Lamont University Professor, Harvard University
- Zhou Xiaochuan, Governor, People's Bank of China

APPENDIX II. TERMS OF REFERENCE

1. Over the past few months, significant progress has been made in the reform of the Fund's governance framework. The Fund's Board of Governors has initiated a process designed to realign members' voting power within the Fund in a manner that will enhance the Fund's effectiveness and legitimacy. Notwithstanding the importance of this initiative, a question remains as to whether the institutional framework of the Fund—through which members' voting power is actually exercised—also requires reform, taking into account the significant changes that have taken place since the Fund's establishment.

2. As a means of addressing this important question, the Managing Director is establishing a Committee that will assess the adequacy of the Fund's existing institutional framework and advise the Managing Director as to what, if any, modifications to this framework may be necessary to enable the Fund to fulfill its mandate more effectively. The Committee will be chaired by Trevor Manuel and will also consist of Michel Camdessus, Kenneth Dam, Mohamed El-Erian, Sri Mulyani Indrawati, Guillermo Ortiz, Robert Rubin, Amartya Sen, and Xiaochuan Zhou.

3. In conducting its work, the Committee is expected to consult broadly among the Fund's various shareholders and others, taking into account the need to obtain broad support from the Fund's membership for possible changes to the Fund's existing institutional framework. In that context, the Committee shall take into account the valuable report of the Fund's Independent Evaluation Office entitled "Aspects of IMF Governance—Including the Role of the Executive Board" and the views of the Fund's Executive Directors with respect to this report.

4. The Committee is expected to present its report to the Managing Director by the 2009 Spring Meetings. The Committee's work will be supported by a small secretariat selected from Fund staff.

APPENDIX III. PRESS RELEASE NO. 08/200: MANAGING DIRECTOR STRAUSS-KAHN APPOINTS COMMITTEE ON IMF GOVERNANCE REFORM

September 4, 2008

Managing Director Dominique Strauss-Kahn of the International Monetary Fund (IMF) today announced the appointment of a committee of eminent persons to assess the adequacy of the Fund's current framework for decision making and advise on any modifications that might enable the institution to fulfill its global mandate more effectively.

The committee, chaired by Trevor Manuel, Minister of Finance of South Africa, includes: Michel Camdessus, former Managing Director of the IMF; Kenneth Dam, Max Pam Professor at the University of Chicago; Mohamed El-Erian, co-CEO and co-CIO of Pacific Investment Management Co.; Sri Mulyani Indrawati, Minister of Finance of Indonesia; Guillermo Ortíz, Governor of the Bank of Mexico; Robert Rubin, Senior Counselor at Citigroup; and Amartya Sen, Lamont University Professor at Harvard University.

"Important progress has been made in the reform of the Fund's governance, including the initiation of a process to realign members' voting power within the Fund. However, the task of enhancing the Fund's legitimacy and effectiveness must also come to grips with the question of whether the significant changes since the establishment of the Fund require reform of the institutional framework through which members' voting power is actually exercised. Among other things, this requires careful consideration of the respective roles and responsibilities of the Board of Governors, the International Monetary and Financial Committee (IMFC), the Executive Board, and Fund Management," Mr. Strauss-Kahn stated.

"The committee's perspective, which I hope to have by next April, will provide yet another important input to our reform efforts, which have benefited recently from important work by many groups and individuals, including the Fund's Independent Evaluation Office; the Fund's Executive Directors, who have formed a working group to focus on these issues; numerous academics and analysts; and civil society groups. I want to thank these eminent persons for agreeing to bring their experience, expertise, and wisdom to bear on the on-going reform of IMF governance. It is my hope that concrete proposals can be distilled from this large body of work by September 2009," Mr. Strauss-Kahn added.

Background

The IMF is governed by, and is accountable to, its member countries through its Board of Governors. There is one Governor from each member country, typically the finance minister or central bank governor. The Governors usually meet once a year, in September or October, at the Annual Meetings of the IMF and the World Bank.

Key policy issues related to the international monetary system are considered twice a year by a committee of Governors called the International Monetary and Financial Committee, or the IMFC. A joint committee of the Boards of Governors of the IMF and the World Bank—the Development Committee—advises and reports to the Governors on development policy and other matters of concern to developing countries.

The day-to-day work of the IMF is carried out by the Executive Board, which receives its powers from the Board of Governors, and the IMF's internationally recruited staff. The Executive Board makes key decisions as well as selects the IMF's Managing Director, who is appointed for a renewable five-year term. The Managing Director reports to the Board, serves as its chair and is the chief of the IMF's staff, is responsible for ordinary business subject to the direction of the Board, and is assisted by a First Deputy Managing Director and two other Deputy Managing Directors.

INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

December 2017

EXTENSION OF THE PERIODS FOR CONSENT TO AND PAYMENT OF QUOTA INCREASES

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- The **Staff Report** on Extension of the Periods for Consent to and Payment of Quota Increases, prepared by IMF staff. The proposed decision in the paper was approved by the Executive Board on December 27, 2017.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Electronic copies of IMF Policy Papers
are available to the public from
http://www.imf.org/external/pp/ppindex.aspx

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

December 20, 2017

EXTENSION OF THE PERIODS FOR CONSENT TO AND PAYMENT OF QUOTA INCREASES

Approved By
Andrew Tweedie

Prepared by the Finance Department
(In consultation with the Legal and Secretary's Departments)

1. This paper proposes a further six-month extension of the period for members to consent to an increase in their quotas under the Fourteenth General Review of Quotas ("Fourteenth Review") through June 29, 2018.[1] The current deadline is due to expire on December 29, 2017.[2] However, Board of Governors Resolution No. 66-2 provides that the Executive Board may extend the period for consent as it may determine. An extension under Resolution No. 66-2 will also extend the periods of consent for quota increases under the 2008 Reform of Quota and Voice (Resolution No. 63-2) and the Eleventh General Review of Quotas (Resolution No. 53-2).[3]

2. This paper also proposes a further six-month extension of the period for payment of quota increases under the Fourteenth Review, and an extension for the payment of the quota increases under the 2008 Reform, through June 29, 2018.

3. As of December 18, 2017, five members had not yet consented to their proposed quota increases under Resolution No. 66-2 (see Appendix I).[4] Two of those members (Somalia and Sudan) are currently not eligible to consent to their quota increases under the Eleventh and Fourteenth General Reviews due to protracted arrears to the Fund in General Resources Account.[5,6]

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[1] See Board of Governors Resolution No. 66-2, *Fourteenth General Review of Quotas and Reform of the Executive Board*, which can be found at: http://www.imf.org/external/pubs/ft/sd/index.asp?decision=66-2.

[2] See *Extension of the Periods for Consent to and Payment of Quota Increases* (06/22/2017).

[3] Paragraph 7 of Resolution No. 66-2 states: "For members that have not yet consented to their increases in quotas under the Eleventh General Review and under Board of Governors Resolution No. 63-2, the deadline for consent to such quota increases shall be the date determined by or under paragraph 4 above."

[4] Palau has not consented to its quota increase under the 2008 Reform. It has, however, consented to its quota increase under the Fourteenth Review but has not made payment of its quota increase.

[5] Resolutions No. 53-2 and 66-2 provide that no member with overdue repurchases, charges, or assessments to the General Resources Account may consent to, or pay for, its quota increase until it becomes current with respect to these obligations.

[6] See *Review of the Fund's Strategy on Overdue Financial Obligations* (8/20/2012), www.imf.org/external/np/pp/eng/2012/082012.pdf.

4. For the Fourteenth Review, under Board of Governors Resolution No. 66-2, each member shall pay to the Fund the increase in its quota within 30 days after the later of (a) the date on which it notifies the Fund of its consent, or (b) the date on which all of the general effectiveness conditions for the quota increases under the Fourteenth Review are met, provided that the Executive Board may extend the payment period as it may determine.[7] The initial 30-day period for payments has been extended seven times, most recently through December 29, 2017.[8] Continued progress is being made in implementing the quota payments.[9] However, some members have indicated that they require additional time to complete internal procedures for the payment of quota increases. Staff is following up with the authorities in each of these cases to facilitate timely arrangements for payments.

5. With respect to the 2008 Reform, among members that have consented to their ad hoc quota increases under the 2008 Reform, two members – Eritrea and the Syrian Arab Republic – require additional time to complete the payments for their ad hoc quota increases. The Executive Board has previously extended the payment deadline for these countries, most recently in June 2017.[10] Their deadline for payment is currently December 29, 2017.

6. While it is important to emphasize that all members who have not yet consented to their Fourteenth Review quota increases should do so without further delay, and that members who have consented to their quota increases should make their quota payments in a timely manner, a further six-month extension in the periods for consent to and payment of quota increases would seem appropriate.

7. In these circumstances, it is proposed to extend the period for consent under Resolution No. 66-2 to end at 6:00 p.m., Washington D.C. time, on June 29, 2018. It is also proposed that the Executive Board extend the period for payment of the quota increases under the Fourteenth General Review of Quotas through June 29, 2018 for those members whose quota payments would otherwise be due earlier. It is also proposed that the Executive Board extend the period for payment of the quota increases under the 2008 Reform for Eritrea and the Syrian Arab Republic through June 29, 2018.

[7] See paragraph 5 in Board of Governors Resolution No. 66-2, *Fourteenth General Review of Quotas and Reform of the Executive Board*.

[8] See *Extension of the Periods for Consent to and Payment of Quota Increases* (06/22/2017).

[9] As of December 18, of the 184 members that had consented to their quota increases under the Fourteenth Review, 181 members had paid their quota increases.

[10] See *Extension of the Periods for Consent to and Payment of Quota Increases* (06/22/2017).

Proposed Decisions

Accordingly, the following decisions, each of which may be adopted by a majority of the votes cast, are proposed for adoption by the Executive Board:

Decision 1: Extension of the Period for Consent to Increase Quotas Under the Fourteenth General Review of Quotas

Pursuant to paragraph 4 of Resolution No. 66-2, *Fourteenth General Review of Quotas and Reform of the Executive Board*, the Executive Board decides that notices of consent from members to increases in their quotas must be received in the Fund by 6:00 p.m., Washington D.C. time, on June 29, 2018.

Decision 2: Extension of the Period of Payment of Quota Increase Under the Fourteenth General Review of Quotas

Pursuant to paragraph 5 of Board of Governors Resolution No. 66-2, *Fourteenth General Review of Quotas and Reform of the Executive Board*, the Executive Board decides that each member shall pay to the Fund the increase in its quota under the Fourteenth General Review by the later of (a) June 29, 2018, or (b) 30 days after the date on which it notifies the Fund of its consent.

Decision 3: Extension of the Period of Payment of Quota Increase Under the 2008 Reform

Pursuant to Paragraph 4 of the Resolution of the Board of Governors No. 63-2, *Reform of Quota and Voice in the International Monetary Fund,* the Executive Board decides to extend the period for payment of quota increase by Eritrea and the Syrian Arab Republic through June 29, 2018.

Appendix I. Status of Members' Consents to Increases in Quotas Under the Fourteenth General Review of Quotas

(as of December 15, 2017)

The five members listed below have not yet consented to their respective quota increases under the Board of Governors Resolution No. 66-2:

Eritrea	Sudan
Micronesia, Federated States of	Syrian Arab Republic
Somalia	

IMF Quotas

Quota subscriptions are central to the IMF's financial resources. Each member country of the IMF is assigned a quota, based broadly on its relative position in the world economy. A member country's quota determines its maximum financial commitment to the IMF, its voting power, and has a bearing on its access to IMF financing.

When a country joins the IMF, it is assigned an initial quota in the same range as the quotas of existing members of broadly comparable economic size and characteristics. The IMF uses a quota formula to help assess a member's relative position.

The current quota formula is a weighted average of GDP (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent). For this purpose, GDP is measured through a blend of GDP—based on market exchange rates (weight of 60 percent) and on PPP exchange rates (40 percent). The formula also includes a "compression factor" that reduces the dispersion in calculated quota shares across members.

Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account. The largest member of the IMF is the United States, with a current quota (as of March 2017) of SDR82.99 billion (about US$118 billion), and the smallest member is Tuvalu, with a quota of SDR2.5 million (about US$3.5 million).

The conditions for implementing the quota increases agreed under the 14th General Quota Review were met on January 26, 2016. As a result, the quotas of each of the IMF's 189 members will increase to a combined SDR477 billion (about US$677 billion) from about SDR238.5 billion (about US$339 billion). As of September 2017, 181 of the 189 members had made their quota payments, accounting for over 99 percent of the total quota increases, and total quotas stood at SDR475 billion (about US$675 billion).

Quotas play several key roles in the IMF

A member's quota determines that country's financial and organizational relationship with the IMF, including:

Subscriptions. A member's quota subscription determines the maximum amount of financial resources the member is obliged to provide to the IMF. A member must pay its subscription in full upon joining the IMF: up to 25 percent must be paid in SDRs or foreign currencies acceptable to the IMF (such as the US dollar, the euro, the Chinese renminbi, the Japanese yen, or the British pound sterling), while the rest is paid in the member's own currency.

Voting power. The quota largely determines a member's voting power in IMF decisions. Each IMF member's votes are comprised of basic votes plus one additional vote for each SDR100,000 of quota. The 2008 reforms fixed the number of basic votes at 5.502 percent of total votes. The current share of basic votes in total votes represents close to a tripling of their share prior to the implementation of the 2008 reforms.

Access to financing. The amount of financing a member can obtain from the IMF (its access limit) is based on its quota. For example, under Stand-By and Extended Arrangements, a member can borrow up to 145 percent of its quota annually and 435 percent cumulatively. However, access may be higher in exceptional circumstances.

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How quota reviews work

The IMF's Board of Governors conducts general quota reviews at regular intervals (usually every five years). Any changes in quotas must be approved by an 85 percent majority of the total voting power, and a member's quota cannot be changed without its consent. There are two main issues addressed in a general quota review: the size of an overall increase and the distribution of the increase among the members.

First, a general quota review allows the IMF to assess the adequacy of quotas both in terms of members' balance of payments financing needs and in terms of its own ability to help meet those needs. Second, a general review allows for increases in members' quotas to reflect changes in their relative positions in the world economy. Ad hoc increases outside general reviews do not occur often, but the increases in quotas for 54 member countries approved under the 2008 Reform are a recent example.

General Quota Reviews

Quota Review	Resolution Adopted	Overall Quota Increase (percent)
First Quinquennial	No increase proposed	---
Second Quinquennial	No increase proposed	---
1958/59[1]	February and April 1959	60.7
Third Quinquennial	No increase proposed	---
Fourth Quinquennial	March 1965	30.7
Fifth General	February 1970	35.4
Sixth General	March 1976	33.6
Seventh General	December 1978	50.9
Eighth General	March 1983	47.5
Ninth General	June 1990	50.0
Tenth General	No increase proposed	---
Eleventh General	January 1998	45.0
Twelfth General	No increase proposed	---
Thirteenth General	No increase proposed	---
Fourteenth General	December 2010	100.0

2010 Reforms: Doubling of quotas and major realignment of quota shares

On December 15, 2010, the Board of Governors, the IMF's highest decision-making body, completed the 14th General Review of Quotas, which involved a package of far-reaching reforms of the IMF's quotas and governance. This reform package, which became effective on January 26, 2016, delivers an unprecedented 100 percent increase in total quotas and a major realignment of quota shares. This will better reflect the changing relative weights of the IMF's member countries in the global economy.

[1] This review was conducted outside the five-year cycle.

The reform package built on earlier reforms from 2008, which had become effective on March 3, 2011. The 2008 reforms strengthened the representation of dynamic economies—many of which are emerging market countries—through ad hoc quota increases for 54 member countries. They also enhanced the voice and participation of low-income countries through a near tripling of basic votes.

Building on the 2008 reforms, the 14th General Review of Quotas:

- doubled quotas from approximately SDR238.5 billion to approximately SDR477 billion (about $677 billion at current exchange rates),
- shifted more than 6 percent of quota shares from over-represented to under-represented member countries,
- shifted more than 6 percent of quota shares to dynamic emerging market and developing countries (EMDCs),
- significantly realigned quota shares. China became the third largest member country in the IMF, and there are now four EMDCs (Brazil, China, India, and Russia) among the 10 largest shareholders in the IMF, and
- preserved the quota and voting share of the poorest member countries. This group of countries was defined as those eligible for the low-income Poverty Reduction and Growth Trust (PRGT) and whose per capita income fell below $1,135 in 2008 (the threshold set by the International Development Association) or twice that amount for small countries.

A comprehensive review of the current quota formula was completed in January 2013, when the Executive Board submitted its report to the Board of Governors. Work on a new quota formula will continue in the context of the 15th General Review of Quotas.

Next steps

The 15th General Quota Review provides an opportunity to assess the appropriate size and composition of the IMF's resources and to continue the process of governance reforms. On December 5, 2016, the Board of Governors adopted a Resolution calling on the Executive Board to work expeditiously on the 15th Review in line with existing Executive Board understandings and the guidance provided by the IMFC, and with the aim of completing the 15th Review by the 2019 Spring Meetings or no later than the 2019 Annual Meetings.

Report of the Executive Board to the Board of Governors on the Outcome of the Quota Formula Review

I. INTRODUCTION

1. In completing the Fourteenth General Review of Quotas and approving the Proposed Amendment on the Reform of the Executive Board, the Board of Governors requested that the Executive Board complete a comprehensive review of the quota formula by January 2013.[1] The Executive Board was also requested to bring forward the timetable for completion of the Fifteenth General Review of Quotas (hereafter the 15th Review) to January 2014. These forward-looking elements were part of an agreed package of 2010 quota and governance reforms. With regard to the 15th Review, Board of Governors' Resolution 66-2 noted that any realignment is expected to result in increases in the quota shares of dynamic economies in line with their relative positions in the world economy, and hence likely in the share of emerging market and developing countries as a whole. It also called for steps to be taken to protect the voice and representation of the poorest members.

2. The Executive Board reaffirmed the urgency of ratifying the 2010 reform, underscoring the importance of quota and governance reform for enhancing the credibility, legitimacy, and effectiveness of the Fund.

3. The Executive Board has held extensive discussions on the quota formula review. The Board met formally to discuss the quota formula review on four occasions during 2012 and has also held two informal meetings. The Board was guided in its work by the views expressed by the International Monetary and Financial Committee (IMFC), and also received inputs from IMFC Deputies, who met in March and September 2012, and January 2013, to discuss the review and support consensus building among the membership.

4. Important progress has been made in identifying key elements that could form the basis for a final agreement on a new quota formula. It was agreed that achieving broad consensus on a new quota formula will best be done in the context of the 15th Review rather than on a stand-alone basis. Thus, the discussions on this issue will be integrated and move in parallel with the discussion on the 15th Review.

5. This report responds to the Board of Governors' request and summarizes the outcome of the quota formula review. It identifies areas of common ground as well as areas where views differ among Board members and further discussions are needed. It is recognized that views on the key elements of the quota formula have evolved during the review and will

[1] See *IMF Quota and Governance Reform—Elements of an Agreement—Report of the Executive Board to the Board of Governors*, and Board of Governors' Resolution 66-2, adopted December 15, 2010.

continue to evolve as further work is undertaken as part of the 15th Review and new data become available. It is further recognized that all these elements are inter-connected and that eventual agreement will require an integrated package that reflects a spirit of cooperation and compromise across the membership.

II. Outcome of the Quota Formula Review

6. The Executive Board's discussions covered a wide range of issues. These included, inter alia, the principles that should guide the review, the role and measurement of the existing quota formula variables, the relative weights of the variables, the scope for further simplifying the formula, and the merits of adding new variables. The discussions were informed by a wide range of simulations of alternative possible reforms and by extensive technical work prepared by staff, including on how to capture potential need for Fund resources, openness and interconnectedness, alternative measures of financial openness, and measuring members' financial contributions to the Fund.[2]

7. The Executive Board took note of the results of updating the quota data through 2010. These showed that the aggregate calculated quota share of emerging market and developing countries had increased by 7.7 percentage points in the 5-year period since 2005, the data used for the 2008 reform. Some saw this shift as providing evidence that the current formula adequately captures dynamic developments in the world economy and is not in need of radical reform. Others considered that the formula remains seriously flawed, producing results that do not adequately reflect members' relative positions in the global economy, including the increased importance of emerging market and developing countries.[3]

8. It was agreed that the principles that underpinned the 2008 reform remained valid as a guide for the quota formula review. Thus, the formula should be simple and transparent, consistent with the multiple roles of quotas,[4] produce results that are broadly acceptable to the membership, and be feasible to implement statistically based on timely, high quality and widely available data.

9. It was agreed that GDP should remain the most important variable, with the largest weight in the formula and scope to further increase its weight. GDP is generally seen as the

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[2] Public Information Notices for all Executive Board discussions and the background papers prepared by staff are available on the Fund's external website at www.imf.org.

[3] The current formula, agreed in 2008, includes four variables: GDP (consisting of market GDP with a 30 percent weight and PPP GDP with a 20 percent weight), openness (30 percent weight), variability (15 percent weight), and reserves (5 percent weight). A compression factor of 0.95 is applied to the weighted sum of these variables.

[4] These include their key role in determining the Fund's financial resources, their role in decisions on members' access to Fund resources, their role in determining members' shares in a general allocation of SDRs, and their close link with members' voting rights.

most comprehensive measure of economic size. Considerable support was expressed for increasing its weight, particularly if variability is dropped (see below), but others preferred to either keep the current weight or maintain it relative to that of openness.

10. Consideration will be given to whether or not the weight of PPP GDP in the GDP blend variable should be adjusted. Two broad views were expressed in the discussions under the review. One view was to retain the current blend, noting that it had been a difficult compromise that should not be reopened. Some who supported this view nevertheless continued to see various problems with using PPP GDP. Others favored increasing the weight of PPP GDP in the blend variable, noting that these data are widely used and that this would increase the share of emerging market and developing countries, including that of low-income countries.

11. It was agreed that openness should continue to play an important role in the formula, and concerns regarding this variable need to be thoroughly examined and addressed. Openness seeks to capture members' integration into the world economy. One view was to keep the openness variable as currently defined, with some favoring increasing its weight if variability is dropped. Another view was that the current measure is seriously flawed reflecting both conceptual and measurement issues, including its reliance on gross flows and given the challenges posed by intra-currency union trade. Several options were examined to bridge these differences, including the possible use of a cap on openness in relation to GDP, but views remained divided. Some also favored increasing the weight of financial openness, but this did not attract sufficient support.

12. There was considerable support for dropping variability from the formula. Extensive consideration was given to the role of variability, which seeks to capture members' potential need for Fund resources. The Executive Board took note of the staff's finding that there is little empirical evidence of a relationship between variability and actual demand for Fund resources and the difficulties of identifying a superior measure. Some conditioned their support for dropping variability on other elements of an integrated reform package, including how its weight is reallocated and the adequacy of measures to protect the poorest members. Some continued to see a role for variability.

13. There was considerable support for retaining reserves with its current weight. The reserves variable provides an indicator of members' financial strength and ability to contribute to the Fund's finances. Views were also expressed in favor of either increasing its weight to better capture members' ability to contribute to global safety nets, or eliminating it given the concern that it could reward excessive reserve accumulation.

14. Options were considered for including a new measure of financial contributions in the formula, with arguments made for and against such a reform. Views diverged on the merits of such an approach. It was agreed to consider whether and how to take into account very

significant voluntary financial contributions through ad hoc adjustments as part of the 15th Review.

15. Consideration will be given to whether or not the current level of compression should be adjusted. It was generally agreed that the quota formula should continue to include a compression factor to help moderate the influence of size in the quota formula. One view was to retain the current compression factor, noting that it had been a difficult compromise that should not be reopened. Others favored increasing the level of compression to give greater voice to small members, as well as to emerging market and developing countries as a group.

16. It was agreed that measures should be taken to protect the voice and representation of the poorest members. Considerable support was expressed for addressing this issue as part of the 15th Review.

17. In sum, the Executive Board's discussions under the review have provided important building blocks for agreement on a new quota formula that better reflects members' relative positions in the global economy. The outcome of this comprehensive review of the quota formula will form a good basis for the Executive Board to agree on a new quota formula as part of its work on the 15th Review, and building the needed consensus among the membership on a reform package that can garner the broadest possible support.

This factsheet is no longer being updated. As a result, the information it contains may not be current.

The IMF's Response to the Global Economic Crisis

The IMF responded to the global economic crisis by mobilizing resources on many fronts to support its member countries. The IMF increased and deployed its lending firepower, used its cross-country experience to offer policy solutions, and introduced reforms that better equipped it to respond to countries' needs.

Creating a crisis firewall. To meet ever increasing financing needs of countries hit by the global financial crisis and to help strengthen global economic and financial stability, the Fund greatly bolstered its lending capacity after the onset of the global crisis in 2008. This was done by increasing quota subscriptions of member countries—the IMF's main source of financing—and securing large borrowing agreements.

Stepping up crisis lending. The IMF overhauled its lending framework to make it better suited to country needs, giving greater emphasis to crisis prevention, and streamlined program conditionality. Since the start of the crisis, the IMF committed well over $700 billion in financing to its member countries.

Helping the world's poorest. The IMF undertook an unprecedented reform of its policies toward low-income countries and quadrupled resources devoted to concessional lending.

Sharpening IMF analysis and policy advice. The IMF provided risk analysis and policy advice to help member countries overcome the challenges and spillovers from the global economic crisis. It also implemented several major initiatives to strengthen and adapt surveillance to a more globalized and interconnected world, taking into account lessons learned from the crisis.

Reforming the IMF's governance. To strengthen its legitimacy, in April 2008 and November 2010, the IMF agreed on wide-ranging governance reforms to reflect the increasing importance of emerging market countries. The reforms also ensured that smaller developing countries would retain their influence in the IMF.

Creating a crisis firewall

Increasing the financial resources available for IMF support to member countries was a key part of the efforts to overcome the global financial crisis. In 2009 and 2010, members provided additional financial resources to the Fund through bilateral borrowing agreements for about SDR 170 billion (about US$250 billion at current exchange rates). These resources were subsequently incorporated into expanded New Arrangements to Borrow (NAB), increasing their size from SDR 34 billion to SDR 370 billion (about $510 billion). In 2012, to respond to worsening global financial conditions, a number of members pledged to further enhance IMF resources through a new round of bilateral borrowing. By the end of 2015, 35 agreements for a total of about SDR 280 billion ($390 billion) were finalized.

The 14th General Review of Quotas, approved in December 2010, doubled the IMF's permanent resources to SDR 477 billion (about $663 billion). The conditions for implementing the increases were met in January 2016. Subsequently, the NAB credit arrangements were rolled back from SDR 370 billion to SDR 182 billion in conjunction with the payments for the 14th Review quota increases, while remaining an important backstop to quota resources.

Currently, the Fund's total lending capacity (comprising quotas, the NAB, and the 2012 Borrowing Agreements after prudential balances) stands at about SDR 690 billion (about $950 billion).

In addition to increasing the Fund's own lending capacity, in 2009, the membership agreed to make a general allocation of SDRs equivalent at the time to $250 billion, resulting in a near ten-fold increase in SDRs. This represented a significant increase in reserves for many countries, in particular low-income countries.

Reforming the IMF's lending framework

To better support countries during the global economic crisis, the IMF beefed up its lending capacity and approved a major overhaul of how it lends money by offering higher and more frontloaded amounts and tailoring loan terms to countries' varying strengths and circumstances.

Credit line for strong performers. The Flexible Credit Line (FCL), introduced in April 2009 and further enhanced in August 2010, is a lending tool for countries with very strong fundamentals that provides large and upfront access to IMF resources, mainly as a form of insurance for crisis prevention. There are no policy conditions to be met once a country has been approved for the credit line. Colombia, Mexico, and Poland have been provided combined access up to about $100 billion under the FCL (no drawings have been made under these arrangements). FCL approval has been found to lead to lower borrowing costs and increased room for policy maneuver.

Access to liquidity on flexible terms. Heightened regional or global stress can affect countries that under normal circumstances would not likely be at risk of crisis. Providing rapid and adequate short-term liquidity to such crisis bystanders during periods of stress could bolster market confidence, limit contagion, and reduce the overall cost of crises. The Precautionary and Liquidity Line (PLL), which was established in 2011, is designed to meet the liquidity needs of member countries with sound economic fundamentals but with some remaining vulnerabilities—Macedonia and Morocco used the PLL.

Reformed terms for IMF lending. Structural performance criteria were discontinued for all IMF loans, including for programs with low-income countries. Structural reforms continue to be part of IMF-supported programs, but have become more focused on areas critical to a country's recovery.

Emphasis on social protection. The IMF helped governments protect and even increase social spending, including social assistance. In particular, the IMF promoted measures to increase spending on, and improve the targeting of social safety net programs that can mitigate the impact of the crisis on the most vulnerable in society.

Crisis Program Review. The IMF conducted several reviews to learn from Fund-supported programs that began after the 2008 global crisis. The reviews found that Fund-supported programs helped chart a path through the global financial crisis that avoided the counterfactual scenario many initially feared, involving a cataclysmic meltdown of the global economic system. Given the radical differences between the 2008 crisis and its predecessors, decisions were made amid significant uncertainty about shocks, transmission channels, and policy responses. Program outcomes helped inform the design of later programs, and contributed to broadening the array of feasible policies over time by strengthening frameworks and reducing the risk of contagion.

Helping the world's poorest

In response to the global financial crisis, the IMF undertook an unprecedented reform of its policies toward low-income countries. As a result, IMF programs are now more flexible and tailored to the individual needs of low-income countries—with streamlined conditionality, higher concessionality, and more emphasis on safeguarding social spending.

Increased access to resources. Concessional resources available to low-income countries through the Poverty Reduction and Growth Trust (PRGT) were substantially increased in 2009, consistent with a call from G20 leaders, while average access limits under the IMF's concessional loan facilities were doubled to enhance the financial safety net for low-income countries.

Sharpening IMF analysis and policy advice

The IMF undertook major initiatives to strengthen surveillance to respond to a more globalized and interconnected world. These initiatives included revamping the legal framework for surveillance to cover spillovers (when economic policies in one country can affect others), deepening analysis of risks and financial systems, stepping up assessments of members' external positions, and responding more promptly to concerns of the membership.

As part of these efforts, in July 2012 the Executive Board adopted a new Integrated Surveillance Decision to strengthen the underlying legal framework for surveillance. In September 2012, the Executive Board endorsed a new Financial Surveillance Strategy that included concrete and prioritized steps to further strengthen financial surveillance. In response to the growing importance of capital flows in the international monetary system, the Board also endorsed an institutional view on the liberalization and management of capital flows to guide Fund surveillance and policy advice to member countries.

External Sector Reports that present a broad and multilaterally consistent analysis of the external sector for the world's largest economies were introduced for annual discussion by the Executive Board. Moreover, risk analysis was enhanced, including by taking a cross-country perspective, including through an early-warning exercise carried out jointly with the Financial Stability Board. Analyses on linkages between the real economy, the financial sector, and external stability were also strengthened. Other work included mapping and understanding the implications of rising financial and trade interconnectedness for surveillance (including through spillover reports) and for lending to strengthen the global financial safety net.

The 2014 Triennial Surveillance Review (TSR), completed in September 2014, focused on building on these reforms and ensuring that IMF surveillance continues to best support sustainable growth in a deeply interconnected post-crisis world. It identified five operational priorities going forward: integrating and deepening risk and spillover analysis; mainstreaming macro-financial surveillance; paying more attention to structural policies, including labor market issues; delivering cohesive and expert policy advice; and having a client-focused approach to surveillance, supported by clear and candid communication. The Managing Director's Action Plan for Strengthening Surveillance published subsequently outlines concrete measures to take forward work in these priority areas, with initial steps already in the process of implementation. A review of the Financial Sector Assessment Program was also completed in September 2014.

With more than 200 million people unemployed across the world, and income inequality on the rise in many countries, the Fund set up an internal "Working Group on Jobs and Growth," which recommended steps and provided guidance to enhance the Fund's effectiveness in helping member countries achieve their growth, employment creation, and income distribution goals.

Reforming IMF governance to better reflect the global economy

A top priority for the IMF's legitimacy and effectiveness has been the completion of governance reform.

On December 15, 2010, the Board of Governors approved far-reaching governance reforms under the 14th General Review of Quotas. The package included a doubling of quotas, with a more than a 6 percentage point shift in quota share to dynamic emerging market and developing countries while protecting the voting shares of the poorest member countries. The reform also included a move to a more representative, fully elected Executive Board and advanced European countries committed to reduce their combined Executive Board representation by two chairs.

The reforms became effective on January 26, 2016, with the entry into force of the amendment to the IMF's Articles of Agreement that created an all-elected Executive Board, after it had been accepted by three-fifths (or 113) of the 189 member countries having 85 percent of the total voting power.

The 2010 reforms built on quota and voice reforms agreed in April 2008 and became effective on March 3, 2011. Under these reforms, 54 members received an increase in their quotas—with China, Korea, India, Brazil, and Mexico as the largest beneficiaries. Another 135 members, including low-income countries, saw an increase in their voting power as a result of the increase in basic votes, which will remain a fixed percentage of total votes. Combined with the 14th Review, the shift in quota share to dynamic emerging market and developing countries is 9 percentage points.

Articles of Association of the Financial Stability Board (FSB)

(of 28 January 2013)[1]

Article 1 Name and headquarters

(1) An association by the name of “Financial Stability Board” (“FSB”) (hereinafter “the Association”) is hereby established pursuant to Article 60 of the Swiss Civil Code.

(2) The Association is domiciled in Basel, Switzerland.

Article 2 Purposes

The Association shall have as its purpose to promote international financial stability. In particular, it has the purpose to further the objectives stipulated in the FSB Charter in its respective current version.

Article 3 Members

(1) The following are eligible to be a Member of the Association:

a. Authorities from jurisdictions that are responsible for maintaining financial stability, such as ministries of finance, central banks, supervisory and regulatory authorities;

b. International Financial Institutions; and

c. international standard setting, regulatory, supervisory and central bank bodies.

(2) The Association’s members are set out in the Annex to these Articles of Association.

(3) Members participate in the Association in accordance with their respective legal and policy frameworks, which may not be modified or superseded by these Articles or any decision of the Association.

(4) Any Member may withdraw at any time from the Association.

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1 An amendment to the Annex to these Articles of Association was adopted by a meeting of the Plenary held on 26 March 2015 in Frankfurt.

Article 4 Plenary

(1) The Plenary is the Association's sole decision-making body.

(2) The Plenary consists of representatives of all Members.

(3) Its responsibilities include all decisions relating to the affairs of the Association, including:

a. amendments to the Articles of Association;

b. the budget of the Association;

c. the appointment of the Executive;

d. the appointment of an external auditor;

e. approval of the audited financial statements; and

f. the dissolution of the Association.

(4) The Plenary is presided over by the Chair of the FSB.

Article 5 The Executive

(1) The Chair of the FSB and the Secretary General of the FSB shall constitute the Executive of the Association.

(2) The Chair of the FSB may concurrently serve in and fulfill the duties of a different role for a Member while serving as Chair of the FSB.

(3) The Secretary General of the FSB shall owe duty entirely to the FSB and to no other authorities or institutions.

(4) The Chair of the FSB and the Secretary General of the FSB shall be authorised to represent the Association in its dealing with third parties. They shall commit the Association legally only with the approval of the Plenary.

Article 6 Decision making

Decisions of the Plenary are taken by consensus.

Article 7 Funding and Resources

The Association will be funded by the Bank for International Settlements (BIS) on the basis of and in accordance with the terms of a renewable “Multi-Year Funding Agreement” and by voluntary contributions from Members.

Article 8 External audit

(1) The accounts and the annual financial statements of the Association shall be audited by external auditors.

(2) The financial year of the Association will begin on 1st April and end on 31st March. The first financial period will end on 31st March 2014.

Article 9 Liability

(1) The liability of the Association shall be limited to the extent of its assets.

(2) Members and their representatives shall not be responsible for the liabilities of the Association.

(3) Membership in the Association shall not constitute a waiver of the sovereign immunity of any Member or the privileges and immunities of international financial institutions participating as Members as provided for by their respective constitutive texts and as provided for under international law and national law.

Article 10 Policy making and related activities

The policy making and related activities of the Association shall be governed by the FSB Charter. These activities, including any decisions reached in their context, shall not be binding or give rise to any legal rights or obligations under the present Articles. Members can recuse themselves at any time from these activities or decision-making where such activities or decision-making are not consistent with their legal or policy frameworks.

The present Articles of Association have been approved and adopted at the Plenary Meeting of the Financial Stability Board held on 28 January 2013 in Zurich. The Annex to the Articles of Association (List of Members) was revised at the Plenary Meeting of the Financial Stability Board held on 26 March 2015 in Frankfurt.

For the Association

Chair	Secretary General
Mark Carney	Svein Andresen

Annex

List of FSB Members

(as amended on 26 March 2015)

A. Authorities from jurisdictions (Article 3 (1) (a))

Argentina

- Ministry of Finance
- Central Bank of Argentina

Australia

- Department of the Treasury
- Reserve Bank of Australia

Brazil

- Ministry of Finance
- Central Bank of Brazil
- Securities and Exchange Commission of Brazil

Canada

- Department of Finance
- Bank of Canada
- Office of the Superintendent of Financial Institutions (OSFI)

China

- Ministry of Finance
- People's Bank of China
- China Banking Regulatory Commission

France

- Ministry of the Economy, Finance and Foreign Trade
- Banque de France
- Autorité des Marchés Financiers (AMF)

Germany

- Ministry of Finance

- Deutsche Bundesbank
- Bundesanstalt für Finanzdienstleistungsaufsicht (Bafin)

Hong Kong SAR

- Hong Kong Monetary Authority

India

- Ministry of Finance
- Reserve Bank of India
- Securities and Exchange Board of India

Indonesia

- Ministry of Finance
- Bank Indonesia

Italy

- Ministry of the Economy and Finance
- Bank of Italy
- Commissione Nazionale per le Società e la Borsa (CONSOB)

Japan

- Ministry of Finance
- Bank of Japan
- Financial Services Agency

Korea

- Bank of Korea
- Financial Services Commission

Mexico

- Ministry of Finance and Public Credit
- Bank of Mexico

Netherlands

- Ministry of Finance
- Netherlands Bank

Russia

- Ministry of Finance

- Central Bank of the Russian Federation

Saudi Arabia
- Ministry of Finance
- Saudi Arabian Monetary Agency

Singapore
- Monetary Authority of Singapore

South Africa
- Ministry of Finance
- South African Reserve Bank

Spain
- Ministry of Economy and Competitiveness
- Bank of Spain

Switzerland
- Swiss Federal Department of Finance
- Swiss National Bank

Turkey
- Undersecretariat of the Treasury
- Central Bank of the Republic of Turkey

United Kingdom
- HM Treasury
- Bank of England
- Financial Conduct Authority

United States
- Department of the Treasury
- Board of Governors of the Federal Reserve System
- Securities and Exchange Commission

European Union
- European Central Bank
- European Commission

B. International Financial Institutions (Article 3 (1) (b))
- Bank for International Settlements (BIS)

- International Monetary Fund (IMF)
- Organisation for Economic Co-operation and Development (OECD)
- International Bank for Reconstruction and Development (IBRD, World Bank)

C. International Standard-Setting, Regulatory, Supervisory and Central Bank Bodies (Article 3 (1) (c))

- Basel Committee on Banking Supervision (BCBS)
- Committee on Payment and Settlement Systems (CPSS)
- Committee on the Global Financial System (CGFS)
- International Accounting Standards Board (IASB)
- International Association of Insurance Supervisors (IAIS)
- International Organization of Securities Commissions (IOSCO)

<u>CANNES SUMMIT FINAL DECLARATION</u>

"BUILDING OUR COMMON FUTURE: RENEWED COLLECTIVE ACTION FOR THE BENEFIT OF ALL"

4 NOVEMBER 2011

1. Since our last meeting, global recovery has weakened, particularly in advanced countries, leaving unemployment at unacceptable levels. Tensions in the financial markets have increased due mostly to sovereign risks in Europe. Signs of vulnerabilities are appearing in emerging markets. Increased commodity prices have harmed growth and hit the most vulnerable. Exchange rate volatility creates a risk to growth and financial stability. Global imbalances persist. Today, we reaffirm our commitment to work together and we have taken decisions to reinvigorate economic growth, create jobs, ensure financial stability, promote social inclusion and make globalization serve the needs of our people.

A global strategy for growth and jobs

2. To address the immediate challenges faced by the global economy, we commit to coordinate our actions and policies. We have agreed on an *Action plan for Growth and Jobs*. Each of us will play their part.

Fostering Employment and Social Protection

3. We firmly believe that employment must be at the heart of the actions and policies to restore growth and confidence that we undertake under the Framework for strong, sustainable and balanced growth. We are committed to renew our efforts to combat unemployment and promote decent jobs, especially for youth and others who have been most affected by the economic crisis. We therefore decide to set up a G20 Task-Force on Employment, with a focus on youth employment, that will provide input to the G20 Labour and Employment Ministerial Meeting to be held under the Mexican Presidency in 2012. We have tasked International organizations (IMF, OECD, ILO, World Bank) to report to Finance Ministers on a global employment outlook and how our economic reform agenda under the G20 Framework will contribute to job creation.

4. We recognize the importance of investing in nationally determined social protection floors in each of our countries, such as access to health care, income security for the elderly and persons with disabilities, child benefits and income security for the unemployed and assistance for the working poor. They will foster growth resilience, social justice and cohesion. In this respect, we note the report of the Social Protection Floor Advisory Group, chaired by Ms Michelle Bachelet.
5. We commit to promote and ensure full respect of the fundamental principles and rights at work. We welcome and encourage the ILO to continue promoting ratification and implementation of the eight ILO Fundamental Conventions.

6. We are determined to strengthen the social dimension of globalisation. Social and employment issues, alongside economic, monetary and financial issues, will remain an integral part of the G20 agenda. We call on international organisations to intensify their coordination and make it more effective. In view of a greater coherence of multilateral action, we encourage the WTO, the ILO, the OECD, the World Bank and the IMF to enhance their dialogue and cooperation.

7. We are convinced of the essential role of social dialogue. In this regard we welcome the B20 and L20 Meetings that took place under the French presidency and the willingness of these fora to work together as witnessed in their joint statement.

8. Our Labour and Employment Ministers met in Paris on September 26-27, 2011 to tackle these issues. We endorse their conclusions, annexed to this Declaration. We ask our Ministers to meet again next year to review progress made on this agenda.

Building a more stable and resilient International Monetary System

9. In 2010, the G20 committed to working towards a more stable and resilient IMS and to ensure systemic stability in the global economy, improve the global economic adjustment, as well as an appropriate transition towards an IMS which better reflects the increased weight of emerging market economies. In 2011, we are taking concrete steps to achieve these goals.

Increasing the benefits from financial integration and resilience against volatile capital flows to foster growth and development

10. We agreed on coherent conclusions to guide us in the management of capital flows drawing on country experiences, in order to reap the benefits from financial globalization, while preventing and managing risks that could undermine financial stability and sustainable growth at the national and global levels.

11. To pursue these objectives, we adopted an action plan to support the development and deepening of local currency bond markets, scaling up technical assistance from different international institutions, improving the data base and preparing joint annual progress reports to the G20. We call on the World Bank, Regional Development Banks, IMF, UNCTAD, OECD, BIS and FSB to work together to support the delivery of this plan and to report back by the time of our next meeting about progress made.

Reflecting the changing economic equilibrium and the emergence of new international currencies

12. We affirm our commitment to move more rapidly toward more market-determined exchange rate systems and enhance exchange rate flexibility to reflect underlying economic fundamentals, avoid persistent exchange rate misalignments and refrain from competitive devaluation of currencies. We are determined to act on our commitments to exchange rate reform articulated in our Action plan for Growth and Jobs to address short term vulnerabilities, restore financial stability and strengthen the medium-term foundations for

growth. Our actions will help address the challenges created by developments in global liquidity and capital flows volatility, thus facilitating further progress on exchange rate reforms and reducing excessive accumulation of reserves.

13. We agreed that the SDR basket composition should continue to reflect the role of currencies in the global trading and financial system and be adjusted over time to reflect currencies' changing role and characteristics. The SDR composition assessment should be based on existing criteria, and we ask the IMF to further clarify them. A broader SDR basket will be an important determinant of its attractiveness, and in turn influence its role as a global reserve asset. This will serve as a reference for appropriate reforms. We look forward to reviewing the composition of the SDR basket in 2015, and earlier if warranted, as currencies meet the criteria, and call for further analytical work of the IMF in this regard, including on potential evolution. We will continue our work on the role of the SDR.

Strengthening our capacity to cope with crises

14. As a contribution to a more structured approach, we agreed to further strengthen global financial safety nets in which national governments, central banks, regional financial arrangements and international financial institutions will each play a role according to and within their respective mandate. We agreed to continue these efforts to this end. We recognize that central banks play a major role in addressing liquidity shocks at a global and regional level, as shown by the recent improvements in regional swap lines such as in East Asia. We agreed on common principles for cooperation between the IMF and Regional Financial Arrangements, which will strengthen crisis prevention and resolution efforts.

15. As a contribution to this structured approach and building on existing instruments and facilities, we support the IMF in putting forward the new Precautionary and Liquidity Line (PLL). This would enable the provision, on a case by case basis, of increased and more flexible short-term liquidity to countries with strong policies and fundamentals facing exogenous, including systemic, shocks. We also support the IMF in putting forward a single emergency facility to provide non-concessional financing for emergency needs such as natural disasters, emergency situations in fragile and post-conflict states, and also other disruptive events. We call on the IMF to expeditiously discuss and finalize both proposals.

16. We welcome the euro area's comprehensive plan and urge rapid elaboration and implementation, including of country reforms. We welcome the euro area's determination to bring its full resources and entire institutional capacity to bear in restoring confidence and financial stability, and in ensuring the proper functioning of money and financial markets.

    We will ensure the IMF continues to have resources to play its systemic role to the benefit of its whole membership, building on the substantial resources we have already mobilized since London in 2009. We stand ready to ensure additional resources could be mobilised in a timely manner and ask our finance ministers by their next meeting to work on deploying a range of various options including bilateral contributions to the IMF, SDRs, and voluntary contributions to an IMF special structure such as an administered account. We will expeditiously implement in full the 2010 quota and governance reform of the IMF.

Strengthening IMF surveillance

17. We agreed that effective and strengthened IMF surveillance will be crucial to the efficiency and stability of the IMS. In this context, a strengthening of multilateral surveillance and a better integration with bilateral surveillance will be important, as well as enhanced monitoring of interlinkages across sectors, countries and regions. Against this background, we welcome the recent improvements to the IMF surveillance toolkit including the consolidated multilateral surveillance report and spillover reports and ask the IMF to continue to improve upon these exercises and methodology.

18. We call on the IMF to make further progress towards a more integrated, even-handed and effective IMF surveillance, taking into account the Independent Evaluation Office report on surveillance, covering in particular financial sector, fiscal, monetary, exchange rate policies and an enhanced analysis of their impact on external stability. We call on the IMF to regularly monitor cross-border capital flows and their transmission channels and update capital flow management measures applied by countries. We also call on the IMF to continue its work on drivers and metrics of reserve accumulation taking into account country circumstances, and, along with the BIS, their work on global liquidity indicators, with a view to future incorporation in the IMF surveillance and other monitoring processes, on the basis of reliable indicators. We will avoid persistent exchange rate misalignments and we asked the IMF to continue to improve its assessment of exchange rates and to publish its assessments as appropriate.

19. While continuing with our efforts to strengthen surveillance, we recognize the need for better integration of bilateral and multilateral surveillance, and we look forward to IMF proposals for a new integrated decision on surveillance early next year.

20. We agreed on the need to increase the ownership and traction of IMF surveillance, which are key components of its effectiveness. We agreed to ensure greater involvement of Ministers and Governors, by providing greater strategic guidance through the IMFC. To increase the transparency of IMF surveillance, we reaffirm the importance of all IMF members to contribute to improve data availability, support the Managing Director's proposal to publish multilateral assessments of external balances, and we recommend timely publication of surveillance reports. We welcome the publication of Art. IV reports by most members of the G20 and look forward to further progress.

Next steps

21. Building a more stable and resilient IMS is a long-term endeavor. We commit to continue working to ensure systemic stability in the global economy and an appropriate transition towards an IMS which better reflects the increased weight of emerging market economies. In 2012, we will continue to take concrete steps in this direction.

Implementing and deepening Financial sector reforms

22. We are determined to fulfill the commitment we made in Washington in November 2008 to ensure that all financial markets, products and participants are regulated or subject to oversight as appropriate to their circumstances in an internationally consistent and non-discriminatory way.

Meeting our commitments notably on banks, OTC derivatives, compensation practices and credit rating agencies, and intensifying our monitoring to track deficiencies

23. We are committed to improve banks' resilience to financial and economic shocks. Building on progress made to date, we call on jurisdictions to meet their commitment to implement fully and consistently the Basel II risk-based framework as well as the Basel II-5 additional requirements on market activities and securitization by end 2011 and the Basel III capital and liquidity standards, while respecting observation periods and review clauses, starting in 2013 and completing full implementation by 1 January 2019.

24. Reforming the over the counter derivatives markets is crucial to build a more resilient financial system. All standardized over-the-counter derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and centrally cleared, by the end of 2012; OTC derivatives contracts should be reported to trade repositories, and non-centrally cleared contracts should be subject to higher capital requirements. We agree to cooperate further to avoid loopholes and overlapping regulations. A coordination group is being established by the FSB to address some of these issues, complementing the existing OTC derivatives working group. We endorse the FSB progress report on implementation and ask the CPSS and IOSCO to work with FSB to carry forward work on identifying data that could be provided by and to trade repositories, and to define principles or guidance on regulators' and supervisors' access to data held by trade repositories. We call on the Basel Committee on Banking Supervision (BCBS), the International Organization for Securities Commission (IOSCO) together with other relevant organizations to develop for consultation standards on margining for non-centrally cleared OTC derivatives by June 2012, and on the FSB to continue to report on progress towards meeting our commitments on OTC derivatives.

25. We reaffirm our commitment to discourage compensation practices that lead to excessive risk taking by implementing the agreed FSB principles and standards on compensation. While good progress has been made, impediments to full implementation remain in some jurisdictions. We therefore call on the FSB to undertake an ongoing monitoring and public reporting on compensation practices focused on remaining gaps and impediments to full implementation of these standards and carry out an on-going bilateral complaint handling process to address level playing field concerns of individual firms. Based on the findings of this ongoing monitoring, we call on the FSB to consider any additional guidance on the definition of material risk takers and the scope and timing of peer review process.

26. We reaffirm our commitment to reduce authorities' and financial institutions' reliance on external credit ratings, and call on standard setters, market participants, supervisors and

central banks to implement the agreed FSB principles and end practices that rely mechanistically on these ratings. We ask the FSB to report to our Finance Ministers and Central Bank Governors at their February meeting on progress made in this area by standard setters and jurisdictions against these principles.

27. We agree to intensify our monitoring of financial regulatory reforms, report on our progress and track our deficiencies. To do so, we endorse the FSB coordination framework for implementation monitoring, notably on key areas such as the Basel capital and liquidity frameworks, OTC derivatives reforms, compensation practices, G-SIFI policies, resolution frameworks, and shadow banking. This work will build on the monitoring activities conducted by standard setting bodies to the extent possible. We stress the need to report the results of this monitoring to the public including on an annual basis through a traffic lights scoreboard prepared by the FSB. We welcome its first publication today and commit to take all necessary actions to progress in the areas where deficiencies have been identified.

Addressing the too big to fail issue

28. We are determined to make sure that no financial firm is “too big to fail” and that taxpayers should not bear the costs of resolution. To this end, we endorse the FSB comprehensive policy framework, comprising a new international standard for resolution regimes, more intensive and effective supervision, and requirements for cross-border cooperation and recovery and resolution planning as well as, from 2016, additional loss absorbency for those banks determined as global systemically important financial institutions (G-SIFIs). The FSB publishes today an initial list of G-SIFIs, to be updated each year in November. We will implement the FSB standards and recommendations within the agreed timelines and commit to undertake the necessary legislative changes, step up cooperation amongst authorities and strengthen supervisory mandates and powers.

29. We ask the FSB in consultation with the BCBS, to deliver a progress report by the G20 April Finance meeting on the definition of the modalities to extend expeditiously the G SIFI framework to domestic systemically important banks. We also ask the IAIS to continue its work on a common framework for the supervision of internationally active insurance groups, call on CPSS and IOSCO to continue their work on systemically important market infrastructures and the FSB in consultation with IOSCO to prepare methodologies to identify systemically important non-bank financial entities by end-2012.

Filling in the gaps in the regulation and supervision of the financial sector

30. Bank-like activities. The shadow banking system can create opportunities for regulatory arbitrage and cause the build-up of systemic risk outside the scope of the regulated banking sector. To this end, we agree to strengthen the regulation and oversight of the shadow banking system and endorse the FSB initial eleven recommendations with a work-plan to further develop them in the course of 2012, building on a balanced approach between indirect regulation of shadow banking through banks and direct regulation of shadow banking activities, including money markets funds, securitization, securities lending and repo

activities, and other shadow banking entities. We ask Finance Ministers and Central Bank Governors to review the progress made in this area at their April meeting.

31. Markets. We must ensure that markets serve efficient allocation of investments and savings in our economies and do not pose risks to financial stability. To this end, we commit to implement initial recommendations by IOSCO on market integrity and efficiency, including measures to address the risks posed by high frequency trading and dark liquidity, and call for further work by mid-2012. We also call on IOSCO to assess the functioning of credit default swap (CDS) markets and the role of those markets in price formation of underlying assets by our next Summit. We support the creation of a global legal entity identifier (LEI) which uniquely identifies parties to financial transactions. We call on the FSB to take the lead in helping coordinate work among the regulatory community to prepare recommendations for the appropriate governance framework, representing the public interest, for such a global LEI by our next Summit.

32. Commodity markets. We welcome the G20 study group report on commodities and endorse IOSCO's report and its common principles for the regulation and supervision of commodity derivatives markets. We need to ensure enhanced market transparency, both on cash and financial commodity markets, including OTC, and achieve appropriate regulation and supervision of participants in these markets. Market regulators and authorities should be granted effective intervention powers to address disorderly markets and prevent market abuses. In particular, market regulators should have, and use formal position management powers, including the power to set ex-ante position limits, particularly in the delivery month where appropriate, among other powers of intervention. We call on IOSCO to report on the implementation of its recommendations by the end of 2012.

33. Consumer protection. We agree that integration of financial consumer protection policies into regulatory and supervisory frameworks contributes to strengthening financial stability, endorse the FSB report on consumer finance protection and the high level principles on financial consumer protection prepared by the OECD together with the FSB. We will pursue the full application of these principles in our jurisdictions and ask the FSB and OECD along with other relevant bodies, to report on progress on their implementation to the upcoming Summits and develop further guidelines if appropriate.

34. Other regulatory issues. We are developing macro-prudential policy frameworks and tools to limit the build-up of risks in the financial sector, building on the ongoing work of the FSB-BIS-IMF on this subject. We endorse the joint report by FSB, IMF and World Bank on issues of particular interest to emerging market and developing economies and call international bodies to take into account emerging market and developing economies' specific considerations and concerns in designing new international financial standards and policies where appropriate. We reaffirm our objective to achieve a single set of high quality global accounting standards and meet the objectives set at the London summit in April 2009, notably as regards the improvement of standards for the valuation of financial instruments. We call on the IASB and the FASB to complete their convergence project and look forward to a progress report at the Finance Ministers and Central Bank governors meeting in April

2012. We look forward to the completion of proposals to reform the IASB governance framework.

Tackling tax havens and non-cooperative jurisdictions

35. We are committed to protect our public finances and the global financial system from the risks posed by tax havens and non cooperative jurisdictions. The damage caused is particularly important for the least developed countries. Today we reviewed progress made in the three following areas:

    - In the tax area, the Global Forum has now 105 members. More than 700 information exchange agreements have been signed and the Global Forum is leading an extensive peer review process of the legal framework (phase 1) and implementation of standards (phase 2). We ask the Global Forum to complete the first round of phase 1 reviews and substantially advance the phase 2 reviews by the end of next year. We will review progress at our next Summit. Many of the 59 jurisdictions which have been reviewed by the Global Forum are fully or largely compliant or are making progress through the implementation of the 379 relevant recommendations. We urge all the jurisdictions to take the necessary action to tackle the deficiencies identified in the course of their reviews, in particular the 11 jurisdictions whose framework does not allow them at this stage to qualify to phase 2. We underline in particular the importance of comprehensive tax information exchange and encourage competent authorities to continue their work in the Global Forum to assess and better define the means to improve it. We welcome the commitment made by all of us to sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and strongly encourage other jurisdictions to join this Convention. In this context, we will consider exchanging information automatically on a voluntary basis as appropriate and as provided for in the convention;

    - In the prudential area, the FSB has led a process and published a statement to evaluate adherence to internationally agreed information exchange and cooperation standards. Out of 61 jurisdictions selected for their importance on several economic and financial indicators, we note with satisfaction that 41 jurisdictions have already demonstrated sufficiently strong adherence to these standards and that 18 others are committing to join them. We urge the identified non-cooperative jurisdictions to take the actions requested by the FSB;

    - In the anti-money laundering and combating the financing of terrorism area, the FATF has recently published an updated list of jurisdictions with strategic deficiencies. We urge all jurisdictions and in particular those identified as not complying or making sufficient progress to strengthen their AML/CFT systems in cooperation with the FATF.

36. We urge all jurisdictions to adhere to the international standards in the tax, prudential and AML/CFT areas. We stand ready, if needed, to use our existing countermeasures to deal with jurisdictions which fail to meet these standards. The FATF, the Global Forum and other international organizations should work closely together to enhance transparency and facilitate cooperation between tax and law enforcement agencies in the implementation of

these standards. We also call on FATF and OECD to do further work to prevent misuse of corporate vehicles.

Strengthening the FSB capacity resources and governance

37. The FSB has played a key role in promoting development and implementation of regulation of the financial sector.

38. To keep pace with this growing role, we agreed to strengthen FSB's capacity, resources and governance, building on its Chair's proposals. These include:

    - the establishment of the FSB on an enduring organizational footing: we have given the FSB a strong political mandate and need to give it a corresponding institutional standing, with legal personality and greater financial autonomy, while preserving the existing and well-functioning strong links with the BIS;

    - the reconstitution of the steering committee: as we move into a phase of policy development and implementation that in many cases will require significant legislative changes, we agree that the upcoming changes to the FSB steering committee should include the executive branch of governments of the G20 Chair and the larger financial systems as well as the geographic regions and financial centers not currently represented, in a balanced manner consistent with the FSB Charter;

    - the strengthening of its coordination role vis-à-vis other standard setting bodies (SSB) on policy development and implementation monitoring, avoiding any functional overlaps and recognizing the independence of the SSBs.

39. We call for first steps to be implemented by the end of this year and will review the implementation of the reform at our next Summit.

Addressing Food Price Volatility and Increasing Agriculture Production and Productivity

40. Increasing agricultural production and productivity is essential to promote food security and foster sustainable economic growth. A more stable, predictable, distortion free, open and transparent trading system allows more investment in agriculture and has a critical role to play in this regard. Mitigating excessive food and agricultural commodity price volatility is also an important endeavour. These are necessary conditions for stable access to sufficient, safe and nutritious food for everyone. We agreed to mobilize the G20 capacities to address these key challenges, in close cooperation with all relevant international organisations and in consultation with producers, civil society and the private sector.

41. Our Agriculture Ministers met for the first time in Paris on 22-23 June 2011 and adopted the Action Plan on Food Price Volatility and Agriculture. We welcome this Action Plan, annexed to this Declaration.

42. We have decided to act on the five objectives of this Action Plan: (i) improving agricultural production and productivity, (ii) increasing market information and transparency, (iii) reducing the effects of price volatility for the most vulnerable, (iv) strengthening international policy coordination and (v) improving the functioning of agricultural commodity derivatives' markets.

43. We commit to sustainably increase agricultural production and productivity. To feed a world population expected to reach more than 9 billion people by 2050, it is estimated that agricultural production will have to increase by 70% over the same period. We agree to further invest in agriculture, in particular in the poorest countries, and bearing in mind the importance of smallholders, through responsible public and private investment. In this regard, we decide to:

   - Urge multilateral development banks to finalise their joint action plan on water, food and agriculture and provide an update on its implementation by our next Summit;

   - Invest in research and development of agricultural productivity. As a first step, we support the "International Research Initiative for Wheat Improvement" (Wheat Initiative), launched in Paris on September 15, 2011 and we welcome the G20 Seminar on Agricultural Productivity held in Brussels on 13 October 2011 and the first G20 Conference on Agricultural Research for Development, held in Montpellier on 12-13 September 2011, designed to foster innovation-sharing with and among developing countries.

44. We commit to improve market information and transparency in order to make international markets for agricultural commodities more effective. To that end, we launched:

   - The "Agricultural Market Information System" (AMIS) in Rome on September 15, 2011, to improve information on markets. It will enhance the quality, reliability, accuracy, timeliness and comparability of food market outlook information. As a first step, AMIS will focus its work on four major crops: wheat, maize, rice and soybeans. AMIS involves G20 countries and, at this stage, Egypt, Vietnam, Thailand, the Philippines, Nigeria, Ukraine and Kazakhstan. It will be managed by a secretariat located in FAO;
   - The "Global Agricultural Geo-monitoring Initiative" in Geneva on September 22-23, 2011. This initiative will coordinate satellite monitoring observation systems in different regions of the world in order to enhance crop production projections and weather forecasting data.

45. We recognize that appropriately regulated and transparent agricultural financial markets are a key for well-functioning physical markets and risk management. We welcome IOSCO recommendations on commodity derivatives endorsed by our Finance Ministers.

46. We commit to mitigate the adverse effects of excessive price volatility for the most vulnerable through the development of appropriate risk-management instruments. These actions are detailed in the development section of this final Declaration.

47. According to the Action Plan, we agree to remove food export restrictions or extraordinary taxes for food purchased for non-commercial humanitarian purposes by the World Food Program and agree not to impose them in the future. In this regard, we encourage the adoption of a declaration by the WTO for the Ministerial Conference in December 2011.

48. We have launched a “Rapid Response Forum” in Rome on September 16, 2011 to improve the international community’s capacity to coordinate policies and develop common responses in time of market crises.

49. We welcome the production of a report by the international organizations on how water scarcity and related issues could be addressed in the appropriate fora.

50. We commend the joint work undertaken by FAO, OECD, The World Bank Group, IFAD, UNCTAD, WFP, WTO, IMF, IFPRI and the UN HLTF to support our agenda and we request that they continue working closely together.

51. We will keep progress on the implementation of the Action Plan on Food Price Volatility and Agriculture.

Improving the functioning of Energy Markets

52. We stress the importance of well-functioning and transparent physical and financial energy markets, reduced excessive price volatility, improved energy efficiency and better access to clean technologies, to achieve strong growth that is both sustainable and inclusive. We are committed to promote sustainable development and green growth and to continue our efforts to face the challenge of climate change.

53. We commit to more transparent physical and financial energy markets. Commodity derivatives are being addressed as part of our financial regulation reform agenda. We have made progress and reaffirm our commitment to improve the timeliness, completeness and reliability of the JODI-Oil database as soon as possible. We also commit to support the IEF – JODI work in order to improve the reliability of JODI-Oil and look forward to receiving their recommendations. We will regularly review and assess progress made on this front.

54. We welcome the IEF Charter’s commitment to improve dialogue between oil producer and consumer countries, as well as the holding on January 24, 2011 of the Riyadh Symposium on short, medium and long term outlook and forecasts for oil markets. We call for those meetings to be held on an annual basis and for the IEF, the IEA and OPEC to release a joint communiqué and a report highlighting their outcomes.

55. We note the new JODI-Gas database and commit to work on contributing to it on the basis of the same principles as the JODI-Oil database. We also call for annual symposiums and communiqués on short, medium and long term outlook and forecasts for gas and coal. We call for further work on gas and coal market transparency and ask the IEA, IEF and OPEC, to provide recommendations in this field by mid-2012.

56. Recognizing the role of Price Reporting Agencies for the proper functioning of oil markets, we ask IOSCO, in collaboration with the IEF, the IEA and OPEC, to prepare recommendations to improve their functioning and oversight to our Finance Ministers by mid-2012.

57. We reaffirm our commitment to rationalise and phase-out over the medium term inefficient fossil fuel subsidies that encourage wasteful consumption, while providing targeted support for the poorest. We welcome the country progress reports on implementing strategies for rationalizing and phasing out inefficient fossil fuel subsidies, as well as the joint report from the IEA, OPEC, OECD and the World Bank on fossil fuels and other energy support measures. We ask our Finance Ministers and other relevant officials to press ahead with reforms and report back next year.

Protecting Marine Environment

58. We decide to take further action to protect the marine environment, in particular to prevent accidents related to offshore oil and gas exploration and development, as well as marine transportation, and to deal with their consequences. We welcome the establishment of a mechanism to share best practices and information on legal frameworks, experiences in preventing and managing accidents and disasters relating to offshore oil and gas drilling, production and maritime transportation. We ask the Global Marine Environment Protection working group, in cooperation with the OECD, the International Regulators Forum and OPEC, to report next year on progress made and to establish this mechanism in order to disseminate these best practices by mid-2012, at which point it will be reviewed. We also commit to foster dialogue with international organisations and relevant stakeholders.

Fostering Clean energy, Green Growth and Sustainable Development

59. We will promote low-carbon development strategies in order to optimize the potential for green growth and ensure sustainable development in our countries and beyond. We commit to encouraging effective policies that overcome barriers to efficiency, or otherwise spur innovation and deployment of clean and efficient energy technologies. We welcome the UN Secretary General's "Sustainable Energy for All" initiative. We support the development and deployment of clean energy and energy efficiency (C3E) technologies. We welcome the assessment of the countries' current situation regarding the deployment of these technologies as well as the on-going exercise of sharing best practices, as a basis for better policy making.

60. We are committed to the success of the United Nations Conference on Sustainable Development in Rio de Janeiro in 2012. "Rio + 20" will be an opportunity to mobilize the political will needed to reinsert sustainable development at the heart of the international agenda, as a long term solution to growth, job creation, poverty reduction and environment protection. A green and inclusive growth will create a broad spectrum of opportunities in new industries and in areas such as environmental services, renewable energy and new ways to provide basic services to the poor.

Pursuing the Fight against Climate Change

61. We are committed to the success of the upcoming Durban Conference on Climate Change on 28 November - 9 December 2011. We support South Africa as the incoming President of the Conference. We call for the implementation of the Cancun agreements and further progress in all areas of negotiation in Durban.

62. We stand ready to work towards operationalization of the Green Climate Fund as part of a balanced outcome in Durban, building upon the report of the Transitional Committee.

63. Financing the fight against climate change is one of our main priorities. In Copenhagen, developed countries have committed to the goal of mobilizing jointly USD 100 billion per year from all sources by 2020 to assist developing countries to mitigate and adapt to the impact of climate change, in the context of meaningful mitigation actions and transparency. We discussed the World Bank – IMF – OECD – regional development banks report on climate finance and call for continued work taking into account the objectives, provisions and principles of the UNFCCC by international financial institutions and the relevant UN organizations. We ask our Finance Ministers to report to us at our next Summit on progress made on climate finance.

64. We reaffirm that climate finance will come from a wide variety of sources, public and private, bilateral and multilateral, including innovative sources of finance. We recognize the role of public finance and public policy in supporting climate-related investments in developing countries. We underline the role of the private sector in supporting climate-related investments globally, particularly through various market-based mechanisms and also call on the MDBs to develop new and innovative financial instruments to increase their leveraging effect on private flows.

Avoiding protectionism and reinforcing the Multilateral Trading System

65. At this critical time for the global economy, it is important to underscore the merits of the multilateral trading system as a way to avoid protectionism and not turn inward. We reaffirm our standstill commitments until the end of 2013, as agreed in Toronto, commit to roll back any new protectionist measure that may have risen, including new export restrictions and WTO-inconsistent measures to stimulate exports and ask the WTO, OECD and UNCTAD to continue monitoring the situation and to report publicly on a semi-annual basis.

66. We stand by the Doha Development Agenda (DDA) mandate. However, it is clear that we will not complete the DDA if we continue to conduct negotiations as we have in the past. We recognize the progress achieved so far. To contribute to confidence, we need to pursue in 2012 fresh, credible approaches to furthering negotiations, including the issues of concern for Least Developed Countries and, where they can bear fruit, the remaining elements of the DDA mandate. We direct our Ministers to work on such approaches at the upcoming Ministerial meeting in Geneva and also to engage into discussions on challenges and opportunities to the multilateral trading system in a globalised economy and to report back by the Mexico Summit.

67. Furthermore, as a contribution to a more effective, rules-based trading system, we support a strengthening of the WTO, which should play a more active role in improving transparency on trade relations and policies and enhancing the functioning of the dispute settlement mechanism.

68. We look forward to welcoming Russia as a WTO member by the end of the year.

Development: Investing for Global Growth

69. As part of our overall objective for growth and jobs, we commit to maximise growth potential and economic resilience in developing countries, in particular in Low-Income Countries (LICs). Development is a key element of our agenda for global recovery and investment for future growth. It is also critical to creating the jobs needed to improve people's living standards worldwide. Recognizing that development is a concern and duty to all G20 countries, our Ministers met for the first time on Development in Washington on September 23, 2011.

70. We support the report of the Development Working Group, annexed to this Declaration, implementing the G20's Seoul Development Consensus for Shared Growth, and call for prompt implementation of our Multi-Year Action Plan.

71. We take actions to overcome the most critical bottlenecks and constraints hampering growth in developing countries. In this regard, we decided to focus on two priorities, food security and infrastructure, and to address the issue of financing for development.

72. The humanitarian crisis in the Horn of Africa underscores the urgent need to strengthen emergency and long-term responses to food insecurity. In accordance with our Multi-Year "Action Plan on Food Price Volatility and Agriculture", we:

    - welcome the initiative of the Economic Community of Western African States (ECOWAS) to set up a targeted regional emergency humanitarian food reserve system, as a pilot project, and the "ASEAN+3" emergency rice reserve initiative;

    - Urge multilateral development banks to finalise their joint action plan on water, food and agriculture and provide an update on its implementation by our next Summit;

    - Support, for those involved, the implementation of the L'Aquila Food Security Initiative and other initiatives, including the Global Agriculture and Food Security Program;

    - Launch a platform for tropical agriculture to enhance capacity-building and knowledge sharing to improve agricultural production and productivity;

    - Foster smallholder sensitive investments in agriculture and explore opportunities for market inclusion and empowerment of small producers in value chains;

- Support risk-management instruments, such as commodity hedging instruments, weather index insurances and contingent financing tools, to protect the most vulnerable against excessive price volatility, including the expansion of the Agricultural Price Risk-Management Product developed by the World Bank Group (IFC). We ask international organisations to work together to provide expertise and advice to low-income countries on risk-management and we welcome the NEPAD initiative to integrate risk management in agricultural policies in Africa;

- Encourage all countries to support the Principles of Responsible Agricultural Investment (PRAI) to ensure sustained investment in agriculture;

- Confirm our commitment to scaling-up nutrition through a combination of direct nutrition interventions and the incorporation of nutrition in all relevant policies.

73. Investing in infrastructure in developing countries, especially in LICs and, whilst not exclusively, with a special emphasis on sub-Saharan Africa, will unlock new sources of growth, contribute to the achievement of the Millennium Development Goals and sustainable development. We support efforts to improve capacities and facilitate the mobilization of resources for infrastructure projects initiated by public and private sectors.

74. We commissioned a High Level Panel (HLP), chaired by Mr Tidjane Thiam, to identify measures to scale-up and diversify sources of financing for infrastructure and we requested the MDBs to develop a joint action plan to address bottlenecks. We welcome both the HLP's report and the MDB Action Plan. In this regard, we support the following recommendations to :

    - Support the development of local capacities to improve supply and quality of projects and make them bankable and enhance knowledge sharing on skills for employment in low income countries. In this regard, we welcome the High Level Panel fellowship program and MDB's efforts to develop and strengthen regional public-private partnerships practitioner's networks;

    - Increase quality of information available to investors, through the establishment of online regional marketplace platforms to better link project sponsors and financiers, such as the "Sokoni Africa Infrastructure Marketplace", and the extension of the Africa Infrastructure Country Diagnosis, which aim at benchmarking infrastructure data;

    - Prioritize project preparation financing, encouraging the MDBs to dedicate a greater share of their funds to preparation facilities that can operate on a revolving basis and call on MDBs to improve effectiveness of the existing preparation facilities;

    - Contribute to building an enabling environment for private and public infrastructure financing, especially for regional projects. We support increased transparency in the construction sector, the review of the Debt Sustainability Framework taking into account the investment-growth nexus. We call on MDBs to harmonize their procurement rules and practices and we support move towards mutual recognition of procedures and eligibility rules;

- Improve access to funding, notably through the strengthening of local intermediaries and financial markets, more effective use of MDBs capital, including through use of credit enhancement and guarantee instruments.

75. We commissioned the HLP to establish criteria to identify exemplary investment projects in cooperation with multilateral development banks. We highlight the 11 projects mentioned in the HLP report annexed to this Declaration, which have the potential to have a transformational regional impact by leading to increased integration and access to global markets, with due consideration to environmental sustainability. We call on the MDBs, working with countries involved and in accordance with regional priorities (in particular the Program for Infrastructure Development in Africa), to pursue the implementation of such projects that meet the HLP criteria and to prioritize project preparation financing, notably the NEPAD Infrastructure Projects Preparation Facility.

76. We stress the importance of following-up on these concrete actions and invite MDBs to provide regular updates on the progress achieved.

77. Recognizing that economic shocks affect disproportionately the most vulnerable, we commit to ensure a more inclusive and resilient growth. We therefore decide to support the implementation and expansion of nationally-designed social protection floors in developing countries, especially low income countries. We will work to reduce the average cost of transferring remittances from 10% to 5% by 2014, contributing to release an additional 15 billion USD per year for recipient families.

78. Recognizing that 2.5 billion people and millions of Small and Medium Enterprises (SMEs) throughout the world lack access to formal financial services, and the crucial importance for developing countries to overcome this challenge, we launched in Seoul an ambitious Global Partnership for Financial Inclusion (GPFI). We commend the ongoing work by the GPFI to foster the development of SME finance and to include financial inclusion principles in international financial standards. We endorse the five recommendations put forward in its report, annexed to this Declaration, and commit to pursue our efforts under the Mexican Presidency.

79. We welcome the presentation of the report by Mr Bill Gates on financing for development. We recognize the importance of the involvement of all actors, both public and private, and the mobilisation of domestic, external and innovative sources of finance.

80. Consistent with the Multi-Year Action Plan agreed in Seoul, we strongly support developing countries' mobilization of domestic resources and their effective management as the main driver for development. This includes technical assistance and capacity building for designing and efficient managing of tax administrations and revenue systems and greater transparency, particularly in mineral and natural resource investment. We urge multinational enterprises to improve transparency and full compliance with applicable tax laws. We

welcome initiatives to assist developing countries, on a demand-led basis, in the drafting and implementation of their transfer pricing legislation. We encourage all countries to join the Global Forum on Transparency and exchange of information in tax purposes.

81. We stress the pivotal role of ODA. Aid commitments made by developed countries should be met. Emerging G20 countries will engage or continue to extend their level of support to other developing countries. We welcome the emphasis on ensuring that poor countries benefit rapidly from innovation and technological advances, and agree to encourage triangular partnerships to drive priority innovations forward. We commit to raise the quality and efficiency of aid by concentrating on the highest impact interventions and increase the focus on concrete results and overall impact on development.

82. We agree that, over time, new sources of funding need to be found to address development needs. We discussed a set of options for innovative financing highlighted by Mr Bill Gates, such as Advance Market Commitments, Diaspora Bonds, taxation regime for bunker fuels, tobacco taxes, and a range of different financial taxes. Some of us have implemented or are prepared to explore some of these options. We acknowledge the initiatives in some of our countries to tax the financial sector for various purposes, including a financial transaction tax, inter alia to support development.

83. We welcome the upcoming 4^{th} High-Level Forum on aid effectiveness to be held in Busan, Korea (29 November-1st December 2011). The Forum will be an opportunity to establish a more inclusive partnership to address development effectiveness.

84. We look forward to a successful replenishment of the Asian Development Fund and of the International Fund for Agriculture Development.

Intensifying our Fight against Corruption

85. Corruption is a major impediment to economic growth and development. We have made significant progress to implement the G20 Anti-Corruption Action Plan. We endorse our experts' report, annexed to this Declaration, which outlines the major steps taken both by individual countries and the G20 collectively, and sets out further actions required to ensure that G20 countries continue to make positive progress against the Action Plan.

86. In this context:

- We welcome the ratification by India of the United Nations Convention against Corruption (UNCAC). We also welcome the decision made by Russia to join the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. We commit to accelerate the ratification and implementation of UNCAC and to have a more active engagement within the OECD Working Group on Bribery on a voluntary basis. We further commend the member countries which are taking steps in the spirit of the Action Plan;

- We commend the first reviews on the implementation of UNCAC. We commit to lead by example in ensuring the transparency and inclusivity of UNCAC reviews by considering the voluntary options in accordance with the Terms of Reference of the Mechanism, notably with regards to the participation of civil society and transparency;

- We support the work of the Financial Action Task Force (FATF) to continue to identify and engage those jurisdictions with strategic Anti-Money Laundering/Counter-Financing of Terrorism (AML/CFT) deficiencies and update and implement the FATF standards calling for transparency of cross-border wires, beneficial ownership, customer due diligence and enhanced due diligence;

- We agree on a work program which includes a framework for asset recovery, building on the World Bank's Stolen Asset Recovery (StAR) Initiative, whistle-blowers' protection, denial of entry to corrupt officials and public sector transparency, including fair and transparent public procurement, with concrete results by the end of 2012.

87. We welcome initiatives aimed at increasing transparency in the relationship between private sector and government, including voluntary participation in the Extractive Industries Transparency Initiative (EITI). We also acknowledge the steps taken by some of us to request companies in the extractive industry to publish what they pay in countries of operation and to support the Construction Sector Transparency Initiative (CoST).

88. We commend the enhanced engagement of the private sector to fight against corruption. We welcome the commitments by the B20 to build on our Action Plan and urge them to take concrete action.

89. We hold ourselves accountable for our commitments and will review progress at our next Summit.

Governance

90. We welcome the report of UK Prime Minister David Cameron on global governance.

91. As our premier Forum for international economic cooperation, the G20 is unique in bringing together the major economies, advanced and emerging alike, to coordinate their policies and generate the political agreement necessary to tackle the challenges of global economic interdependence. It is a Leader-led and informal group and it should remain so. The G20 is part of the overall framework of international governance.

92. We agree that, in order to strengthen its ability to build and sustain the political consensus needed to respond to challenges, the G20 must remain efficient, transparent and accountable. To achieve this, we decide to:

    - Maintain our focus on the broad global economic challenges;

- Bolster our ability to deliver our agenda and work program effectively. We decide to formalise the Troika, made of past, present and future Presidencies to steer the work of the G20 in consultation with its members. We ask our Sherpas to develop working practices for the G20 under the Mexican Presidency;

- Pursue consistent and effective engagement with non-members, regional and international organisations, including the United Nations, and other actors, and we welcome their contribution to our work as appropriate. We also encourage engagement with civil society. We request our Sherpas to make us proposals for the next meeting.

93. We reaffirm that the G20's founding spirit of bringing together the major economies on an equal footing to catalyse action is fundamental and therefore agree to put our collective political will behind our economic and financial agenda, and the reform and more effective working of relevant international institutions.

94. On December 1st. 2011, Mexico will start chairing the G20. We will convene in Los Cabos, Baja California, in June 2012, under the Chairmanship of Mexico. Russia will chair the G20 in 2013, Australia in 2014 and Turkey in 2015. We have also agreed, as part of our reforms to the G20, that after 2015, annual presidencies of the G20 will be chosen from rotating regional groups, starting with the Asian grouping comprising of China, Indonesia, Japan and Korea. Details of the regional groups are attached.

95. We thank France for its G20 Presidency and for hosting the successful Cannes Summit.

<u>The Global Plan for Recovery and Reform</u>
<u>2 April 2009</u>

1. We, the Leaders of the Group of Twenty, met in London on 2 April 2009.

2. We face the greatest challenge to the world economy in modern times; a crisis which has deepened since we last met, which affects the lives of women, men, and children in every country, and which all countries must join together to resolve. A global crisis requires a global solution.

3. We start from the belief that prosperity is indivisible; that growth, to be sustained, has to be shared; and that our global plan for recovery must have at its heart the needs and jobs of hard-working families, not just in developed countries but in emerging markets and the poorest countries of the world too; and must reflect the interests, not just of today's population, but of future generations too. We believe that the only sure foundation for sustainable globalisation and rising prosperity for all is an open world economy based on market principles, effective regulation, and strong global institutions.

4. We have today therefore pledged to do whatever is necessary to:

   - restore confidence, growth, and jobs;
   - repair the financial system to restore lending;
   - strengthen financial regulation to rebuild trust;
   - fund and reform our international financial institutions to overcome this crisis and prevent future ones;
   - promote global trade and investment and reject protectionism, to underpin prosperity; and
   - build an inclusive, green, and sustainable recovery.

   By acting together to fulfil these pledges we will bring the world economy out of recession and prevent a crisis like this from recurring in the future.

5. The agreements we have reached today, to treble resources available to the IMF to $750 billion, to support a new SDR allocation of $250 billion, to support at least $100 billion of additional lending by the MDBs, to ensure $250 billion of support for trade finance, and to use the additional resources from agreed IMF gold sales for concessional finance for the poorest countries, constitute an additional $1.1 trillion programme of support to restore credit, growth and jobs in the world economy. Together with the measures we have each taken nationally, this constitutes a global plan for recovery on an unprecedented scale.

Restoring growth and jobs

6. We are undertaking an unprecedented and concerted fiscal expansion, which will save or create millions of jobs which would otherwise have been destroyed, and that will, by the end of next year, amount to $5 trillion, raise output by 4 per cent, and accelerate the transition to a green economy. We are committed to deliver the scale of sustained fiscal effort necessary to restore growth.

7. Our central banks have also taken exceptional action. Interest rates have been cut aggressively in most countries, and our central banks have pledged to maintain expansionary policies for as long as needed and to use the full range of monetary policy instruments, including unconventional instruments, consistent with price stability.

8. Our actions to restore growth cannot be effective until we restore domestic lending and international capital flows. We have provided significant and comprehensive support to our banking systems to provide liquidity, recapitalise financial institutions, and address decisively the problem of impaired assets. We are committed to take all necessary actions to restore the normal flow of credit through the financial system and ensure the soundness of systemically important institutions, implementing our policies in line with the agreed G20 framework for restoring lending and repairing the financial sector.

9. Taken together, these actions will constitute the largest fiscal and monetary stimulus and the most comprehensive support programme for the financial sector in modern times. Acting together strengthens the impact and the exceptional policy actions announced so far must be implemented without delay. Today, we have further agreed over $1 trillion of additional resources for the world economy through our international financial institutions and trade finance.

10. Last month the IMF estimated that world growth in real terms would resume and rise to over 2 percent by the end of 2010. We are confident that the actions we have agreed today, and our unshakeable commitment to work together to restore growth and jobs, while preserving long-term fiscal sustainability, will accelerate the return to trend growth. We commit today to taking whatever action is necessary to secure that outcome, and we call on the IMF to assess regularly the actions taken and the global actions required.

11. We are resolved to ensure long-term fiscal sustainability and price stability and will put in place credible exit strategies from the measures that need to be taken now to support the financial sector and restore global demand. We are convinced that by implementing our agreed policies we will limit the longer-term costs to

our economies, thereby reducing the scale of the fiscal consolidation necessary over the longer term.

12. We will conduct all our economic policies cooperatively and responsibly with regard to the impact on other countries and will refrain from competitive devaluation of our currencies and promote a stable and well-functioning international monetary system. We will support, now and in the future, to candid, even-handed, and independent IMF surveillance of our economies and financial sectors, of the impact of our policies on others, and of risks facing the global economy.

Strengthening financial supervision and regulation

13. Major failures in the financial sector and in financial regulation and supervision were fundamental causes of the crisis. Confidence will not be restored until we rebuild trust in our financial system. We will take action to build a stronger, more globally consistent, supervisory and regulatory framework for the future financial sector, which will support sustainable global growth and serve the needs of business and citizens.

14. We each agree to ensure our domestic regulatory systems are strong. But we also agree to establish the much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards, that a global financial system requires. Strengthened regulation and supervision must promote propriety, integrity and transparency; guard against risk across the financial system; dampen rather than amplify the financial and economic cycle; reduce reliance on inappropriately risky sources of financing; and discourage excessive risk-taking. Regulators and supervisors must protect consumers and investors, support market discipline, avoid adverse impacts on other countries, reduce the scope for regulatory arbitrage, support competition and dynamism, and keep pace with innovation in the marketplace.

15. To this end we are implementing the Action Plan agreed at our last meeting, as set out in the attached progress report. We have today also issued a Declaration, *Strengthening the Financial System*. In particular we agree:

    - to establish a new Financial Stability Board (FSB) with a strengthened mandate, as a successor to the Financial Stability Forum (FSF), including all G20 countries, FSF members, Spain, and the European Commission;

    - that the FSB should collaborate with the IMF to provide early warning of macroeconomic and financial risks and the actions needed to address them;

- to reshape our regulatory systems so that our authorities are able to identify and take account of macro-prudential risks;

- to extend regulation and oversight to all systemically important financial institutions, instruments and markets. This will include, for the first time, systemically important hedge funds;

- to endorse and implement the FSF's tough new principles on pay and compensation and to support sustainable compensation schemes and the corporate social responsibility of all firms;

- to take action, once recovery is assured, to improve the quality, quantity, and international consistency of capital in the banking system. In future, regulation must prevent excessive leverage and require buffers of resources to be built up in good times;

- to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of tax information;

- to call on the accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards; and

- to extend regulatory oversight and registration to Credit Rating Agencies to ensure they meet the international code of good practice, particularly to prevent unacceptable conflicts of interest.

16. We instruct our Finance Ministers to complete the implementation of these decisions in line with the timetable set out in the Action Plan. We have asked the FSB and the IMF to monitor progress, working with the Financial Action Taskforce and other relevant bodies, and to provide a report to the next meeting of our Finance Ministers in Scotland in November.

Strengthening our global financial institutions

17. Emerging markets and developing countries, which have been the engine of recent world growth, are also now facing challenges which are adding to the current downturn in the global economy. It is imperative for global confidence and economic recovery that capital continues to flow to them. This will require a substantial strengthening of the international financial institutions, particularly the

IMF. We have therefore agreed today to make available an additional $850 billion of resources through the global financial institutions to support growth in emerging market and developing countries by helping to finance counter-cyclical spending, bank recapitalisation, infrastructure, trade finance, balance of payments support, debt rollover, and social support. To this end:

- we have agreed to increase the resources available to the IMF through immediate financing from members of $250 billion, subsequently incorporated into an expanded and more flexible New Arrangements to Borrow, increased by up to $500 billion, and to consider market borrowing if necessary; and

- we support a substantial increase in lending of at least $100 billion by the Multilateral Development Banks (MDBs), including to low income countries, and ensure that all MDBs have the appropriate capital.

18. It is essential that these resources can be used effectively and flexibly to support growth. We welcome in this respect the progress made by the IMF with its new Flexible Credit Line (FCL) and its reformed lending and conditionality framework which will enable the IMF to ensure that its facilities address effectively the underlying causes of countries' balance of payments financing needs, particularly the withdrawal of external capital flows to the banking and corporate sectors. We support Mexico's decision to seek an FCL arrangement.

19. We have agreed to support a general SDR allocation which will inject $250 billion into the world economy and increase global liquidity, and urgent ratification of the Fourth Amendment.

20. In order for our financial institutions to help manage the crisis and prevent future crises we must strengthen their longer term relevance, effectiveness and legitimacy. So alongside the significant increase in resources agreed today we are determined to reform and modernise the international financial institutions to ensure they can assist members and shareholders effectively in the new challenges they face. We will reform their mandates, scope and governance to reflect changes in the world economy and the new challenges of globalisation, and that emerging and developing economies, including the poorest, must have greater voice and representation. This must be accompanied by action to increase the credibility and accountability of the institutions through better strategic oversight and decision making. To this end:

- we commit to implementing the package of IMF quota and voice reforms agreed in April 2008 and call on the IMF to complete the next review of quotas by January 2011;

- we agree that, alongside this, consideration should be given to greater involvement of the Fund's Governors in providing strategic direction to the IMF and increasing its accountability;

- we commit to implementing the World Bank reforms agreed in October 2008. We look forward to further recommendations, at the next meetings, on voice and representation reforms on an accelerated timescale, to be agreed by the 2010 Spring Meetings;

- we agree that the heads and senior leadership of the international financial institutions should be appointed through an open, transparent, and merit-based selection process; and

- building on the current reviews of the IMF and World Bank we asked the Chairman, working with the G20 Finance Ministers, to consult widely in an inclusive process and report back to the next meeting with proposals for further reforms to improve the responsiveness and adaptability of the IFIs.

21. In addition to reforming our international financial institutions for the new challenges of globalisation we agreed on the desirability of a new global consensus on the key values and principles that will promote sustainable economic activity. We support discussion on such a charter for sustainable economic activity with a view to further discussion at our next meeting. We take note of the work started in other fora in this regard and look forward to further discussion of this charter for sustainable economic activity.

Resisting protectionism and promoting global trade and investment

22. World trade growth has underpinned rising prosperity for half a century. But it is now falling for the first time in 25 years. Falling demand is exacerbated by growing protectionist pressures and a withdrawal of trade credit. Reinvigorating world trade and investment is essential for restoring global growth. We will not repeat the historic mistakes of protectionism of previous eras. To this end:

    - we reaffirm the commitment made in Washington: to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organisation (WTO) inconsistent measures to stimulate exports. In addition we will rectify promptly any such measures. We extend this pledge to the end of 2010;

- we will minimise any negative impact on trade and investment of our domestic policy actions including fiscal policy and action in support of the financial sector. We will not retreat into financial protectionism, particularly measures that constrain worldwide capital flows, especially to developing countries;

- we will notify promptly the WTO of any such measures and we call on the WTO, together with other international bodies, within their respective mandates, to monitor and report publicly on our adherence to these undertakings on a quarterly basis;

- we will take, at the same time, whatever steps we can to promote and facilitate trade and investment; and

- we will ensure availability of at least $250 billion over the next two years to support trade finance through our export credit and investment agencies and through the MDBs. We also ask our regulators to make use of available flexibility in capital requirements for trade finance.

23. We remain committed to reaching an ambitious and balanced conclusion to the Doha Development Round, which is urgently needed. This could boost the global economy by at least $150 billion per annum. To achieve this we are committed to building on the progress already made, including with regard to modalities.

24. We will give renewed focus and political attention to this critical issue in the coming period and will use our continuing work and all international meetings that are relevant to drive progress.

Ensuring a fair and sustainable recovery for all

25. We are determined not only to restore growth but to lay the foundation for a fair and sustainable world economy. We recognise that the current crisis has a disproportionate impact on the vulnerable in the poorest countries and recognise our collective responsibility to mitigate the social impact of the crisis to minimise long-lasting damage to global potential. To this end:

    - we reaffirm our historic commitment to meeting the Millennium Development Goals and to achieving our respective ODA pledges, including commitments on Aid for Trade, debt relief, and the Gleneagles commitments, especially to sub-Saharan Africa;

    - the actions and decisions we have taken today will provide $50 billion to support social protection, boost trade and safeguard development in low income countries, as part of the significant increase in crisis support for these and other developing countries and emerging markets;

- we are making available resources for social protection for the poorest countries, including through investing in long-term food security and through voluntary bilateral contributions to the World Bank's Vulnerability Framework, including the Infrastructure Crisis Facility, and the Rapid Social Response Fund;

- we have committed, consistent with the new income model, that additional resources from agreed sales of IMF gold will be used, together with surplus income, to provide $6 billion additional concessional and flexible finance for the poorest countries over the next 2 to 3 years. We call on the IMF to come forward with concrete proposals at the Spring Meetings;

- we have agreed to review the flexibility of the Debt Sustainability Framework and call on the IMF and World Bank to report to the IMFC and Development Committee at the Annual Meetings; and

- we call on the UN, working with other global institutions, to establish an effective mechanism to monitor the impact of the crisis on the poorest and most vulnerable.

26. We recognise the human dimension to the crisis. We commit to support those affected by the crisis by creating employment opportunities and through income support measures. We will build a fair and family-friendly labour market for both women and men. We therefore welcome the reports of the London Jobs Conference and the Rome Social Summit and the key principles they proposed. We will support employment by stimulating growth, investing in education and training, and through active labour market policies, focusing on the most vulnerable. We call upon the ILO, working with other relevant organisations, to assess the actions taken and those required for the future.

27. We agreed to make the best possible use of investment funded by fiscal stimulus programmes towards the goal of building a resilient, sustainable, and green recovery. We will make the transition towards clean, innovative, resource efficient, low carbon technologies and infrastructure. We encourage the MDBs to contribute fully to the achievement of this objective. We will identify and work together on further measures to build sustainable economies.

28. We reaffirm our commitment to address the threat of irreversible climate change, based on the principle of common but differentiated responsibilities, and to reach

agreement at the UN Climate Change conference in Copenhagen in December 2009.

Delivering our commitments

29. We have committed ourselves to work together with urgency and determination to translate these words into action. We agreed to meet again before the end of this year to review progress on our commitments.

LEADERS' STATEMENT
THE PITTSBURGH SUMMIT
SEPTEMBER 24 – 25 2009

PREAMBLE

1. We meet in the midst of a critical transition from crisis to recovery to turn the page on an era of irresponsibility and to adopt a set of policies, regulations and reforms to meet the needs of the 21st century global economy.

2. When we last gathered in April, we confronted the greatest challenge to the world economy in our generation.

3. Global output was contracting at pace not seen since the 1930s. Trade was plummeting. Jobs were disappearing rapidly. Our people worried that the world was on the edge of a depression.

4. At that time, our countries agreed to do everything necessary to ensure recovery, to repair our financial systems and to maintain the global flow of capital.

5. It worked.

6. Our forceful response helped stop the dangerous, sharp decline in global activity and stabilize financial markets. Industrial output is now rising in nearly all our economies. International trade is starting to recover. Our financial institutions are raising needed capital, financial markets are showing a willingness to invest and lend, and confidence has improved.

7. Today, we reviewed the progress we have made since the London Summit in April. Our national commitments to restore growth resulted in the largest and most coordinated fiscal and monetary stimulus ever undertaken. We acted together to increase dramatically the resources necessary to stop the crisis from spreading around the world. We took steps to fix the broken regulatory system and started to implement sweeping reforms to reduce the risk that financial excesses will again destabilize the global economy.

8. A sense of normalcy should not lead to complacency.

9. The process of recovery and repair remains incomplete. In many countries, unemployment remains unacceptably high. The conditions for a recovery of private demand are not yet fully in place. We cannot rest until the global economy is restored to full health, and hard-working families the world over can find decent jobs.

10. We pledge today to sustain our strong policy response until a durable recovery is secured. We will act to ensure that when growth returns, jobs do too. We will avoid

any premature withdrawal of stimulus. At the same time, we will prepare our exit strategies and, when the time is right, withdraw our extraordinary policy support in a cooperative and coordinated way, maintaining our commitment to fiscal responsibility.

11. Even as the work of recovery continues, we pledge to adopt the policies needed to lay the foundation for strong, sustained and balanced growth in the 21^{st} century. We recognize that we have to act forcefully to overcome the legacy of the recent, severe global economic crisis and to help people cope with the consequences of this crisis. We want growth without cycles of boom and bust and markets that foster responsibility not recklessness.

12. Today we agreed:

13. *To launch a framework that lays out the policies and the way we act together to generate strong, sustainable and balanced global growth*. We need a durable recovery that creates the good jobs our people need.

14. We need to shift from public to private sources of demand, establish a pattern of growth across countries that is more sustainable and balanced, and reduce development imbalances. We pledge to avoid destabilizing booms and busts in asset and credit prices and adopt macroeconomic policies, consistent with price stability, that promote adequate and balanced global demand. We will also make decisive progress on structural reforms that foster private demand and strengthen long-run growth potential.

15. Our Framework for Strong, Sustainable and Balanced Growth is a compact that commits us to work together to assess how our policies fit together, to evaluate whether they are collectively consistent with more sustainable and balanced growth, and to act as necessary to meet our common objectives.

16. *To make sure our regulatory system for banks and other financial firms reins in the excesses that led to the crisis*. Where reckless behavior and a lack of responsibility led to crisis, we will not allow a return to banking as usual.

17. We committed to act together to raise capital standards, to implement strong international compensation standards aimed at ending practices that lead to excessive risk-taking, to improve the over-the-counter derivatives market and to create more powerful tools to hold large global firms to account for the risks they take. Standards for large global financial firms should be commensurate with the cost of their failure. For all these reforms, we have set for ourselves strict and precise timetables.

18. *To reform the global architecture to meet the needs of the 21^{st} century*. After this crisis, critical players need to be at the table and fully vested in our institutions to

allow us to cooperate to lay the foundation for strong, sustainable and balanced growth.

19. We designated the G-20 to be the premier forum for our international economic cooperation. We established the Financial Stability Board (FSB) to include major emerging economies and welcome its efforts to coordinate and monitor progress in strengthening financial regulation.

20. We are committed to a shift in International Monetary Fund (IMF) quota share to dynamic emerging markets and developing countries of at least 5% from over-represented countries to under-represented countries using the current quota formula as the basis to work from. Today we have delivered on our promise to contribute over $500 billion to a renewed and expanded IMF New Arrangements to Borrow (NAB).

21. We stressed the importance of adopting a dynamic formula at the World Bank which primarily reflects countries' evolving economic weight and the World Bank's development mission, and that generates an increase of at least 3% of voting power for developing and transition countries, to the benefit of under-represented countries. While recognizing that over-represented countries will make a contribution, it will be important to protect the voting power of the smallest poor countries. We called on the World Bank to play a leading role in responding to problems whose nature requires globally coordinated action, such as climate change and food security, and agreed that the World Bank and the regional development banks should have sufficient resources to address these challenges and fulfill their mandates.

22. *To take new steps to increase access to food, fuel and finance among the world's poorest while clamping down on illicit outflows*. Steps to reduce the development gap can be a potent driver of global growth.

23. Over four billion people remain undereducated, ill-equipped with capital and technology, and insufficiently integrated into the global economy. We need to work together to make the policy and institutional changes needed to accelerate the convergence of living standards and productivity in developing and emerging economies to the levels of the advanced economies. To start, we call on the World Bank to develop a new trust fund to support the new Food Security Initiative for low-income countries announced last summer. We will increase, on a voluntary basis, funding for programs to bring clean affordable energy to the poorest, such as the Scaling Up Renewable Energy Program.

24. *To phase out and rationalize over the medium term inefficient fossil fuel subsidies while providing targeted support for the poorest*. Inefficient fossil fuel subsidies encourage wasteful consumption, reduce our energy security, impede investment in clean energy sources and undermine efforts to deal with the threat of climate change.

25. We call on our Energy and Finance Ministers to report to us their implementation strategies and timeline for acting to meet this critical commitment at our next meeting.

26. We will promote energy market transparency and market stability as part of our broader effort to avoid excessive volatility.

27. *To maintain our openness and move toward greener, more sustainable growth*.

28. We will fight protectionism. We are committed to bringing the Doha Round to a successful conclusion in 2010.

29. We will spare no effort to reach agreement in Copenhagen through the United Nations Framework Convention on Climate Change (UNFCCC) negotiations.

30. We warmly welcome the report by the Chair of the London Summit commissioned at our last meeting and published today.

31. Finally, we agreed to meet in Canada in June 2010 and in Korea in November 2010. We expect to meet annually thereafter and will meet in France in 2011.

* * *

1. We assessed the progress we have made together in addressing the global crisis and agreed to maintain our steps to support economic activity until recovery is assured. We further committed to additional steps to ensure strong, sustainable, and balanced growth, to build a stronger international financial system, to reduce development imbalances, and to modernize our architecture for international economic cooperation.

A Framework for Strong, Sustainable, and Balanced Growth

2. The growth of the global economy and the success of our coordinated effort to respond to the recent crisis have increased the case for more sustained and systematic international cooperation. In the short-run, we must continue to implement our stimulus programs to support economic activity until recovery clearly has taken hold. We also need to develop a transparent and credible process for withdrawing our extraordinary fiscal, monetary and financial sector support, to be implemented when recovery becomes fully secured. We task our Finance Ministers, working with input from the IMF and FSB, at their November meeting to continue developing cooperative and coordinated exit strategies recognizing that the scale, timing, and sequencing of this process will vary across countries or regions and across the type of policy measures. Credible exit strategies should be designed and communicated clearly to anchor expectations and reinforce confidence.

3. The IMF estimates that world growth will resume this year and rise by nearly 3% by the end of 2010. Subsequently, our objective is to return the world to high, sustainable, and balanced growth, while maintaining our commitment to fiscal responsibility and sustainability, with reforms to increase our growth potential and capacity to generate jobs and policies designed to avoid both the re-creation of asset bubbles and the re-emergence of unsustainable global financial flows. We commit to put in place the necessary policy measures to achieve these outcomes.

4. We will need to work together as we manage the transition to a more balanced pattern of global growth. The crisis and our initial policy responses have already produced significant shifts in the pattern and level of growth across countries. Many countries have already taken important steps to expand domestic demand, bolstering global activity and reducing imbalances. In some countries, the rise in private saving now underway will, in time, need to be augmented by a rise in public saving. Ensuring a strong recovery will necessitate adjustments across different parts of the global economy, while requiring macroeconomic policies that promote adequate and balanced global demand as well as decisive progress on structural reforms that foster private domestic demand, narrow the global development gap, and strengthen long-run growth potential. The IMF estimates that only with such adjustments and realignments, will global growth reach a strong, sustainable, and balanced pattern. While governments have started moving in the right direction, a shared understanding and deepened dialogue will help build a more stable, lasting, and sustainable pattern of growth. Raising living standards in the emerging markets and developing

countries is also a critical element in achieving sustainable growth in the global economy.

5. Today we are launching a Framework for Strong, Sustainable, and Balanced Growth. To put in place this framework, we commit to develop a process whereby we set out our objectives, put forward policies to achieve these objectives, and together assess our progress. We will ask the IMF to help us with its analysis of how our respective national or regional policy frameworks fit together. We will ask the World Bank to advise us on progress in promoting development and poverty reduction as part of the rebalancing of global growth. We will work together to ensure that our fiscal, monetary, trade, and structural policies are collectively consistent with more sustainable and balanced trajectories of growth. We will undertake macro prudential and regulatory policies to help prevent credit and asset price cycles from becoming forces of destabilization. As we commit to implement a new, sustainable growth model, we should encourage work on measurement methods so as to better take into account the social and environmental dimensions of economic development.

6. We call on our Finance Ministers and Central Bank Governors to launch the new Framework by November by initiating a cooperative process of mutual assessment of our policy frameworks and the implications of those frameworks for the pattern and sustainability of global growth. We believe that regular consultations, strengthened cooperation on macroeconomic policies, the exchange of experiences on structural policies, and ongoing assessment will promote the adoption of sound policies and secure a healthy global economy. Our compact is that:

    - G-20 members will agree on shared policy objectives. These objectives should be updated as conditions evolve.
    - G-20 members will set out our medium-term policy frameworks and will work together to assess the collective implications of our national policy frameworks for the level and pattern of global growth and to identify potential risks to financial stability.
    - G-20 Leaders will consider, based on the results of the mutual assessment, and agree any actions to meet our common objectives.

7. This process will only be successful if it is supported by candid, even-handed, and balanced analysis of our policies. We ask the IMF to assist our Finance Ministers and Central Bank Governors in this process of mutual assessment by developing a forward-looking analysis of whether policies pursued by individual G-20 countries are collectively consistent with more sustainable and balanced trajectories for the global economy, and to report regularly to both the G-20 and the International Monetary and Financial Committee (IMFC), building on the IMF's existing bilateral and multilateral surveillance analysis, on global economic developments, patterns of growth and suggested policy adjustments. Our Finance Ministers and Central Bank Governors will elaborate this process at their November meeting and we will review the results of the first mutual assessment at our next summit.

8. These policies will help us to meet our responsibility to the community of nations to build a more resilient international financial system and to reduce development imbalances.

9. Building on Chancellor Merkel's proposed Charter, on which we will continue to work, we adopted today Core Values for Sustainable Economic Activity, which will include those of propriety, integrity, and transparency, and which will underpin the Framework.

Strengthening the International Financial Regulatory System

10. Major failures of regulation and supervision, plus reckless and irresponsible risk taking by banks and other financial institutions, created dangerous financial fragilities that contributed significantly to the current crisis. A return to the excessive risk taking prevalent in some countries before the crisis is not an option.

11. Since the onset of the global crisis, we have developed and begun implementing sweeping reforms to tackle the root causes of the crisis and transform the system for global financial regulation. Substantial progress has been made in strengthening prudential oversight, improving risk management, strengthening transparency, promoting market integrity, establishing supervisory colleges, and reinforcing international cooperation. We have enhanced and expanded the scope of regulation and oversight, with tougher regulation of over-the-counter (OTC) derivatives, securitization markets, credit rating agencies, and hedge funds. We endorse the institutional strengthening of the FSB through its Charter, following its establishment in London, and welcome its reports to Leaders and Ministers. The FSB's ongoing efforts to monitor progress will be essential to the full and consistent implementation of needed reforms. We call on the FSB to report on progress to the G-20 Finance Ministers and Central Bank Governors in advance of the next Leaders summit.

12. Yet our work is not done. Far more needs to be done to protect consumers, depositors, and investors against abusive market practices, promote high quality standards, and help ensure the world does not face a crisis of the scope we have seen. We are committed to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage. Our efforts to deal with impaired assets and to encourage the raising of additional capital must continue, where needed. We commit to conduct robust, transparent stress tests as needed. We call on banks to retain a greater proportion of current profits to build capital, where needed, to support lending. Securitization sponsors or originators should retain a part of the risk of the underlying assets, thus encouraging them to act prudently. It is important to ensure an adequate balance between macroprudential and microprudential regulation to control risks, and to develop the tools necessary to monitor and assess the buildup of macroprudential risks in the financial system. In addition, we have agreed to improve

the regulation, functioning, and transparency of financial and commodity markets to address excessive commodity price volatility.

13. As we encourage the resumption of lending to households and businesses, we must take care not to spur a return of the practices that led to the crisis. The steps we are taking here, when fully implemented, will result in a fundamentally stronger financial system than existed prior to the crisis. If we all act together, financial institutions will have stricter rules for risk-taking, governance that aligns compensation with long-term performance, and greater transparency in their operations. All firms whose failure could pose a risk to financial stability must be subject to consistent, consolidated supervision and regulation with high standards. Our reform is multi-faceted but at its core must be stronger capital standards, complemented by clear incentives to mitigate excessive risk-taking practices. Capital allows banks to withstand those losses that inevitably will come. It, together with more powerful tools for governments to wind down firms that fail, helps us hold firms accountable for the risks that they take. Building on their Declaration on Further Steps to Strengthen the International Financial System, we call on our Finance Ministers and Central Bank Governors to reach agreement on an international framework of reform in the following critical areas:

    - *Building high quality capital and mitigating pro-cyclicality:* We commit to developing by end-2010 internationally agreed rules to improve both the quantity and quality of bank capital and to discourage excessive leverage. These rules will be phased in as financial conditions improve and economic recovery is assured, with the aim of implementation by end-2012. The national implementation of higher level and better quality capital requirements, counter-cyclical capital buffers, higher capital requirements for risky products and off-balance sheet activities, as elements of the Basel II Capital Framework, together with strengthened liquidity risk requirements and forward-looking provisioning, will reduce incentives for banks to take excessive risks and create a financial system better prepared to withstand adverse shocks. We welcome the key measures recently agreed by the oversight body of the Basel Committee to strengthen the supervision and regulation of the banking sector. We support the introduction of a leverage ratio as a supplementary measure to the Basel II risk-based framework with a view to migrating to a Pillar 1 treatment based on appropriate review and calibration. To ensure comparability, the details of the leverage ratio will be harmonized internationally, fully adjusting for differences in accounting. All major G-20 financial centers commit to have adopted the Basel II Capital Framework by 2011.

    - *Reforming compensation practices to support financial stability:* Excessive compensation in the financial sector has both reflected and encouraged excessive risk taking. Reforming compensation policies and practices is an essential part of our effort to increase financial stability. We fully endorse the implementation standards of the FSB aimed at aligning compensation with long-term value creation, not excessive risk-taking, including by (i) avoiding multi-year guaranteed bonuses; (ii) requiring a significant portion of variable compensation to be deferred, tied to performance and subject to appropriate clawback and to be vested in the form of stock or stock-like instruments, as long as these create incentives aligned with long-term value creation and the time horizon of risk; (iii) ensuring that compensation for senior executives and other employees having a material impact on the firm's risk exposure align with performance and risk; (iv) making firms' compensation policies and structures transparent through disclosure requirements; (v) limiting variable compensation as a percentage of total net revenues when it is inconsistent with the maintenance of a sound capital base; and (vi) ensuring that compensation committees overseeing compensation policies are able to act independently. Supervisors should have the responsibility to review firms' compensation policies and structures with institutional and systemic risk in mind and, if necessary to offset additional risks, apply corrective measures, such as higher capital requirements, to those firms that fail to implement sound compensation policies and practices. Supervisors should have the ability to modify compensation structures in the case of firms that fail or require extraordinary public intervention. We call on firms to implement these sound compensation practices immediately. We task the FSB to monitor the implementation of FSB standards and propose additional measures as required by March 2010.

- *Improving over-the-counter derivatives markets:* All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.

- *Addressing cross-border resolutions and systemically important financial institutions by end-2010:* Systemically important financial firms should develop internationally-consistent firm-specific contingency and resolution plans. Our authorities should establish crisis management groups for the major cross-border firms and a legal framework for crisis intervention as well as improve information sharing in times of stress. We should develop resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce moral hazard in the future. Our prudential standards for systemically important institutions should be commensurate with the costs of their failure. The FSB should propose by the end of October 2010 possible measures including more intensive supervision and specific additional capital, liquidity, and other prudential requirements.

14. We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June

2011. The International Accounting Standards Board's (IASB) institutional framework should further enhance the involvement of various stakeholders.

15. Our commitment to fight non-cooperative jurisdictions (NCJs) has produced impressive results. We are committed to maintain the momentum in dealing with tax havens, money laundering, proceeds of corruption, terrorist financing, and prudential standards. We welcome the expansion of the Global Forum on Transparency and Exchange of Information, including the participation of developing countries, and welcome the agreement to deliver an effective program of peer review. The main focus of the Forum's work will be to improve tax transparency and exchange of information so that countries can fully enforce their tax laws to protect their tax base. We stand ready to use countermeasures against tax havens from March 2010. We welcome the progress made by the Financial Action Task Force (FATF) in the fight against money laundering and terrorist financing and call upon the FATF to issue a public list of high risk jurisdictions by February 2010. We call on the FSB to report progress to address NCJs with regards to international cooperation and information exchange in November 2009 and to initiate a peer review process by February 2010.

16. We task the IMF to prepare a report for our next meeting with regard to the range of options countries have adopted or are considering as to how the financial sector could make a fair and substantial contribution toward paying for any burdens associated with government interventions to repair the banking system.

Modernizing our Global Institutions to Reflect Today's Global Economy

17. Modernizing the international financial institutions and global development architecture is essential to our efforts to promote global financial stability, foster sustainable development, and lift the lives of the poorest. We warmly welcome Prime Minister Brown's report on his review of the responsiveness and adaptability of the international financial institutions (IFIs) and ask our Finance Ministers to consider its conclusions.

Reforming the Mandate, Mission and Governance of the IMF

18. Our commitment to increase the funds available to the IMF allowed it to stem the spread of the crisis to emerging markets and developing countries. This commitment and the innovative steps the IMF has taken to create the facilities needed for its resources to be used efficiently and flexibly have reduced global risks. Capital again is flowing to emerging economies.

19. We have delivered on our promise to treble the resources available to the IMF. We are contributing over $500 billion to a renewed and expanded IMF New Arrangements to Borrow (NAB). The IMF has made Special Drawing Rights (SDR) allocations of $283 billion in total, more than $100 billion of which will supplement emerging market and developing countries' existing reserve assets. Resources from the agreed sale of IMF gold, consistent with the IMF's new income model, and funds

from internal and other sources will more than double the Fund's medium-term concessional lending capacity.

20. Our collective response to the crisis has highlighted both the benefits of international cooperation and the need for a more legitimate and effective IMF. The Fund must play a critical role in promoting global financial stability and rebalancing growth. We welcome the reform of IMF's lending facilities, including the creation of the innovative Flexible Credit Line. The IMF should continue to strengthen its capacity to help its members cope with financial volatility, reducing the economic disruption from sudden swings in capital flows and the perceived need for excessive reserve accumulation. As recovery takes hold, we will work together to strengthen the Fund's ability to provide even-handed, candid and independent surveillance of the risks facing the global economy and the international financial system. We ask the IMF to support our effort under the Framework for Strong, Sustainable and Balanced Growth through its surveillance of our countries' policy frameworks and their collective implications for financial stability and the level and pattern of global growth.

21. Modernizing the IMF's governance is a core element of our effort to improve the IMF's credibility, legitimacy, and effectiveness. We recognize that the IMF should remain a quota-based organization and that the distribution of quotas should reflect the relative weights of its members in the world economy, which have changed substantially in view of the strong growth in dynamic emerging market and developing countries. To this end, we are committed to a shift in quota share to dynamic emerging market and developing countries of at least five percent from over-represented to under-represented countries using the current IMF quota formula as the basis to work from. We are also committed to protecting the voting share of the poorest in the IMF. On this basis and as part of the IMF's quota review, to be completed by January 2011, we urge an acceleration of work toward bringing the review to a successful conclusion. As part of that review, we agree that a number of other critical issues will need to be addressed, including: the size of any increase in IMF quotas, which will have a bearing on the ability to facilitate change in quota shares; the size and composition of the Executive Board; ways of enhancing the Board's effectiveness; and the Fund Governors' involvement in the strategic oversight of the IMF. Staff diversity should be enhanced. As part of a comprehensive reform package, we agree that the heads and senior leadership of all international institutions should be appointed through an open, transparent and merit-based process. We must urgently implement the package of IMF quota and voice reforms agreed in April 2008.

Reforming the Mission, Mandate and Governance of Our Development banks

22. The Multilateral Development Banks (MDBs) responded to our April call to accelerate and expand lending to mitigate the impact of the crisis on the world's poorest with streamlined facilities, new tools and facilities, and a rapid increase in their lending. They are on track to deliver the promised $100 billion in additional

lending. We welcome and encourage the MDBs to continue making full use of their balance sheets. We also welcome additional measures such as the temporary use of callable capital contributions from a select group of donors as was done at the InterAmerican Development Bank (IaDB). Our Finance Ministers should consider how mechanisms such as temporary callable and contingent capital could be used in the future to increase MDB lending at times of crisis. We reaffirm our commitment to ensure that the Multilateral Development Banks and their concessional lending facilities, especially the International Development Agency (IDA) and the African Development Fund, are appropriately funded.

23. Even as we work to mitigate the impact of the crisis, we must strengthen and reform the global development architecture for responding to the world's long-term challenges.

24. We agree that development and reducing global poverty are central to the development banks' core mission. The World Bank and other multilateral development banks are also critical to our ability to act together to address challenges, such as climate change and food security, which are global in nature and require globally coordinated action. The World Bank, working with the regional development banks and other international organizations, should strengthen:

- its focus on food security through enhancements in agricultural productivity and access to technology, and improving access to food, in close cooperation with relevant specialized agencies;
- its focus on human development and security in the poorest and most challenging environments;
- support for private-sector led growth and infrastructure to enhance opportunities for the poorest, social and economic inclusion, and economic growth; and
- contributions to financing the transition to a green economy through investment in sustainable clean energy generation and use, energy efficiency and climate resilience; this includes responding to countries needs to integrate climate change concerns into their core development strategies, improved domestic policies, and to access new sources of climate finance.

25. To enhance their effectiveness, the World Bank and the regional development banks should strengthen their coordination, when appropriate, with other bilateral and multilateral institutions. They should also strengthen recipient country ownership of strategies and programs and allow adequate policy space.

26. We will help ensure the World Bank and the regional development banks have sufficient resources to fulfill these four challenges and their development mandate, including through a review of their general capital increase needs to be completed by the first half of 2010. Additional resources must be joined to key institutional reforms to ensure effectiveness: greater coordination and a clearer division of labor; an increased commitment to transparency, accountability, and good corporate

governance; an increased capacity to innovate and achieve demonstrable results; and greater attention to the needs of the poorest populations.

27. We commit to pursue governance and operational effectiveness reform in conjunction with voting reform to ensure that the World Bank is relevant, effective, and legitimate. We stress the importance of moving towards equitable voting power in the World Bank over time through the adoption of a dynamic formula which primarily reflects countries' evolving economic weight and the World Bank's development mission, and that generates in the next shareholding review a significant increase of at least 3% of voting power for developing and transition countries, in addition to the 1.46% increase under the first phase of this important adjustment, to the benefit of under-represented countries. While recognizing that over-represented countries will make a contribution, it will be important to protect the voting power of the smallest poor countries. We recommit to reaching agreement by the 2010 Spring Meetings.

Energy Security and Climate Change

28. Access to diverse, reliable, affordable and clean energy is critical for sustainable growth. Inefficient markets and excessive volatility negatively affect both producers and consumers. Noting the St. Petersburg Principles on Global Energy Security, which recognize the shared interest of energy producing, consuming and transiting countries in promoting global energy security, we individually and collectively commit to:

    - Increase energy market transparency and market stability by publishing complete, accurate, and timely data on oil production, consumption, refining and stock levels, as appropriate, on a regular basis, ideally monthly, beginning by January 2010. We note the Joint Oil Data Initiative as managed by the International Energy Forum (IEF) and welcome their efforts to examine the expansion of their data collection to natural gas. We will improve our domestic capabilities to collect energy data and improve energy demand and supply forecasting and ask the International Energy Agency (IEA) and the Organization of Petroleum Exporting Countries (OPEC) to ramp up their efforts to assist interested countries in developing those capabilities. We will strengthen the producer-consumer dialogue to improve our understanding of market fundamentals, including supply and demand trends, and price volatility, and note the work of the IEF experts group.

    - Improve regulatory oversight of energy markets by implementing the International Organization of Securities Commissions (IOSCO) recommendations on commodity futures markets and calling on relevant regulators to collect data on large concentrations of trader positions on oil in our national commodities futures markets. We ask our relevant regulators to report back at our next meeting on progress towards implementation. We will direct relevant regulators to also collect related data on over-the-counter oil markets and to take steps to combat market manipulation leading to excessive price volatility. We call for further refinement and improvement of commodity market information, including through the publication of more detailed and disaggregated data, coordinated as far as possible internationally. We ask IOSCO to help national governments design and implement these policies, conduct further analysis including with regard with to excessive volatility, make specific recommendations, and to report regularly on our progress.

29. Enhancing our energy efficiency can play an important, positive role in promoting energy security and fighting climate change. Inefficient fossil fuel subsidies encourage wasteful consumption, distort markets, impede investment in clean energy sources and undermine efforts to deal with climate change. The Organization for Economic Cooperation and Development (OECD) and the IEA have found that eliminating fossil fuel subsidies by 2020 would reduce global greenhouse gas emissions in 2050 by ten percent. Many countries are reducing fossil fuel subsidies while preventing adverse impact on the poorest. Building on these efforts and recognizing the challenges of populations suffering from energy poverty, we commit to:

- Rationalize and phase out over the medium term inefficient fossil fuel subsidies that encourage wasteful consumption. As we do that, we recognize the importance of providing those in need with essential energy services, including through the use of targeted cash transfers and other appropriate mechanisms. This reform will not apply to our support for clean energy, renewables, and technologies that dramatically reduce greenhouse gas emissions. We will have our Energy and Finance Ministers, based on their national circumstances, develop implementation strategies and timeframes, and report back to Leaders at the next Summit. We ask the international financial institutions to offer support to countries in this process. We call on all nations to adopt policies that will phase out such subsidies worldwide.

30. We request relevant institutions, such as the IEA, OPEC, OECD, and World Bank, provide an analysis of the scope of energy subsidies and suggestions for the implementation of this initiative and report back at the next summit.

31. Increasing clean and renewable energy supplies, improving energy efficiency, and promoting conservation are critical steps to protect our environment, promote sustainable growth and address the threat of climate change. Accelerated adoption of economically sound clean and renewable energy technology and energy efficiency measures diversifies our energy supplies and strengthens our energy security. We commit to:

- Stimulate investment in clean energy, renewables, and energy efficiency and provide financial and technical support for such projects in developing countries.

- Take steps to facilitate the diffusion or transfer of clean energy technology including by conducting joint research and building capacity. The reduction or elimination of barriers to trade and investment in this area are being discussed and should be pursued on a voluntary basis and in appropriate fora.

32. As leaders of the world's major economies, we are working for a resilient, sustainable, and green recovery. We underscore anew our resolve to take strong action to address the threat of dangerous climate change. We reaffirm the objective, provisions, and principles of the United Nations Framework Convention on Climate Change (UNFCCC), including common but differentiated responsibilities. We note the principles endorsed by Leaders at the Major Economies Forum in L'Aquila, Italy. We will intensify our efforts, in cooperation with other parties, to reach agreement in Copenhagen through the UNFCCC negotiation. An agreement must include mitigation, adaptation, technology, and financing.

33. We welcome the work of the Finance Ministers and direct them to report back at their next meeting with a range of possible options for climate change financing to be provided as a resource to be considered in the UNFCCC negotiations at Copenhagen.

Strengthening Support for the Most Vulnerable

34. Many emerging and developing economies have made great strides in raising living standards as their economies converge toward the productivity levels and living standards of advanced economies. This process was interrupted by the crisis and is still far from complete. The poorest countries have little economic cushion to protect vulnerable populations from calamity, particularly as the financial crisis followed close on the heels of a global spike in food prices. We note with concern the adverse impact of the global crisis on low income countries' (LICs) capacity to protect critical core spending in areas such as health, education, safety nets, and infrastructure. The UN's new Global Impact Vulnerability Alert System will help our efforts to monitor the impact of the crisis on the most vulnerable. We share a collective responsibility to mitigate the social impact of the crisis and to assure that all parts of the globe participate in the recovery.

35. The MDBs play a key role in the fight against poverty. We recognize the need for accelerated and additional concessional financial support to LICs to cushion the impact of the crisis on the poorest, welcome the increase in MDB lending during the crisis and support the MDBs having the resources needed to avoid a disruption of concessional financing to the most vulnerable countries. The IMF also has increased its concessional lending to LICs during the crisis. Resources from the sale of IMF gold, consistent with the new income model, and funds from internal and other sources will double the Fund's medium-term concessional lending capacity.

36. Several countries are considering creating, on a voluntary basis, mechanisms that could allow, consistent with their national circumstances, the mobilization of existing SDR resources to support the IMF's lending to the poorest countries. Even as we

work to mitigate the impact of the crisis, we must strengthen and reform the global development architecture for responding to the world's long-term challenges. We ask our relevant ministers to explore the benefits of a new crisis support facility in IDA to protect LICs from future crises and the enhanced use of financial instruments in protecting the investment plans of middle income countries from interruption in times of crisis, including greater use of guarantees.

37. We reaffirm our historic commitment to meet the Millennium Development Goals and our respective Official Development Assistance (ODA) pledges, including commitments on Aid for Trade, debt relief, and those made at Gleneagles, especially to sub-Saharan Africa, to 2010 and beyond.

38. Even before the crisis, too many still suffered from hunger and poverty and even more people lack access to energy and finance. Recognizing that the crisis has exacerbated this situation, we pledge cooperation to improve access to food, fuel, and finance for the poor.

39. Sustained funding and targeted investments are urgently needed to improve long-term food security. We welcome and support the food security initiative announced in L'Aquila and efforts to further implement the Global Partnership for Agriculture and Food Security and to address excessive price volatility. We call on the World Bank to work with interested donors and organizations to develop a multilateral trust fund to scale-up agricultural assistance to low-income countries. This will help support innovative bilateral and multilateral efforts to improve global nutrition and build sustainable agricultural systems, including programs like those developed through the Comprehensive African Agricultural Development Program (CAADP). It should be designed to ensure country ownership and rapid disbursement of funds, fully respecting the aid effectiveness principles agreed in Accra, and facilitate the participation of private foundations, businesses, and non-governmental organizations (NGOs) in this historic effort. These efforts should complement the UN Comprehensive Framework for Agriculture. We ask the World Bank, the African Development Bank, UN, Food and Agriculture Organization (FAO), International Fund for Agricultural Development (IFAD), World Food Programme (WFP) and other stakeholders to coordinate their efforts, including through country-led mechanisms, in order to complement and reinforce other existing multilateral and bilateral efforts to tackle food insecurity.

40. To increase access to energy, we will promote the deployment of clean, affordable energy resources to the developing world. We commit, on a voluntary basis, to funding programs that achieve this objective, such as the Scaling Up Renewable Energy Program and the Energy for the Poor Initiative, and to increasing and more closely harmonizing our bilateral efforts.

41. We commit to improving access to financial services for the poor. We have agreed to support the safe and sound spread of new modes of financial service delivery capable of reaching the poor and, building on the example of micro finance, will scale up the

successful models of small and medium-sized enterprise (SME) financing. Working with the Consultative Group to Assist the Poor (CGAP), the International Finance Corporation (IFC) and other international organizations, we will launch a G-20 Financial Inclusion Experts Group. This group will identify lessons learned on innovative approaches to providing financial services to these groups, promote successful regulatory and policy approaches and elaborate standards on financial access, financial literacy, and consumer protection. We commit to launch a *G-20 SME Finance Challenge*, a call to the private sector to put forward its best proposals for how public finance can maximize the deployment of private finance on a sustainable and scalable basis.

42. As we increase the flow of capital to developing countries, we also need to prevent its illicit outflow. We will work with the World Bank's Stolen Assets Recovery (StAR) program to secure the return of stolen assets to developing countries, and support other efforts to stem illicit outflows. We ask the FATF to help detect and deter the proceeds of corruption by prioritizing work to strengthen standards on customer due diligence, beneficial ownership and transparency. We note the principles of the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action and will work to increase the transparency of international aid flows by 2010. We call for the adoption and enforcement of laws against transnational bribery, such as the OECD Anti-Bribery Convention, and the ratification by the G-20 of the UN Convention against Corruption (UNCAC) and the adoption during the third Conference of the Parties in Doha of an effective, transparent, and inclusive mechanism for the review of its implementation. We support voluntary participation in the Extractive Industries Transparency Initiative, which calls for regular public disclosure of payments by extractive industries to governments and reconciliation against recorded receipt of those funds by governments.

Putting Quality Jobs at the Heart of the Recovery

43. The prompt, vigorous and sustained response of our countries has saved or created millions of jobs. Based on International Labour Organization (ILO) estimates, our efforts will have created or saved at least 7 – 11 million jobs by the end of this year. Without sustained action, unemployment is likely to continue rising in many of our countries even after economies stabilize, with a disproportionate impact on the most vulnerable segments of our population. As growth returns, every country must act to ensure that employment recovers quickly. We commit to implementing recovery plans that support decent work, help preserve employment, and prioritize job growth. In addition, we will continue to provide income, social protection, and training support for the unemployed and those most at risk of unemployment. We agree that the current challenges do not provide an excuse to disregard or weaken internationally recognized labor standards. To assure that global growth is broadly beneficial, we should implement policies consistent with ILO fundamental principles and rights at work.

44. Our new Framework for Strong, Sustainable, and Balanced Growth requires structural reforms to create more inclusive labor markets, active labor market policies, and quality education and training programs. Each of our countries will need, through its own national policies, to strengthen the ability of our workers to adapt to changing market demands and to benefit from innovation and investments in new technologies, clean energy, environment, health, and infrastructure. It is no longer sufficient to train workers to meet their specific current needs; we should ensure access to training programs that support lifelong skills development and focus on future market needs. Developed countries should support developing countries to build and strengthen their capacities in this area. These steps will help to assure that the gains from new inventions and lifting existing impediments to growth are broadly shared.

45. We pledge to support robust training efforts in our growth strategies and investments. We recognize successful employment and training programs are often designed together with employers and workers, and we call on the ILO, in partnership with other organizations, to convene its constituents and NGOs to develop a training strategy for our consideration.

46. We agree on the importance of building an employment-oriented framework for future economic growth. In this context, we reaffirm the importance of the London Jobs Conference and Rome Social Summit. We also welcome the recently-adopted ILO Resolution on Recovering from the Crisis: A Global Jobs Pact, and we commit our nations to adopt key elements of its general framework to advance the social dimension of globalization. The international institutions should consider ILO standards and the goals of the Jobs Pact in their crisis and post-crisis analysis and policy-making activities.

47. To ensure our continued focus on employment policies, the Chair of the Pittsburgh Summit has asked his Secretary of Labor to invite our Employment and Labor Ministers to meet as a group in early 2010 consulting with labor and business and building on the upcoming OECD Labour and Employment Ministerial meeting on the jobs crisis. We direct our Ministers to assess the evolving employment situation, review reports from the ILO and other organizations on the impact of policies we have adopted, report on whether further measures are desirable, and consider medium-term employment and skills development policies, social protection programs, and best practices to ensure workers are prepared to take advantage of advances in science and technology.

An Open Global Economy

48. Continuing the revival in world trade and investment is essential to restoring global growth. It is imperative we stand together to fight against protectionism. We welcome the swift implementation of the $250 billion trade finance initiative. We will keep markets open and free and reaffirm the commitments made in Washington and London: to refrain from raising barriers or imposing new barriers to investment or to trade in goods and services, imposing new export restrictions or implementing

World Trade Organization (WTO) inconsistent measures to stimulate exports and commit to rectify such measures as they arise. We will minimize any negative impact on trade and investment of our domestic policy actions, including fiscal policy and action to support the financial sector. We will not retreat into financial protectionism, particularly measures that constrain worldwide capital flows, especially to developing countries. We will notify promptly the WTO of any relevant trade measures. We welcome the latest joint report from the WTO, OECD, IMF, and United Nations Conference on Trade and Development (UNCTAD) and ask them to continue to monitor the situation within their respective mandates, reporting publicly on these commitments on a quarterly basis.

49. We remain committed to further trade liberalization. We are determined to seek an ambitious and balanced conclusion to the Doha Development Round in 2010, consistent with its mandate, based on the progress already made, including with regard to modalities. We understand the need for countries to directly engage with each other, within the WTO bearing in mind the centrality of the multilateral process, in order to evaluate and close the remaining gaps. We note that in order to conclude the negotiations in 2010, closing those gaps should proceed as quickly as possible. We ask our ministers to take stock of the situation no later than early 2010, taking into account the results of the work program agreed to in Geneva following the Delhi Ministerial, and seek progress on Agriculture, Non-Agricultural Market Access, as well as Services, Rules, Trade Facilitation and all other remaining issues. We will remain engaged and review the progress of the negotiations at our next meeting.

The Path from Pittsburgh

50. Today, we designated the G-20 as the premier forum for our international economic cooperation. We have asked our representatives to report back at the next meeting with recommendations on how to maximize the effectiveness of our cooperation. We agreed to have a G-20 Summit in Canada in June 2010, and in Korea in November 2010. We expect to meet annually thereafter, and will meet in France in 2011.

ANNEX: Core Values for Sustainable Economic Activity

1. The economic crisis demonstrates the importance of ushering in a new era of sustainable global economic activity grounded in responsibility. The current crisis has once again confirmed the fundamental recognition that our growth and prosperity are interconnected, and that no region of the globe can wall itself off in a globalized world economy.

2. We, the Leaders of the countries gathered for the Pittsburgh Summit, recognize that concerted action is needed to help our economies get back to stable ground and prosper tomorrow. We commit to taking responsible actions to ensure that every stakeholder – consumers, workers, investors, entrepreneurs – can participate in a balanced, equitable, and inclusive global economy.

3. We share the overarching goal to promote a broader prosperity for our people through balanced growth within and across nations; through coherent economic, social, and environmental strategies; and through robust financial systems and effective international collaboration.

4. We recognize that there are different approaches to economic development and prosperity, and that strategies to achieve these goals may vary according to countries' circumstances.

5. We also agree that certain key principles are fundamental, and in this spirit we commit to respect the following core values:

   - We have a responsibility to ensure sound macroeconomic policies that serve long-term economic objectives and help avoid unsustainable global imbalances.

   - We have a responsibility to reject protectionism in all its forms, support open markets, foster fair and transparent competition, and promote entrepreneurship and innovation across countries.

   - We have a responsibility to ensure, through appropriate rules and incentives, that financial and other markets function based on propriety, integrity and transparency and to encourage businesses to support the efficient allocation of resources for sustainable economic performance.

   - We have a responsibility to provide for financial markets that serve the needs of households, businesses and productive investment by strengthening oversight, transparency, and accountability.

   - We have a responsibility to secure our future through sustainable consumption, production and use of resources that conserve our environment and address the challenge of climate change.

- We have a responsibility to invest in people by providing education, job training, decent work conditions, health care and social safety net support, and to fight poverty, discrimination, and all forms of social exclusion.

- We have a responsibility to recognize that all economies, rich and poor, are partners in building a sustainable and balanced global economy in which the benefits of economic growth are broadly and equitably shared. We also have a responsibility to achieve the internationally agreed development goals.

- We have a responsibility to ensure an international economic and financial architecture that reflects changes in the world economy and the new challenges of globalization.

G-20 Framework for Strong, Sustainable, and Balanced Growth

1. Our countries have a shared responsibility to adopt policies to achieve strong, sustainable and balanced growth, to promote a resilient international financial system, and to reap the benefits of an open global economy. To this end, we recognize that our strategies will vary across countries. In our Framework for Strong, Sustainable and Balanced Growth, we will:

   - implement responsible fiscal policies, attentive to short-term flexibility considerations and longer-run sustainability requirements.
   - strengthen financial supervision to prevent the re-emergence in the financial system of excess credit growth and excess leverage and undertake macro prudential and regulatory policies to help prevent credit and asset price cycles from becoming forces of destabilization.
   - promote more balanced current accounts and support open trade and investment to advance global prosperity and growth sustainability, while actively rejecting protectionist measures.
   - undertake monetary policies consistent with price stability in the context of market oriented exchange rates that reflect underlying economic fundamentals.
   - undertake structural reforms to increase our potential growth rates and, where needed, improve social safety nets.
   - promote balanced and sustainable economic development in order to narrow development imbalances and reduce poverty.

2. We recognize that the process to ensure more balanced global growth must be undertaken in an orderly manner. All G-20 members agree to address the respective weaknesses of their economies.

   - G-20 members with sustained, significant external deficits pledge to undertake policies to support private savings and undertake fiscal consolidation while maintaining open markets and strengthening export sectors.
   - G-20 members with sustained, significant external surpluses pledge to strengthen domestic sources of growth. According to national circumstances this could include increasing investment, reducing financial markets distortions, boosting productivity in service sectors, improving social safety nets, and lifting constraints on demand growth.

3. Each G-20 member bears primary responsibility for the sound management of its economy. The G-20 members also have a responsibility to the community of nations to assure the overall health of the global economy. Regular consultations, strengthened cooperation on macroeconomic policies, the exchange of experiences on structural policies, and ongoing assessment can strengthen our cooperation and promote the adoption of sound policies. As part of our process of mutual assessment:

   - G-20 members will agree on shared policy objectives. These objectives should be updated as conditions evolve.

- G-20 members will set out their medium-term policy frameworks and will work together to assess the collective implications of our national policy frameworks for the level and pattern of global growth, and to identify potential risks to financial stability.
- G-20 leaders will consider, based on the results of the mutual assessment, and agree any actions to meet our common objectives.

4. We call on our Finance Ministers to develop our process of mutual assessment to evaluate the collective implications of national policies for the world economy. To accomplish this, our Finance Ministers should, with the assistance of the IMF:

   - Develop a forward looking assessment of G-20 economic developments to help analyze whether patterns of demand and supply, credit, debt and reserves growth are supportive of strong, sustainable and balanced growth.
   - Assess the implications and consistency of fiscal and monetary policies, credit growth and asset markets, foreign exchange developments, commodity and energy prices, and current account imbalances.
   - Report regularly to both the G-20 and the IMFC on global economic developments, key risks, and concerns with respect to patterns of growth and suggested G-20 policy adjustments, individually and collectively.

THE G-20 TORONTO SUMMIT
DECLARATION
June 26 – 27, 2010

Preamble

1. In Toronto, we held our first Summit of the G-20 in its new capacity as the premier forum for our international economic cooperation.

2. Building on our achievements in addressing the global economic crisis, we have agreed on the next steps we should take to ensure a full return to growth with quality jobs, to reform and strengthen financial systems, and to create strong, sustainable and balanced global growth.

3. Our efforts to date have borne good results. Unprecedented and globally coordinated fiscal and monetary stimulus is playing a major role in helping to restore private demand and lending. We are taking strong steps toward increasing the stability and strength of our financial systems. Significantly increased resources for international financial institutions are helping stabilise and address the impact of the crisis on the world's most vulnerable. Ongoing governance and management reforms, which must be completed, will also enhance the effectiveness and relevance of these institutions. We have successfully maintained our strong commitment to resist protectionism.

4. But serious challenges remain. While growth is returning, the recovery is uneven and fragile, unemployment in many countries remains at unacceptable levels, and the social impact of the crisis is still widely felt. Strengthening the recovery is key. To sustain recovery, we need to follow through on delivering existing stimulus plans, while working to create the conditions for robust private demand. At the same time, recent events highlight the importance of sustainable public finances and the need for our countries to put in place credible, properly phased and growth-friendly plans to deliver fiscal sustainability, differentiated for and tailored to national circumstances. Those countries with serious fiscal challenges need to accelerate the pace of consolidation. This should be combined with efforts to rebalance global demand to help ensure global growth continues on a sustainable path. Further progress is also required on financial repair and reform to increase the transparency and strengthen the balance sheets of our financial institutions, and support credit availability and rapid growth, including in the real economy. We took new steps to build a better regulated and more resilient financial system that serves the needs of our citizens. There is also a pressing need to complete the reforms of the international financial institutions.

5. Recognizing the importance of achieving strong job growth and providing social protection to our citizens, particularly our most vulnerable, we welcome the recommendations of our

Labour and Employment Ministers, who met in April 2010, and the training strategy prepared by the International Labour Organization (ILO) in collaboration with the Organisation for Economic Co-operation and Development (OECD).

6. We are determined to be accountable for the commitments we have made, and have instructed our Ministers and officials to take all necessary steps to implement them fully within agreed timelines.

The Framework for Strong, Sustainable and Balanced Growth

7. The G-20's highest priority is to safeguard and strengthen the recovery and lay the foundation for strong, sustainable and balanced growth, and strengthen our financial systems against risks. We therefore welcome the actions taken and commitments made by a number of G-20 countries to boost demand and rebalance growth, strengthen our public finances, and make our financial systems stronger and more transparent. These measures represent substantial contributions to our collective well-being and build on previous actions. We will continue to co-operate and undertake appropriate actions to bolster economic growth and foster a strong and lasting recovery.

8. The Framework for Strong, Sustainable and Balanced Growth that we launched in Pittsburgh is the means to achieving our shared objectives, by assessing the collective consistency of policy actions and strengthening policy frameworks.

9. We have completed the first stage of our Mutual Assessment Process and we concluded that we can do much better. The IMF and World Bank estimate that if we choose a more ambitious path of reforms, over the medium term:
    - global output would be higher by almost $4 trillion;
    - tens of millions more jobs would be created;
    - even more people would be lifted out of poverty; and
    - global imbalances would be significantly reduced.

    Increasing global growth on a sustainable basis is the most important step we can take in improving the lives of all of our citizens, including those in the poorest countries.

10. We are committed to taking concerted actions to sustain the recovery, create jobs and to achieve stronger, more sustainable and more balanced growth. These will be differentiated and tailored to national circumstances. We agreed today on:
    - Following through on fiscal stimulus and communicating "growth friendly" fiscal consolidation plans in advanced countries that will be implemented going forward. Sound fiscal finances are essential to sustain recovery, provide flexibility to respond to new shocks, ensure the capacity to meet the challenges of aging populations, and avoid leaving future generations with a legacy of deficits and debt. The path of adjustment must be carefully calibrated to sustain the recovery in private demand.

There is a risk that synchronized fiscal adjustment across several major economies could adversely impact the recovery. There is also a risk that the failure to implement consolidation where necessary would undermine confidence and hamper growth. Reflecting this balance, advanced economies have committed to fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016. Recognizing the circumstances of Japan, we welcome the Japanese government's fiscal consolidation plan announced recently with their growth strategy. Those with serious fiscal challenges need to accelerate the pace of consolidation. Fiscal consolidation plans will be credible, clearly communicated, differentiated to national circumstances, and focused on measures to foster economic growth.

- Strengthening social safety nets, enhancing corporate governance reform, financial market development, infrastructure spending, and greater exchange rate flexibility in some emerging markets;
- Pursuing structural reforms across the entire G-20 membership to increase and sustain our growth prospects; and
- Making more progress on rebalancing global demand.

Monetary policy will continue to be appropriate to achieve price stability and thereby contribute to the recovery.

11. Advanced deficit countries should take actions to boost national savings while maintaining open markets and enhancing export competitiveness.

12. Surplus economies will undertake reforms to reduce their reliance on external demand and focus more on domestic sources of growth.

13. We are committed to narrowing the development gap and that we must consider the impact of our policy actions on low-income countries. We will continue to support development financing, including through new approaches that encourage development financing from both public and private sources.

14. We recognize that these measures will need to be implemented at the national level and will need to be tailored to individual country circumstances. To facilitate this process, we have agreed that the second stage of our country-led and consultative mutual assessment will be conducted at the country and European level and that we will each identify additional measures, as necessary, that we will take toward achieving strong, sustainable, and balanced growth.

Financial Sector Reform

15. We are building a more resilient financial system that serves the needs of our economies, reduces moral hazard, limits the build up of systemic risk, and supports strong and stable economic growth. We have strengthened the global financial system by fortifying

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prudential oversight, improving risk management, promoting transparency, and reinforcing international cooperation. A great deal has been accomplished. We welcome the full implementation of the European Stabilization Mechanism and Facility, the EU decision to publicly release the results of ongoing tests on European banks, and the recent US financial reform bill.

16. But more work is required. Accordingly, we pledge to act together to achieve the commitments to reform the financial sector made at the Washington, London and Pittsburgh Summits by the agreed or accelerated timeframes. The transition to new standards will take into account the cumulative macroeconomic impact of the reforms in advanced and emerging economies. We are committed to international assessment and peer review to ensure that all our decisions are fully implemented.

17. Our reform agenda rests on four pillars.

18. The first pillar is a strong regulatory framework. We took stock of the progress of the Basel Committee on Banking Supervision (BCBS) towards a new global regime for bank capital and liquidity and we welcome and support its work. Substantial progress has been made on reforms that will materially raise levels of resilience of our banking systems. The amount of capital will be significantly higher and the quality of capital will be significantly improved when the new reforms are fully implemented. This will enable banks to withstand – without extraordinary government support – stresses of a magnitude associated with the recent financial crisis. We support reaching agreement at the time of the Seoul Summit on the new capital framework. We agreed that all members will adopt the new standards and these will be phased in over a timeframe that is consistent with sustained recovery and limits market disruption, with the aim of implementation by end-2012, and a transition horizon informed by the macroeconomic impact assessment of the Financial Stability Board (FSB) and BCBS. Phase-in arrangements will reflect different national starting points and circumstances, with initial variance around the new standards narrowing over time as countries converge to the new global standard.

19. We agreed to strengthen financial market infrastructure by accelerating the implementation of strong measures to improve transparency and regulatory oversight of hedge funds, credit rating agencies and over-the-counter derivatives in an internationally consistent and non-discriminatory way. We re-emphasized the importance of achieving a single set of high quality improved global accounting standards and the implementation of the FSB's standards for sound compensation.

20. The second pillar is effective supervision. We agreed that new, stronger rules must be complemented with more effective oversight and supervision. We tasked the FSB, in consultation with the IMF, to report to our Finance Ministers and Central Bank Governors in October 2010 on recommendations to strengthen oversight and supervision, specifically

relating to the mandate, capacity and resourcing of supervisors and specific powers which should be adopted to proactively identify and address risks, including early intervention.

21. The third pillar is resolution and addressing systemic institutions. We are committed to design and implement a system where we have the powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden, and adopted principles that will guide implementation. We called upon the FSB to consider and develop concrete policy recommendations to effectively address problems associated with, and resolve, systemically important financial institutions by the Seoul Summit. To reduce moral hazard risks, there is a need to have a policy framework including effective resolution tools, strengthened prudential and supervisory requirements, and core financial market infrastructures. We agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or fund resolution, and reduce risks from the financial system. We recognized that there are a range of policy approaches to this end. Some countries are pursuing a financial levy. Other countries are pursuing different approaches.

22. The fourth pillar is transparent international assessment and peer review. We have strengthened our commitment to the IMF/World Bank Financial Sector Assessment Program (FSAP) and pledge to support robust and transparent peer review through the FSB. We are addressing non-cooperative jurisdictions based on comprehensive, consistent, and transparent assessment with respect to tax havens, the fight against money laundering and terrorist financing and the adherence to prudential standards.

International Financial Institutions and Development

23. The International Financial Institutions (IFIs) have been a central part of the global response to the financial and economic crisis, mobilizing critical financing, including $750 billion by the IMF and $235 billion by the Multilateral Development Banks (MDBs). This has underscored the value of these institutions as platforms for our global cooperation.

24. We commit to strengthening the legitimacy, credibility and effectiveness of the IFIs to make them even stronger partners for us in the future.

25. Towards this end, we have fulfilled our Pittsburgh Summit commitment on the MDBs. This includes $350 billion in capital increases for the MDBs, allowing them to nearly double their lending. This new capital is joined to ongoing and important reforms to make these institutions more transparent, accountable and effective, and to strengthen their focus on lifting the lives of the poor, underwriting growth, and addressing climate change and food security.

26. We will fulfill our commitment to ensure an ambitious replenishment for the concessional lending facilities of the MDBs, especially the International Development Association and the African Development Fund.

27. We have endorsed the important voice reforms agreed by shareholders at the World Bank, which will increase the voting power of developing and transition countries by 4.59% since 2008.

28. We underscore our resolve to ensure ratification of the 2008 IMF Quota and Voice Reforms and expansion of the New Arrangements to Borrow (NAB).

29. We called for an acceleration of the substantial work still needed for the IMF to complete the quota reform by the Seoul Summit and in parallel deliver on other governance reforms, in line with commitments made in Pittsburgh.

30. Today we build on our earlier commitment to open, transparent and merit-based selection processes for the heads and senior leadership of all the IFIs. We will strengthen the selection processes in the lead up to the Seoul Summit in the context of broader reform.

31. We agreed to task our Finance Ministers and Central Bank Governors to prepare policy options to strengthen global financial safety nets for our consideration at the Seoul Summit. Our goal is to build a more stable and resilient international monetary system.

32. We stand united with the people of Haiti and are providing much-needed reconstruction assistance, including the full cancellation of all of Haiti's IFI debt. We welcome the launching of the Haiti Reconstruction Fund.

33. We have launched the SME Finance Challenge and commit to mobilizing funding for implementation of winning proposals, including through the strong support of the MDBs. We have developed a set of principles for innovative financial inclusion.

34. We welcome the launch of the Global Agriculture and Food Security Program in fulfillment of our Pittsburgh commitment on food security, an important step to further implement the Global Partnership for Agriculture and Food Security, and invite further contributions. Looking ahead, we commit to exploring innovative, results-based mechanisms to harness the private sector for agricultural innovation. We call for the full implementation of the L'Aquila Initiative and the application of its principles.

Fighting Protectionism and Promoting Trade and Investment

35. While the global economic crisis led to the sharpest decline of trade in more than seventy years, G-20 countries chose to keep markets open to the opportunities that trade and investment offer. It was the right choice.

36. As such, we renew for a further three years, until the end of 2013, our commitment to refrain from raising barriers or imposing new barriers to investment or trade in goods and services, imposing new export restrictions or implementing World Trade Organization (WTO)-inconsistent measures to stimulate exports, and commit to rectify such measures as they arise. We will minimize any negative impact on trade and investment of our domestic policy actions, including fiscal policy and action to support the financial sector. We ask the WTO, OECD and UNCTAD to continue to monitor the situation within their respective mandates, reporting publicly on these commitments on a quarterly basis.

37. Open markets play a pivotal role in supporting growth and job creation, and in achieving our goals under the G-20 Framework for Strong, Sustainable and Balanced Growth. We ask the OECD, the ILO, World Bank, and the WTO to report on the benefits of trade liberalization for employment and growth at the Seoul Summit.

38. We therefore reiterate our support for bringing the WTO Doha Development Round to a balanced and ambitious conclusion as soon as possible, consistent with its mandate and based on the progress already made. We direct our representatives, using all negotiating avenues, to pursue this objective, and to report on progress at our next meeting in Seoul, where we will discuss the status of the negotiations and the way forward.

39. We commit to maintain momentum for Aid for Trade. We also ask international agencies, including the World Bank and other Multilateral Development Banks to step up their capacity and support trade facilitation which will boost world trade.

Other Issues and Forward Agenda

40. We agree that corruption threatens the integrity of markets, undermines fair competition, distorts resource allocation, destroys public trust and undermines the rule of law. We call for the ratification and full implementation by all G-20 members of the United Nations Convention against Corruption (UNCAC) and encourage others to do the same. We will fully implement the reviews in accordance with the provisions of UNCAC. Building on the progress made since Pittsburgh to address corruption, we agree to establish a Working Group to make comprehensive recommendations for consideration by Leaders in Korea on how the G-20 could continue to make practical and valuable contributions to international efforts to combat corruption and lead by example, in key areas that include, but are not limited to, adopting and enforcing strong and effective anti-bribery rules, fighting corruption

in the public and private sectors, preventing access of corrupt persons to global financial systems, cooperation in visa denial, extradition and asset recovery, and protecting whistleblowers who stand-up against corruption.

41. We reiterate our commitment to a green recovery and to sustainable global growth. Those of us who have associated with the Copenhagen Accord reaffirm our support for it and its implementation and call on others to associate with it. We are committed to engage in negotiations under the UNFCCC on the basis of its objective provisions and principles including common but differentiated responsibilities and respective capabilities and are determined to ensure a successful outcome through an inclusive process at the Cancun Conferences. We thank Mexico for undertaking to host the sixteenth Conference of the Parties (COP 16) in Cancun from November 29 to December 20, 2010 and express our appreciation for its efforts to facilitate negotiations. We look forward to the outcome of the UN Secretary-General's High-Level Advisory Group on Climate Change Financing which is, *inter alia*, exploring innovative finance.

42. We note with appreciation the report on energy subsidies from the International Energy Agency (IEA), Organization of the Petroleum Exporting Countries (OPEC), OECD and World Bank. We welcome the work of Finance and Energy Ministers in delivering implementation strategies and timeframes, based on national circumstances, for the rationalization and phase out over the medium term of inefficient fossil fuel subsidies that encourage wasteful consumption, taking into account vulnerable groups and their development needs. We also encourage continued and full implementation of country-specific strategies and will continue to review progress towards this commitment at upcoming summits.

43. Following the recent oil spill in the Gulf of Mexico we recognize the need to share best practices to protect the marine environment, prevent accidents related to offshore exploration and development, as well as transportation, and deal with their consequences.

44. We recognize that 2010 marks an important year for development issues. The September 2010 Millennium Development Goals (MDG) High Level Plenary will be a crucial opportunity to reaffirm the global development agenda and global partnership, to agree on actions for all to achieve the MDGs by 2015, and to reaffirm our respective commitments to assist the poorest countries.

45. In this regard it is important to work with Least Developed Countries (LDCs) to make them active participants in and beneficiaries of the global economic system. Accordingly we thank Turkey for its decision to host the 4th United Nations Conference on the LDCs in June 2011.

46. We welcome the Global Pulse Initiative interim report and look forward to an update.

47. Narrowing the development gap and reducing poverty are integral to our broader objective of achieving strong, sustainable and balanced growth and ensuring a more robust and resilient global economy for all. In this regard, we agree to establish a Working Group on Development and mandate it to elaborate, consistent with the G-20's focus on measures to promote economic growth and resilience, a development agenda and multi-year action plans to be adopted at the Seoul Summit.

48. We will meet next in Seoul, Korea, on November 11-12, 2010. We will convene in November 2011 under the Chairmanship of France and in 2012 under the Chairmanship of Mexico.

49. We thank Canada for hosting the successful Toronto Summit.

ANNEX I

The Framework for Strong, Sustainable and Balanced Growth

1. As a result of the extraordinary and highly coordinated policy actions agreed to at the Washington, London and Pittsburgh G-20 Summits, the global economy is recovering faster than was expected. Our decisive and unprecedented actions over the past two years have limited the downturn and spurred recovery.

2. Yet risks remain. Unemployment remains unacceptably high in many G-20 economies. The recovery is uneven across G-20 members both across advanced economies and between advanced and emerging economies. This poses risks to the continued economic expansion. There is a risk that global current account imbalances will widen again, absent further policy action. While considerable progress has been made in moving ahead on our financial sector repair and reform agenda, financial markets remain fragile and credit flows restrained. Concerns over large fiscal deficits and rising debt levels in some countries have also become a source of uncertainty and financial market volatility.

3. The G-20's highest priority is to safeguard and strengthen the recovery and lay the foundation for strong, sustainable and balanced growth, including strengthening our financial systems against risks. We therefore welcome the actions taken and commitments made by a number of G-20 countries. Among more recent measures, we particularly welcome the full implementation of the European Financial Stability Mechanism and Facility; the EU decision to publicly release the results of ongoing tests on European banks; and the recent announcements of fiscal consolidation plans and targets by a number of G-20 countries. These represent substantial contributions to our collective well-being and build on our previous actions. We will continue to cooperate and undertake appropriate actions to bolster economic growth and foster a strong and lasting recovery.

4. The Framework for Strong, Sustainable and Balanced Growth we launched in Pittsburgh is the means to achieving our shared objectives. G-20 members have a responsibility to the community of nations to assure the overall health of the global economy. We committed to assess the collective consistency of our policy actions and to strengthen our policy frameworks in order to meet our common objectives. Through our collective policy action, we will ensure growth is sustained, more balanced, shared across all countries and regions of the world, and consistent with our development goals.

5. We have completed the first stage of our Mutual Assessment Process. As we requested in Pittsburgh, G-20 Finance Ministers and Central Bank Governors, with the support of the IMF, World Bank, OECD, ILO and other international organisations, have assessed the collective consistency of our individual policy frameworks and global prospects under alternative policy scenarios.

6. The assessment is that in the absence of a coordinated policy response: global output is likely to remain below its pre-crisis trend; unemployment remains above pre-crisis levels in most countries; fiscal deficits and debt in some advanced economies reach unacceptably high levels; and, global current account imbalances, which narrowed during the crisis, widen again. Moreover, this outlook is subject to considerable downside risks.

7. We concluded that we can do much better. The IMF and World Bank estimate that if we choose a more ambitious path of reforms, over the medium term, we could:
   - raise global output by up to $4 trillion;
   - create an estimated 52 million jobs;
   - lift up to 90 million people out of poverty; and
   - significantly reduce global current account balances.

   If we act in a coordinated manner, all regions are better off, now and in the future. Moreover, increasing global growth on a sustainable basis is the most important step we can take in improving the lives of all, including those in the poorest countries.

8. We are committed to taking concerted actions to sustain the recovery, create jobs and to achieve stronger, more sustainable and more balanced growth. These will be differentiated and tailored to national circumstances. We agreed today on:
   - Following through on fiscal stimulus and communicating "growth-friendly" fiscal consolidation plans in advanced countries and that will be implemented going forward;
   - strengthening social safety nets, enhancing corporate governance reform, financial market development, infrastructure spending, and increasing exchange rate flexibility in some emerging markets;
   - pursuing structural reforms across the entire G-20 membership to increase and sustain our growth prospects; and
   - Making further progress on rebalancing global demand.

   Monetary policy will continue to be appropriate to achieve price stability and thereby contribute to the recovery.

9. We agreed to follow through on fiscal stimulus and communicating "growth friendly" fiscal consolidation plans in advanced countries that will be implemented going forward. Sound fiscal finances are essential to sustain recovery, provide flexibility to respond to new shocks, ensure the capacity to meet the challenges of aging populations, and avoid leaving future generations with a legacy of deficits and debt. The path of adjustment must be carefully calibrated to sustain the recovery in private demand. There is a risk that synchronized fiscal adjustment across several major economies could adversely impact the recovery. There is also a risk that the failure to implement consolidation where necessary would undermine confidence and hamper growth. Reflecting this balance, advanced economies have

committed to fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016. Recognizing the circumstances of Japan, we welcome the Japanese government's fiscal consolidation plan announced recently with their growth strategy. Those with serious fiscal challenges need to accelerate the pace of consolidation. Fiscal consolidation plans will be credible, clearly communicated, differentiated to national circumstances, and focused on measures to foster economic growth.

10. We have agreed on a set of principles to guide these fiscal consolidation plans by advanced economies:
    - *Fiscal consolidation plans will be credible*. They will be based on prudent assumptions with respect to economic growth and our respective fiscal positions, and they will identify specific measures to achieve a target path that ensures fiscal sustainability. Strengthened budgetary frameworks and institutions can help underpin the credibility of consolidation strategies.
    - *The time to communicate our medium-term fiscal plans is now.* We will elaborate clear and credible plans that put our fiscal finances on a sustainable footing. The speed and timing of withdrawing fiscal stimulus and reducing deficits and debt will be differentiated for and tailored to national circumstances, and the needs of the global economy. However, it is clear that consolidation will need to begin in advanced economies in 2011, and earlier for countries experiencing significant fiscal challenges at present.
    - *Fiscal consolidation will focus on measures that will foster economic growth*. We will look at ways to use our fiscal resources more efficiently, to help reduce the overall cost of our interventions while targeting resources to where they are most needed. In addition, we will focus on structural reforms that will promote long-term growth.

11. Advanced deficit countries should take actions to boost national savings while maintaining open markets and enhancing export competitiveness.

12. Surplus economies will undertake reforms to reduce their reliance on the external demand and focus more on domestic sources of growth. This will help strengthen their resilience to external shocks and promote more stable growth. To do this, advanced surplus economies will focus on structural reforms that support increased domestic demand. Emerging surplus economies will undertake reforms tailored to country circumstances to:
    - Strengthen social safety nets (such as public health care and pension plans), corporate governance and financial market development to help reduce precautionary savings and stimulate private spending;
    - Increase infrastructure spending to help boost productive capacity and reduce supply bottlenecks; and

- Enhance exchange rate flexibility to reflect underlying economic fundamentals. Excess volatility and disorderly movements in exchange rates can have adverse implications for economic and financial stability. Market-oriented exchange rates that reflect underlying economic fundamentals contribute to global economic stability.

13. Across all G-20 members, we recognise that structural reforms can have a substantial impact on economic growth and global welfare. We will implement measures that will enhance the growth potential of our economies in a manner that pays particular attention to the most vulnerable. Reforms could support the broadly-shared expansion of demand if wages grow in line with productivity. It will be important to strike the right balance between policies that support greater market competition and economic growth and policies that preserve social safety nets consistent with national circumstances. Together these measures will also help unlock demand. These include:
    - Product, service and labour market reforms in advanced economies, particularly those economies that may have lost some productive capacity during the crisis. Labour market reforms might include: better targeted unemployment benefits and more effective active labour market policies (such as job retraining, job search and skills development programs, and raising labour mobility). It might also include putting in place the right conditions for wage bargaining systems to support employment. Product and service market reforms might include strengthening competition in the service sector; reducing barriers to competition in network industries, professional services and retail sectors, encouraging innovation and further reducing the barriers to foreign competition.
    - Reducing restrictions on labour mobility, enhancing foreign investment opportunities and simplifying product market regulation in emerging market economies.
    - Avoiding new protectionist measures.
    - Completing the Doha Round to accelerate global growth through trade flows. Open trade will yield significant benefits for all and can facilitate global rebalancing.
    - Actions to accelerate financial repair and reform. Weaknesses in financial sector regulation and supervision in advanced economies led to the recent crisis. We will implement the G-20 financial reform agenda and ensure a stronger financial system serves the needs of the real economy. While not at the centre of the crisis, financial sectors in some emerging economies need to be developed further so that they can provide the depth and breadth of services required to promote and sustain high rates of economic growth and development. It is important that financial reforms in advanced economies take into account any adverse effects on financial flows to emerging and developing economies. Vigilance is also needed to ensure open capital markets and avoid financial protectionism.

14. We welcome the recommendations of our Labour and Employment Ministers, who met in April 2010, on the employment impacts of the global economic crisis. We reaffirm our

commitment to achieving strong job growth and providing social protection to our most vulnerable citizens. An effective employment policy should place quality jobs at the heart of the recovery. We appreciate the work done by the International Labour Organization in collaboration with the OECD on a training strategy that will help equip the workforce with the skills required for the jobs of today and those of tomorrow.

15. We are committed to narrowing the development gap and that we must consider the impact of our policy actions on low-income countries. We will continue support development financing, including through new approaches that encourage development financing from both public and private sources. The crisis will have long lasting impact on the development trajectories of poor countries in every region of the world. Among these effects, developing countries are likely to face increased challenges in securing financing from both public and private sources. Many of us have already taken steps to help address this shortfall by implementing innovative approaches to financing, such as advance market commitments, the SME challenge and recent progress with respect to financial inclusion. Low-income countries have the potential to contribute to stronger and more balanced global growth, and should be viewed as markets for investment.

16. These measures need to be implemented at the national level and tailored to individual country circumstances. We welcome additional measures announced by some G-20 members aimed at meeting our shared objectives.

17. To facilitate this process, the second stage of our country-led, consultative mutual assessment will be conducted at the country and European level. Each G-20 member will identify the measures it is taking to implement the policies we have agreed upon today to ensure stronger, more sustainable and balanced growth. We ask our Finance Ministers and Central Bank Governors to elaborate on these measures and report on them when we next meet. We will continue to draw on the expertise of the IMF, World Bank, OECD, ILO and other international organisations, as necessary. These measures will form the basis of our comprehensive action plan that will be announced in the Seoul Summit. As we pursue strong, sustainable and more balanced growth, we continue to encourage work on measurement methods to take into account social and environmental dimensions of economic development.

18. The policy commitments we are making today, along with the significant policy measures we have already taken, will allow us to reach our objective of strong, sustainable and balanced growth, the benefits of which will be felt both within the G-20 and across the globe.

G20 TORONTO
CANADA 2010

ANNEX II

Financial Sector Reform

1. The financial crisis has imposed huge costs. This must not be allowed to happen again. The recent financial volatility has strengthened our resolve to work together to complete financial repair and reform. We need to build a more resilient financial system that serves the needs of our economies, reduces moral hazard, limits the build-up of systemic risk and supports strong and stable economic growth.

2. Collectively we have made considerable progress toward strengthening the global financial system by fortifying prudential oversight, improving risk management, promoting transparency and continuously reinforcing international cooperation. We welcome the strong financial regulatory reform bill in the United States.

3. But there is more to be done. Further repair to the financial sector is critical to achieving sustainable global economic recovery. More work is required to restore the soundness and enhance the transparency of banks' balance sheets and markets; and improve the corporate governance and risk management of financial firms in order to strengthen the global financial system and restore the credit needed to fuel sustainable economic growth. We welcome the decision of EU leaders to publish the results of ongoing tests on European banks to reassure markets of the resilience and transparency of the European banking system.

4. We pledge to act together to achieve the commitments to reform the financial sector made at the Washington, London and Pittsburgh Summits by the agreed or accelerated timeframes. Transition horizons will take into account the cumulative macroeconomic impact of the reforms in advanced and emerging economies

Capital and Liquidity

5. We agreed that the core of the financial sector reform agenda rests on improving the strength of capital and liquidity and discouraging excessive leverage. We agreed to increase the quality, quantity, and international consistency of capital, to strengthen liquidity standards, to discourage excessive leverage and risk taking, and reduce procyclicality.

6. We took stock of the progress of the Basel Committee on Banking Supervision (BCBS) towards a new global regime for bank capital and liquidity and we welcome and support its work. Substantial progress has been made on reforms that will materially raise levels of resilience of our banking systems.
    - The amount of capital will be significantly higher when the new reforms are fully implemented.

- The quality of capital will be significantly improved to reinforce banks' ability to absorb losses.

7. We support reaching agreement, at the time of the Seoul Summit, on a new capital framework that would raise capital requirements by:
    - establishing a new requirement that each bank hold in Tier 1 capital, at a minimum, an increasing share of common equity, after deductions, measured as a percentage of risk-weighted assets, that enables them to withstand with going concern fully-loss-absorbing capital – without extraordinary government support – stresses of a magnitude associated with the recent financial crisis.
    - moving to a globally consistent and transparent set of conservative deductions generally applied at the level of common equity, or its equivalent in the case of non-joint stock companies, over a suitable globally-consistent transition period.

8. Based on our agreement at the Pittsburgh Summit that Basel II will be adopted in all major centers by 2011, we agreed that all members will adopt the new standards and these will be phased in over a timeframe that is consistent with sustained recovery and limits market disruption, with the aim of implementation by end-2012, and a transition horizon informed by the macroeconomic impact assessment of the Financial Stability Board (FSB) and BCBS.

9. Phase-in arrangements will reflect different national starting points and circumstances, with initial variance around the new standards narrowing over time as countries converge to the new global standard. Existing public sector capital injections will be grandfathered for the extent of the transition.

10. We reiterated support for the introduction of a leverage ratio as a supplementary measure to the Basel II risk-based framework with a view to migrating to Pillar I treatment after an appropriate transition period based on appropriate review and calibration. To ensure comparability, the details of the leverage ratio will be harmonized internationally, fully adjusting for differences in accounting.

11. We acknowledged the importance of the quantitative impact study currently being conducted by the BCBS that measures the potential impact of the new Basel standards and will ensure that the new capital and liquidity standards are of high quality and adequately calibrated. The BCBS- FSB macroeconomic impact study will inform the development of the phase-in period of the new standards.

12. We welcomed the BCBS agreement on a coordinated start date not later than 31 December 2011 for all elements of the revised trading book rules.

13. We support the BCBS' work to consider the role of contingent capital in strengthening market discipline and helping to bring about a financial system where the private sector

fully bears the losses on their investments. Consideration of contingent capital should be included as part of the 2010 reform package.

14. We called upon the FSB and the BCBS to report on progress of the full package of reform measures by the Seoul Summit. We recognize the critical role of the financial sector in driving a robust economy. We are committed to design a financial system which is resilient, stable and ensures the continued availability of credit.

More Intensive Supervision

15. We agreed that new, stronger rules must be complemented with more effective oversight and supervision. We are committed to the Basel Committee's Core Principles for Effective Banking Supervision and tasked the FSB, in consultation with the International Monetary Fund (IMF), to report to our Finance Ministers and Central Bank Governors in October 2010 on recommendations to strengthen oversight and supervision, specifically relating to the mandate, capacity and resourcing of supervisors and specific powers which should be adopted to proactively identify and address risks, including early intervention.

Resolution of Financial Institutions

16. We are following through on our commitment to reduce moral hazard in the financial system. We are committed to design and implement a system where we have the powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden. These powers should facilitate "going concern" capital and liquidity restructuring as well as "gone concern" restructuring and wind-down measures. We endorsed and have committed to implement our domestic resolution powers and tools in a manner that preserves financial stability and are committed to implement the ten key recommendations on cross-border bank resolution issued by the BCBS in March 2010. In this regard, we support changes to national resolution and insolvency processes and laws where needed to provide the relevant national authorities with the capacity to cooperate and coordinate resolution actions across borders.

17. We agree that resolution regimes should provide for:
    - Proper allocation of losses to reduce moral hazard and protect taxpayers;
    - Continuity of critical financial services, including uninterrupted service for insured depositors;
    - Credibility of the resolution regime in the market;
    - Minimization of contagion;
    - Advanced planning for orderly resolution and transfer of contractual relationships; and,

- Effective cooperation and information exchange domestically and among jurisdictions in the event of a failure of a cross-border institution.

Addressing Systemically Important Financial Institutions

18. We welcomed the FSB's interim report on reducing the moral hazard risks posed by systemically important financial institutions. We recognized that more must be done to address these risks. Prudential requirements for such firms should be commensurate with the cost of their failure. We called upon the FSB to consider and develop concrete policy recommendations to effectively address problems associated with and resolve systemically important financial institutions by the Seoul Summit. This should include more intensive supervision along with consideration of financial instruments and mechanisms to encourage market discipline, including contingent capital, bail-in options, surcharges, levies, structural constraints, and methods to haircut unsecured creditors.

19. We welcomed the substantial progress that has been made regarding the development of supervisory colleges and crisis management groups for the major complex financial institutions identified by the FSB.

20. We continue to work together to develop robust agreed-upon institution-specific recovery and rapid resolution plans for major cross-border institutions by the end of 2010. We further committed to continue working on ensuring cooperation among jurisdictions in financial institution resolution proceedings.

Financial Sector Responsibility

21. We agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or fund resolution.

22. To that end, we recognized that there is a range of policy approaches. Some countries are pursuing a financial levy. Other countries are pursuing different approaches. We agreed the range of approaches would follow these principles:
    - Protect taxpayers;
    - Reduce risks from the financial system;
    - Protect the flow of credit in good times and bad times;
    - Take into account individual countries' circumstances and options; and,
    - Help promote a level playing field.

23. We thanked the IMF for its work in this area.

Financial Market Infrastructure and Scope of Regulation

24. We agreed on the need to strengthen financial market infrastructure in order to reduce systemic risk, improve market efficiency, transparency and integrity. Global action is important to minimize regulatory arbitrage, promote a level playing field, and foster the widespread application of the principles of propriety, integrity, and transparency.

25. We pledged to work in a coordinated manner to accelerate the implementation of over-the-counter (OTC) derivatives regulation and supervision and to increase transparency and standardization. We reaffirm our commitment to trade all standardized OTC derivatives contracts on exchanges or electronic trading platforms, where appropriate, and clear through central counterparties (CCPs) by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories (TRs). We will work towards the establishment of CCPs and TRs in line with global standards and ensure that national regulators and supervisors have access to all relevant information. In addition we agreed to pursue policy measures with respect to haircut-setting and margining practices for securities financing and OTC derivatives transactions that will reduce procyclicality and enhance financial market resilience. We recognized that much work has been done in this area. We will continue to support further progress in implementing these measures.

26. We committed to accelerate the implementation of strong measures to improve transparency and regulatory oversight of hedge funds, credit rating agencies and over-the-counter derivatives in an internationally consistent and non-discriminatory way. We also committed to improve the functioning and transparency of commodities markets. We call on credit rating agencies to increase transparency and improve quality and avoid conflicts of interest, and on national supervisors to continue to focus on these issues in conducting their oversight.

27. We committed to reduce reliance on external ratings in rules and regulations. We acknowledged the work underway at the BCBS to address adverse incentives arising from the use of external ratings in the regulatory capital framework, and at the FSB to develop general principles to reduce authorities' and financial institutions' reliance on external ratings. We called on them to report to our Finance Ministers and Central Bank Governors in October 2010.

28. We acknowledged the significant work of the International Organization of Securities Commission (IOSCO) to facilitate the exchange of information amongst regulators and supervisors, as well as IOSCO's principles regarding the oversight of hedge funds aimed at addressing related regulatory and systemic risks.

29. We called on the FSB to review national and regional implementation of prior G-20 commitments in these areas and promote global policy cohesion and to assess and report to

our Finance Ministers and Central Bank Governors in October 2010 if further work is required.

Accounting Standards

30. We re-emphasized the importance we place on achieving a single set of high quality improved global accounting standards. We urged the International Accounting Standards Board and the Financial Accounting Standards Board to increase their efforts to complete their convergence project by the end of 2011.

31. We encouraged the International Accounting Standards Board to further improve the involvement of stakeholders, including outreach to emerging market economies, within the framework of the independent accounting standard setting process.

Assessment and Peer Review

32. We pledged to support robust and transparent independent international assessment and peer review of our financial systems through the IMF and World Bank's Financial Sector Assessment Program and the FSB peer review process. The mutual dependence and integrated nature of our financial system requires that we all live up to our commitments. Weak financial systems in some countries pose a threat to the stability of the international financial system. International assessment and peer review are fundamental in making the financial sector safer for all.

33. We reaffirmed the FSB's principal role in the elaboration of international financial sector supervisory and regulatory policies and standards, co-ordination across various standard-setting bodies, and ensuring accountability for the reform agenda by conducting thematic and country peer reviews and fostering a level playing field through coherent implementation across sectors and jurisdictions. To that end, we encourage the FSB to look at ways to strengthen its capacity to keep pace with growing demands.

34. We called upon the FSB to expand upon and formalize its outreach activities beyond the membership of the G-20 to reflect the global nature of our financial system. We recognized the prominent role of the FSB, along with other important organizations including, the IMF and World Bank. These organizations, along with other international standard setters and supervisory authorities, play a central role to the health and well-being of our financial system.

35. We fully support the FSB's thematic peer reviews as a means of fostering consistent cross-country implementation of financial and regulatory policies and to assess their effectiveness in achieving their intended results. We welcomed the FSB's first thematic peer review report on compensation, which showed progress in the implementation of the FSB's

standards for sound compensation, but full implementation is far from complete. We encouraged all countries and financial institutions to fully implement the FSB principles and standards by year-end. We call on the FSB to undertake ongoing monitoring in this area and conduct a second thorough peer review in the second quarter of 2011. We also look forward to the results of the FSB's thematic review of risk disclosures.

36. We acknowledged the significant progress in the FSB's country review program. These reviews are an important complement to the IMF/World Bank Financial Sector Assessment Program and provide a forum for peer learning and dialogue to address challenges. Three reviews will be completed this year.

Other International Standards and Non-cooperative Jurisdictions

37. We agreed to consider measures and mechanisms to address non-cooperative jurisdictions based on comprehensive, consistent and transparent assessment, and encourage adherence, including by providing technical support, with the support of the international financial institutions (IFIs).

38. We fully support the work of the Global Forum on Transparency and Exchange of Information for Tax Purposes, and welcomed progress on their peer review process, and the development of a multilateral mechanism for information exchange which will be open to all interested countries. Since our meeting in London in April 2009, the number of signed tax information agreements has increased by almost 500. We encourage the Global Forum to report to Leaders by November 2011 on progress countries have made in addressing the legal framework required to achieve an effective exchange of information. We also welcome progress on the Stolen Asset Recovery Program, and support its efforts to monitor progress to recover the proceeds of corruption. We stand ready to use countermeasures against tax havens.

39. We fully support the work of the Financial Action Task Force (FATF) and FATF-Style Regional Bodies in their fight against money laundering and terrorist financing and regular updates of a public list on jurisdictions with strategic deficiencies. We also encourage the FATF to continue monitoring and enhancing global compliance with the anti-money laundering and counter-terrorism financing international standards.

40. We welcomed the implementation of the FSB's evaluation process on the adherence to prudential information exchange and international cooperation standards in all jurisdictions.

ANNEX III

Enhancing the Legitimacy, Credibility and Effectiveness of the IFIs and Further Supporting the Needs of the Most Vulnerable

1. The global economic and financial crisis has demonstrated the value of the International Financial Institutions (IFIs) as instruments for coordinating multilateral action. These institutions were on the front-line in responding to the crisis, mobilizing $985 billion in critical financing. In addition, the international community and the IFIs mobilized over $250 billion in trade finance.

2. The crisis also demonstrated the importance of delivering further reforms. As key platforms for our cooperation, we are committed to strengthening the legitimacy, credibility and effectiveness of the IFIs, to ensure that they are capable of helping us maintain global financial and economic stability and supporting the growth and development of all their members.

3. To enhance the legitimacy and effectiveness of the IFIs, we committed in London and Pittsburgh to support new open, transparent and merit-based selection processes for the heads and senior leadership of all International Financial Institutions. We will strengthen these processes in the lead up to the Seoul Summit in the context of broader reform.

MDB Financing

4. Since the start of the global financial crisis, the MDBs have been playing an important role in the global response by exceeding our London commitment, in providing $235 billion in lending, more than half of which has come from the World Bank Group. At a time when private sector sources of finance were diminished, this lending was critical to global stabilization. Now more than ever, the MDBs are key development partners for many countries.

5. We have fulfilled our commitment to ensure that the MDBs have appropriate resources through capital increases for the major MDBs, including the Asian Development Bank (AsDB), the African Development Bank (AfDB), the Inter-American Development Bank (IADB), the European Bank for Reconstruction and Development (EBRD), the World Bank Group, notably the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC). As major shareholders at these institutions, we have worked together with other members to increase their capital base by 85%, or approximately $350 billion. Overall, their total lending to developing countries will grow from $37 billion per year to $71 billion per year. This will improve their ability to address the increasing demand in the short and medium terms and to have enough resources to

support their members. We support efforts to implement these agreements as quickly as possible.

MDB	Capital Increase	Pre-Crisis Annual Lending[a]	New Annual Lending[b]
AfDB	200% increase	$1.8 B	$6 B
AsDB	200% increase	$5.8 B	$10 B
EBRD[c]	50% increase	$5.3 B	$11 B
IADB[d]	70% increase	$6.7 B	$12 B
IBRD	30% increase	$12.1 B	$15 B
IFC	$200M selective capital increase	$5.4 B	$17 B
Total	**85% increase in MDB capital**	**$37 B**	**$71 B**

***All dollar figures USD**

[a] 2000-2008. [b] 2012-2020. [c] mostly callable, of a temporary nature, for CRR4; [d] Includes agreement to relieve Haiti's debt to the IADB

6. We recognize the acute development needs in Africa, the region the furthest behind on the Millennium Development Goals. For this reason, the African Development Bank will be capitalized for substantial growth, with a 200% increase in its capital and corresponding tripling of its annual lending levels, to strengthen capacity to support the region's long-term growth and development.

7. To ensure that the IFC has the resources necessary for its continued growth, we will consider a long-term hybrid instrument to shareholders and earnings retention, to complement the recent selective capital increase linked to voice reforms.

8. In order to support low income countries, given their need to borrow at more concessional terms, we will fulfill our commitment to ensure an ambitious replenishment for the concessional lending facilities of the MDBs, especially the International Development Association (IDA) and the African Development Fund, which are undergoing financial replenishments this year. We welcome the fact that many G-20 members have taken important steps to join as donors to these institutions. We reiterated our support for fairer and wider burden sharing.

MDB Reforms

9. We have also fulfilled our commitment to ensure that these capital increases are joined to ongoing and important institutional reforms to make the MDBs more effective, efficient and accountable. These include:

- Commitments to further support the poorest countries in a financially prudent way, including by transferring resources, where feasible, from MDB net income to their respective lending facilities for low income countries and increasing their investment activities in low income countries and frontier regions. This will ensure that the new capital resources benefit both low income and middle income countries.
- Specific actions for greater transparency, stronger accountability, improved institutional governance deeper country ownership, more decentralization and use of country systems where appropriate, and enhanced procurement guidelines, new ways of managing and tracking results and financial contributions, strengthen knowledge management, ensuring the right human resources with appropriate diversity, better implementing environmental and social safeguards, sound risk management, and ensuring financial sustainability with pricing linked to expenses, and a commitment to continue to reduce administrative expenses and make them more transparent.
- Deeper support for private sector development, including through more private sector operations and investment, as a vital component of sustainable and inclusive development.
- Recommitting to their core development mandates and taking up a greater role in the provision of global solutions to transnational problems, such as climate change and food security.

10. With these reform commitments, we are building not just bigger MDBs, but better MDBs, with more strategic focus on lifting the lives of the poor, underwriting growth, promoting security, and addressing the global challenges of climate change and food security. Implementation of these reforms has already begun, and we will continue to ensure that this work is completed and that further reforms are undertaken where necessary.

World Bank Group Voice Reforms

11. We welcomed the agreement on the World Bank's voice reform to increase the voting power of developing and transition countries by 3.13% consistent with the agreement at the Pittsburgh Summit. When combined with the 1.46% increase agreed in the previous phase of the reforms, this will provide a total shift of 4.59% to DTCs, bringing their overall voting power to 47.19%. We committed to continue moving over time towards equitable voting power, while protecting the smallest nations, by arriving at a dynamic formula which primarily reflects countries' evolving economic weight and the World Bank's development mission. We also endorsed voice reforms at the IFC which will provide a total shift of 6.07%, to bring DTC voting power to 39.48%.

Debt Relief for Haiti

12. We stand united with the people of Haiti as they struggle to recover from the devastation wrought by the earthquake in January, and we join other donors in providing assistance in

this difficult time, including through the Haiti Reconstruction Fund set up by the World Bank, the Inter-American Development Bank and the United Nations. To ensure that Haiti's recovery efforts can focus on its reconstruction action plan, rather than the debt obligations of its past, our Finance Ministers agreed last April to support full cancellation of Haiti's debts to all IFIs, including through burden sharing of the associated costs, where necessary. We are pleased that an agreement on a framework for cancelling such debt has been reached at the IMF; the World Bank, the International Fund for Agriculture Development, and soon at the Inter-American Development Bank. We will contribute our fair shares of the associated costs as soon as possible. We will report on progress at the Seoul Summit.

IMF Reforms

13. We are committed to strengthening the legitimacy, credibility and effectiveness of the IMF to ensure it succeeds in carrying out its mandate. Important actions have been taken by the G-20 and the international community since the onset of the crisis, including the mobilization of $750 billion to support IMF members' needs for crisis financing. The IMF raised $250 billion in new resources through immediate bilateral loans and note purchase agreements, to be subsequently incorporated into a $500 billion expansion of the New Arrangements to Borrow (NAB). The IMF also implemented a $250 billion new general allocation of SDRs to bolster the foreign exchange reserves of all members. Along with important surveillance and lending reforms, including a new early-warning exercise and the creation of new precautionary instruments such as the Flexible Credit Line, these actions have significantly increased the IMF's crisis response capacity. However, important work remains to be completed to fully reform the IMF.

14. We called for an acceleration of the substantial work still needed for the IMF to complete the quota reform by the Seoul Summit and in parallel deliver on other governance reforms, in line with commitments made in Pittsburgh. Modernizing the IMF's governance is a core element of our effort to improve the IMF's credibility, legitimacy, and effectiveness. We recognize that the IMF should remain a quota-based organization and that the distribution of quotas should reflect the relative weights of its members in the world economy, which have changed substantially in view of the strong growth in dynamic emerging market and developing countries. To this end, we are committed to a shift in quota share to dynamic emerging market and developing countries of at least five percent from over-represented to under-represented countries using the current IMF quota formula as the basis to work from. We are also committed to protecting the voting share of the poorest in the IMF. As part of this process, we agree that a number of other critical issues will need to be addressed, including: the size of any increase in IMF quotas, which will have a bearing on the ability to facilitate change in quota shares; the size and composition of the Executive Board; ways of enhancing the Board's effectiveness; and the Fund Governors' involvement in the strategic oversight of the IMF. Staff diversity should be enhanced.

15. We underscored our resolve to ensure the IMF has the resources it needs so that it can play its important role in the world economy. The majority of G-20 members have ratified the 2008 IMF Quota and Voice Reforms, fulfilling an important commitment made in London. Those members who have yet to ratify commit to doing so by the Seoul Summit. This action will not just enhance the legitimacy of the IMF by increasing the voice and participation of developing countries, it will also provide the IMF with $30 billion in new quota resources. We call on all IMF members to ratify the agreement this year.

16. A number of G-20 members have already formally accepted the recently agreed reforms to the expanded NAB, which will provide a significant back-stop to IMF quota resources, consolidating over $500 billion for IMF lending to countries in crisis. Other participating G-20 members will complete the acceptance process by the next meeting of G-20 Finance Ministers and Central Bank Governors. We call on all existing and new NAB participants to do the same.

17. G-20 members committed to ensure that the IMF's concessional financing for the poorest countries be expanded by $6 billion through the proceeds from the agreed sale of IMF gold, consistent with the IMF's new income model, and the employment of internal and other resources. We are delivering. Some G-20 members have supported this commitment with additional loan and subsidy resources for the Poverty Reduction and Growth Trust (PRGT) and some others plan to contribute in the coming months.

18. We acknowledged a need for national, regional and international efforts to deal with capital flow volatility, financial fragility, and prevent crisis contagion. We task our Finance Ministers and Central Bank Governors to prepare policy options, based on sound incentives, to strengthen global financial safety nets for our consideration at the Seoul Summit. In line with these efforts, we also call on the IMF to make rapid progress in reviewing its lending instruments, with a view to further reforming them as appropriate. In parallel, IMF surveillance should be enhanced to focus on systemic risks and vulnerabilities wherever they may lie. Our goal is to build a more stable and resilient international monetary system.

Further Supporting the Needs of the Most Vulnerable

19. We have made significant progress in supporting the poorest countries during the crisis and must continue to take measures to assist the most vulnerable and must ensure that the poorest countries benefit from our efforts to restore global growth. We recognize the urgency of this, and are committed to meeting the Millennium Development Goals by 2015 and will reinforce our efforts to this end, including through the use of Official Development Assistance.

20. We have made concrete progress on our commitment to improving access to financial services for the poor and to increasing financing available to small- and medium-sized enterprises (SMEs) in developing countries.

21. Adequately financed small and medium-sized businesses are vital to job creation and a growing economy, particularly in emerging economies. We have launched the SME Finance Challenge aimed at finding the most promising models for public-private partnerships that catalyze finance for SMEs. We are committed to mobilizing the funding needed to implement winning proposals, including through the strong support of the MDBs. We welcome the strong support of the MDBs for scalable and sustainable SME financing proposals, including those from the Challenge in partnership with the private sector. We look forward to announcing the winning proposals of the SME Finance Challenge and to receiving recommendations to scale-up successful SME finance models at the Seoul Summit.

22. We have developed a set of principles for innovative financial inclusion, which will form the basis of a concrete and pragmatic action plan for improving access to financial services amongst the poor. This action plan will be released at the Seoul Summit.

23. At the Pittsburgh Summit, we recognised the importance of sustained funding and targeted investments to improve long-term food security in low income countries. We welcome the launch of the Global Agriculture and Food Security Program (GAFSP), which will provide predictable financing for low income countries to improve agricultural productivity, raise rural incomes, and build sustainable agricultural systems. We are particularly pleased that the fund has approved inaugural grants totalling $224 million for Bangladesh, Rwanda, Haiti, Togo, and Sierra Leone. We also support the development of the private sector window of the GAFSP, which will increase private sector investments to support small and medium sized agri-businesses and farmers in poor countries. We welcome the support already received, and encourage additional donor contributions to both the public and private sector windows of the GAFSP.

24. There is still an urgency to accelerate research and development to close agricultural productivity gaps, including through regional and South-South cooperation, amidst growing demands and mounting environmental stresses, particularly in Africa. The private sector will be critical in the development and deployment of innovative solutions that provide concrete results on the ground. We commit to exploring the potential of innovative, results-based mechanisms such as advance market commitments to harness the creativity and resources of the private sector in achieving breakthrough innovations in food security and agriculture development in poor countries. We will report on progress at the Seoul Summit.

DECLARATION
SUMMIT ON FINANCIAL MARKETS AND THE WORLD ECONOMY
November 15, 2008

1. We, the Leaders of the Group of Twenty, held an initial meeting in Washington on November 15, 2008, amid serious challenges to the world economy and financial markets. We are determined to enhance our cooperation and work together to restore global growth and achieve needed reforms in the world's financial systems.

2. Over the past months our countries have taken urgent and exceptional measures to support the global economy and stabilize financial markets. These efforts must continue. At the same time, we must lay the foundation for reform to help to ensure that a global crisis, such as this one, does not happen again. Our work will be guided by a shared belief that market principles, open trade and investment regimes, and effectively regulated financial markets foster the dynamism, innovation, and entrepreneurship that are essential for economic growth, employment, and poverty reduction.

Root Causes of the Current Crisis

3. During a period of strong global growth, growing capital flows, and prolonged stability earlier this decade, market participants sought higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence. At the same time, weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage combined to create vulnerabilities in the system. Policy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions.

4. Major underlying factors to the current situation were, among others, inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms, which led to unsustainable global macroeconomic outcomes. These developments, together, contributed to excesses and ultimately resulted in severe market disruption.

Actions Taken and to Be Taken

5. We have taken strong and significant actions to date to stimulate our economies, provide liquidity, strengthen the capital of financial institutions, protect savings and deposits, address regulatory deficiencies, unfreeze credit markets, and are working to ensure that international financial institutions (IFIs) can provide critical support for the global economy.

6. But more needs to be done to stabilize financial markets and support economic growth. Economic momentum is slowing substantially in major economies and the global outlook has weakened. Many emerging market economies, which helped sustain

the world economy this decade, are still experiencing good growth but increasingly are being adversely impacted by the worldwide slowdown.

7. Against this background of deteriorating economic conditions worldwide, we agreed that a broader policy response is needed, based on closer macroeconomic cooperation, to restore growth, avoid negative spillovers and support emerging market economies and developing countries. As immediate steps to achieve these objectives, as well as to address longer-term challenges, we will:

- Continue our vigorous efforts and take whatever further actions are necessary to stabilize the financial system.
- Recognize the importance of monetary policy support, as deemed appropriate to domestic conditions.
- Use fiscal measures to stimulate domestic demand to rapid effect, as appropriate, while maintaining a policy framework conducive to fiscal sustainability.
- Help emerging and developing economies gain access to finance in current difficult financial conditions, including through liquidity facilities and program support. We stress the International Monetary Fund's (IMF) important role in crisis response, welcome its new short-term liquidity facility, and urge the ongoing review of its instruments and facilities to ensure flexibility.
- Encourage the World Bank and other multilateral development banks (MDBs) to use their full capacity in support of their development agenda, and we welcome the recent introduction of new facilities by the World Bank in the areas of infrastructure and trade finance.
- Ensure that the IMF, World Bank and other MDBs have sufficient resources to continue playing their role in overcoming the crisis.

Common Principles for Reform of Financial Markets

8. In addition to the actions taken above, we will implement reforms that will strengthen financial markets and regulatory regimes so as to avoid future crises. Regulation is first and foremost the responsibility of national regulators who constitute the first line of defense against market instability. However, our financial markets are global in scope, therefore, intensified international cooperation among regulators and strengthening of international standards, where necessary, and their consistent implementation is necessary to protect against adverse cross-border, regional and global developments affecting international financial stability. Regulators must ensure that their actions support market discipline, avoid potentially adverse impacts on other countries, including regulatory arbitrage, and support competition, dynamism and innovation in the marketplace. Financial institutions must also bear their responsibility for the turmoil and should do their part to overcome it including by recognizing losses, improving disclosure and strengthening their governance and risk management practices.

9. We commit to implementing policies consistent with the following common principles for reform.

- **Strengthening Transparency and Accountability:** We will strengthen financial market transparency, including by enhancing required disclosure on complex financial products and ensuring complete and accurate disclosure by firms of their financial conditions. Incentives should be aligned to avoid excessive risk-taking.

- **Enhancing Sound Regulation:** We pledge to strengthen our regulatory regimes, prudential oversight, and risk management, and ensure that all financial markets, products and participants are regulated or subject to oversight, as appropriate to their circumstances. We will exercise strong oversight over credit rating agencies, consistent with the agreed and strengthened international code of conduct. We will also make regulatory regimes more effective over the economic cycle, while ensuring that regulation is efficient, does not stifle innovation, and encourages expanded trade in financial products and services. We commit to transparent assessments of our national regulatory systems.

- **Promoting Integrity in Financial Markets:** We commit to protect the integrity of the world's financial markets by bolstering investor and consumer protection, avoiding conflicts of interest, preventing illegal market manipulation, fraudulent activities and abuse, and protecting against illicit finance risks arising from non-cooperative jurisdictions. We will also promote information sharing, including with respect to jurisdictions that have yet to commit to international standards with respect to bank secrecy and transparency.

- **Reinforcing International Cooperation:** We call upon our national and regional regulators to formulate their regulations and other measures in a consistent manner. Regulators should enhance their coordination and cooperation across all segments of financial markets, including with respect to cross-border capital flows. Regulators and other relevant authorities as a matter of priority should strengthen cooperation on crisis prevention, management, and resolution.

- **Reforming International Financial Institutions:** We are committed to advancing the reform of the Bretton Woods Institutions so that they can more adequately reflect changing economic weights in the world economy in order to increase their legitimacy and effectiveness. In this respect, emerging and developing economies, including the poorest countries, should have greater voice and representation. The Financial Stability Forum (FSF) must expand urgently to a broader membership of emerging economies, and other major standard setting bodies should promptly review their membership. The IMF, in collaboration with the expanded FSF and other bodies, should work to better identify vulnerabilities, anticipate potential stresses, and act swiftly to play a key role in crisis response.

Tasking of Ministers and Experts

10. We are committed to taking rapid action to implement these principles. We instruct our Finance Ministers, as coordinated by their 2009 G-20 leadership (Brazil, UK, Republic of Korea), to initiate processes and a timeline to do so. An initial list of specific measures is set forth in the attached Action Plan, including high priority actions to be completed prior to March 31, 2009.

In consultation with other economies and existing bodies, drawing upon the recommendations of such eminent independent experts as they may appoint, we request our Finance Ministers to formulate additional recommendations, including in the following specific areas:

- Mitigating against pro-cyclicality in regulatory policy;
- Reviewing and aligning global accounting standards, particularly for complex securities in times of stress;
- Strengthening the resilience and transparency of credit derivatives markets and reducing their systemic risks, including by improving the infrastructure of over-the-counter markets;
- Reviewing compensation practices as they relate to incentives for risk taking and innovation;
- Reviewing the mandates, governance, and resource requirements of the IFIs; and
- Defining the scope of systemically important institutions and determining their appropriate regulation or oversight.

11. In view of the role of the G-20 in financial systems reform, we will meet again by April 30, 2009, to review the implementation of the principles and decisions agreed today.

Commitment to an Open Global Economy

12. We recognize that these reforms will only be successful if grounded in a commitment to free market principles, including the rule of law, respect for private property, open trade and investment, competitive markets, and efficient, effectively regulated financial systems. These principles are essential to economic growth and prosperity and have lifted millions out of poverty, and have significantly raised the global standard of living. Recognizing the necessity to improve financial sector regulation, we must avoid over-regulation that would hamper economic growth and exacerbate the contraction of capital flows, including to developing countries.

13. We underscore the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty. In this regard, within the next 12 months, we will refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports. Further, we shall strive to reach agreement

this year on modalities that leads to a successful conclusion to the WTO's Doha Development Agenda with an ambitious and balanced outcome. We instruct our Trade Ministers to achieve this objective and stand ready to assist directly, as necessary. We also agree that our countries have the largest stake in the global trading system and therefore each must make the positive contributions necessary to achieve such an outcome.

14. We are mindful of the impact of the current crisis on developing countries, particularly the most vulnerable. We reaffirm the importance of the Millennium Development Goals, the development assistance commitments we have made, and urge both developed and emerging economies to undertake commitments consistent with their capacities and roles in the global economy. In this regard, we reaffirm the development principles agreed at the 2002 United Nations Conference on Financing for Development in Monterrey, Mexico, which emphasized country ownership and mobilizing all sources of financing for development.

15. We remain committed to addressing other critical challenges such as energy security and climate change, food security, the rule of law, and the fight against terrorism, poverty and disease.

16. As we move forward, we are confident that through continued partnership, cooperation, and multilateralism, we will overcome the challenges before us and restore stability and prosperity to the world economy.

Action Plan to Implement Principles for Reform

This Action Plan sets forth a comprehensive work plan to implement the five agreed principles for reform. Our finance ministers will work to ensure that the taskings set forth in this Action Plan are fully and vigorously implemented. They are responsible for the development and implementation of these recommendations drawing on the ongoing work of relevant bodies, including the International Monetary Fund (IMF), an expanded Financial Stability Forum (FSF), and standard setting bodies.

Strengthening Transparency and Accountability

Immediate Actions by March 31, 2009

- The key global accounting standards bodies should work to enhance guidance for valuation of securities, also taking into account the valuation of complex, illiquid products, especially during times of stress.
- Accounting standard setters should significantly advance their work to address weaknesses in accounting and disclosure standards for off-balance sheet vehicles.
- Regulators and accounting standard setters should enhance the required disclosure of complex financial instruments by firms to market participants.
- With a view toward promoting financial stability, the governance of the international accounting standard setting body should be further enhanced, including by undertaking a review of its membership, in particular in order to ensure transparency, accountability, and an appropriate relationship between this independent body and the relevant authorities.
- Private sector bodies that have already developed best practices for private pools of capital and/or hedge funds should bring forward proposals for a set of unified best practices. Finance Ministers should assess the adequacy of these proposals, drawing upon the analysis of regulators, the expanded FSF, and other relevant bodies.

Medium-term actions

- The key global accounting standards bodies should work intensively toward the objective of creating a single high-quality global standard.
- Regulators, supervisors, and accounting standard setters, as appropriate, should work with each other and the private sector on an ongoing basis to ensure consistent application and enforcement of high-quality accounting standards.
- Financial institutions should provide enhanced risk disclosures in their reporting and disclose all losses on an ongoing basis, consistent with international best practice, as appropriate. Regulators should work to ensure that a financial institution' financial statements include a complete, accurate, and timely picture of the firm's activities (including off-balance sheet activities) and are reported on a consistent and regular basis.

Enhancing Sound Regulation

Regulatory Regimes

Immediate Actions by March 31, 2009

- The IMF, expanded FSF, and other regulators and bodies should develop recommendations to mitigate pro-cyclicality, including the review of how valuation and leverage, bank capital, executive compensation, and provisioning practices may exacerbate cyclical trends.

Medium-term actions

- To the extent countries or regions have not already done so, each country or region pledges to review and report on the structure and principles of its regulatory system to ensure it is compatible with a modern and increasingly globalized financial system. To this end, all G-20 members commit to undertake a Financial Sector Assessment Program (FSAP) report and support the transparent assessments of countries' national regulatory systems.
- The appropriate bodies should review the differentiated nature of regulation in the banking, securities, and insurance sectors and provide a report outlining the issue and making recommendations on needed improvements. A review of the scope of financial regulation, with a special emphasis on institutions, instruments, and markets that are currently unregulated, along with ensuring that all systemically-important institutions are appropriately regulated, should also be undertaken.
- National and regional authorities should review resolution regimes and bankruptcy laws in light of recent experience to ensure that they permit an orderly wind-down of large complex cross-border financial institutions.
- Definitions of capital should be harmonized in order to achieve consistent measures of capital and capital adequacy.

Prudential Oversight

Immediate Actions by March 31, 2009

- Regulators should take steps to ensure that credit rating agencies meet the highest standards of the international organization of securities regulators and that they avoid conflicts of interest, provide greater disclosure to investors and to issuers, and differentiate ratings for complex products. This will help ensure that credit rating agencies have the right incentives and appropriate oversight to enable them to perform their important role in providing unbiased information and assessments to markets.
- The international organization of securities regulators should review credit rating agencies' adoption of the standards and mechanisms for monitoring compliance.
- Authorities should ensure that financial institutions maintain adequate capital in amounts necessary to sustain confidence. International standard setters should set out strengthened capital requirements for banks' structured credit and securitization activities.

- Supervisors and regulators, building on the imminent launch of central counterparty services for credit default swaps (CDS) in some countries, should: speed efforts to reduce the systemic risks of CDS and over-the-counter (OTC) derivatives transactions; insist that market participants support exchange traded or electronic trading platforms for CDS contracts; expand OTC derivatives market transparency; and ensure that the infrastructure for OTC derivatives can support growing volumes.

Medium-term actions

- Credit Ratings Agencies that provide public ratings should be registered.
- Supervisors and central banks should develop robust and internationally consistent approaches for liquidity supervision of, and central bank liquidity operations for, cross-border banks.

Risk Management

Immediate Actions by March 31, 2009

- Regulators should develop enhanced guidance to strengthen banks' risk management practices, in line with international best practices, and should encourage financial firms to reexamine their internal controls and implement strengthened policies for sound risk management.
- Regulators should develop and implement procedures to ensure that financial firms implement policies to better manage liquidity risk, including by creating strong liquidity cushions.
- Supervisors should ensure that financial firms develop processes that provide for timely and comprehensive measurement of risk concentrations and large counterparty risk positions across products and geographies.
- Firms should reassess their risk management models to guard against stress and report to supervisors on their efforts.
- The Basel Committee should study the need for and help develop firms' new stress testing models, as appropriate.
- Financial institutions should have clear internal incentives to promote stability, and action needs to be taken, through voluntary effort or regulatory action, to avoid compensation schemes which reward excessive short-term returns or risk taking.
- Banks should exercise effective risk management and due diligence over structured products and securitization.

Medium -term actions

- International standard setting bodies, working with a broad range of economies and other appropriate bodies, should ensure that regulatory policy makers are aware and able to respond rapidly to evolution and innovation in financial markets and products.
- Authorities should monitor substantial changes in asset prices and their implications for the macroeconomy and the financial system.

Promoting Integrity in Financial Markets

Immediate Actions by March 31, 2009

- Our national and regional authorities should work together to enhance regulatory cooperation between jurisdictions on a regional and international level.
- National and regional authorities should work to promote information sharing about domestic and cross-border threats to market stability and ensure that national (or regional, where applicable) legal provisions are adequate to address these threats.
- National and regional authorities should also review business conduct rules to protect markets and investors, especially against market manipulation and fraud and strengthen their cross-border cooperation to protect the international financial system from illicit actors. In case of misconduct, there should be an appropriate sanctions regime.

Medium -term actions

- National and regional authorities should implement national and international measures that protect the global financial system from uncooperative and non-transparent jurisdictions that pose risks of illicit financial activity.
- The Financial Action Task Force should continue its important work against money laundering and terrorist financing, and we support the efforts of the World Bank - UN Stolen Asset Recovery (StAR) Initiative.
- Tax authorities, drawing upon the work of relevant bodies such as the Organization for Economic Cooperation and Development (OECD), should continue efforts to promote tax information exchange. Lack of transparency and a failure to exchange tax information should be vigorously addressed.

Reinforcing International Cooperation

Immediate Actions by March 31, 2009

- Supervisors should collaborate to establish supervisory colleges for all major cross-border financial institutions, as part of efforts to strengthen the surveillance of cross-border firms. Major global banks should meet regularly with their supervisory college for comprehensive discussions of the firm's activities and assessment of the risks it faces.
- Regulators should take all steps necessary to strengthen cross-border crisis management arrangements, including on cooperation and communication with each other and with appropriate authorities, and develop comprehensive contact lists and conduct simulation exercises, as appropriate.

Medium -term actions

- Authorities, drawing especially on the work of regulators, should collect information on areas where convergence in regulatory practices such as accounting standards, auditing, and deposit insurance is making progress, is in need of accelerated progress, or where there may be potential for progress.

- Authorities should ensure that temporary measures to restore stability and confidence have minimal distortions and are unwound in a timely, well-sequenced and coordinated manner.

Reforming International Financial Institutions

Immediate Actions by March 31, 2009

- The FSF should expand to a broader membership of emerging economies.
- The IMF, with its focus on surveillance, and the expanded FSF, with its focus on standard setting, should strengthen their collaboration, enhancing efforts to better integrate regulatory and supervisory responses into the macro-prudential policy framework and conduct early warning exercises.
- The IMF, given its universal membership and core macro-financial expertise, should, in close coordination with the FSF and others, take a leading role in drawing lessons from the current crisis, consistent with its mandate.
- We should review the adequacy of the resources of the IMF, the World Bank Group and other multilateral development banks and stand ready to increase them where necessary. The IFIs should also continue to review and adapt their lending instruments to adequately meet their members' needs and revise their lending role in the light of the ongoing financial crisis.
- We should explore ways to restore emerging and developing countries' access to credit and resume private capital flows which are critical for sustainable growth and development, including ongoing infrastructure investment.
- In cases where severe market disruptions have limited access to the necessary financing for counter-cyclical fiscal policies, multilateral development banks must ensure arrangements are in place to support, as needed, those countries with a good track record and sound policies.

Medium -term actions

- We underscored that the Bretton Woods Institutions must be comprehensively reformed so that they can more adequately reflect changing economic weights in the world economy and be more responsive to future challenges. Emerging and developing economies should have greater voice and representation in these institutions.
- The IMF should conduct vigorous and even-handed surveillance reviews of all countries, as well as giving greater attention to their financial sectors and better integrating the reviews with the joint IMF/World Bank financial sector assessment programs. On this basis, the role of the IMF in providing macro-financial policy advice would be strengthened.
- Advanced economies, the IMF, and other international organizations should provide capacity-building programs for emerging market economies and developing countries on the formulation and the implementation of new major regulations, consistent with international standards.

DECLARATION ON STRENGTHENING THE FINANCIAL SYSTEM – LONDON SUMMIT, 2 APRIL 2009

We, the Leaders of the G20, have taken, and will continue to take, action to strengthen regulation and supervision in line with the commitments we made in Washington to reform the regulation of the financial sector. Our principles are strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets and reinforcing international cooperation. The material in this declaration expands and provides further detail on the commitments in our statement. We published today a full progress report against each of the 47 actions set out in the Washington Action Plan. In particular, we have agreed the following major reforms.

<u>Financial Stability Board</u>

We have agreed that the Financial Stability Forum should be expanded, given a broadened mandate to promote financial stability, and re-established with a stronger institutional basis and enhanced capacity as the Financial Stability Board (FSB).
The FSB will:

- assess vulnerabilities affecting the financial system, identify and oversee action needed to address them;
- promote co-ordination and information exchange among authorities responsible for financial stability;
- monitor and advise on market developments and their implications for regulatory policy;
- advise on and monitor best practice in meeting regulatory standards;
- undertake joint strategic reviews of the policy development work of the international Standard Setting Bodies to ensure their work is timely, coordinated, focused on priorities, and addressing gaps;
- set guidelines for, and support the establishment, functioning of, and participation in, supervisory colleges, including through ongoing identification of the most systemically important cross-border firms;
- support contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and
- collaborate with the IMF to conduct Early Warning Exercises to identify and report to the IMFC and the G20 Finance Ministers and Central Bank Governors on the build up of macroeconomic and financial risks and the actions needed to address them.

Members of the FSB commit to pursue the maintenance of financial stability, enhance the openness and transparency of the financial sector, and implement international financial standards (including the 12 key International Standards and Codes), and agree to undergo periodic peer reviews, using among other evidence IMF / World Bank public Financial Sector Assessment Program reports. The FSB will elaborate and report on these commitments and the evaluation process.

We welcome the FSB's and IMF's commitment to intensify their collaboration, each complementing the other's role and mandate.

International cooperation

To strengthen international cooperation we have agreed:

- to establish the remaining supervisory colleges for significant cross-border firms by June 2009, building on the 28 already in place;
- to implement the FSF principles for cross-border crisis management immediately, and that home authorities of each major international financial institution should ensure that the group of authorities with a common interest in that financial institution meet at least annually;
- to support continued efforts by the IMF, FSB, World Bank, and BCBS to develop an international framework for cross-border bank resolution arrangements;
- the importance of further work and international cooperation on the subject of exit strategies;
- that the IMF and FSB should together launch an Early Warning Exercise at the 2009 Spring Meetings.

Prudential regulation

We have agreed to strengthen international frameworks for prudential regulation:

- until recovery is assured the international standard for the minimum level of capital should remained unchanged;
- where appropriate, capital buffers above the required minima should be allowed to decline to facilitate lending in deteriorating economic conditions;
- once recovery is assured, prudential regulatory standards should be strengthened. Buffers above regulatory minima should be increased and the quality of capital should be enhanced. Guidelines for harmonisation of the definition of capital should be produced by end 2009. The BCBS should review minimum levels of capital and develop recommendations in 2010;
- the FSB, BCBS, and CGFS, working with accounting standard setters, should take forward, with a deadline of end 2009, implementation of the recommendations published today to mitigate procyclicality, including a requirement for banks to build buffers of resources in good times that they can draw down when conditions deteriorate;
- risk-based capital requirements should be supplemented with a simple, transparent, non-risk based measure which is internationally comparable, properly takes into account off-balance sheet exposures, and can help contain the build-up of leverage in the banking system;
- the BCBS and authorities should take forward work on improving incentives for risk management of securitisation, including considering due diligence and quantitative retention requirements, by 2010;
- all G20 countries should progressively adopt the Basel II capital framework; and

- the BCBS and national authorities should develop and agree by 2010 a global framework for promoting stronger liquidity buffers at financial institutions, including cross-border institutions.

The scope of regulation

We have agreed that all systemically important financial institutions, markets, and instruments should be subject to an appropriate degree of regulation and oversight. In particular:

- we will amend our regulatory systems to ensure authorities are able to identify and take account of macro-prudential risks across the financial system including in the case of regulated banks, shadow banks, and private pools of capital to limit the build up of systemic risk. We call on the FSB to work with the BIS and international standard setters to develop macro-prudential tools and provide a report by autumn 2009;
- large and complex financial institutions require particularly careful oversight given their systemic importance;
- we will ensure that our national regulators possess the powers for gathering relevant information on all material financial institutions, markets, and instruments in order to assess the potential for their failure or severe stress to contribute to systemic risk. This will be done in close coordination at international level in order to achieve as much consistency as possible across jurisdictions;
- in order to prevent regulatory arbitrage, the IMF and the FSB will produce guidelines for national authorities to assess whether a financial institution, market, or an instrument is systemically important by the next meeting of our Finance Ministers and Central Bank Governors. These guidelines should focus on what institutions do rather than their legal form;
- hedge funds or their managers will be registered and will be required to disclose appropriate information on an ongoing basis to supervisors or regulators, including on their leverage, necessary for assessment of the systemic risks that they pose individually or collectively. Where appropriate, registration should be subject to a minimum size. They will be subject to oversight to ensure that they have adequate risk management. We ask the FSB to develop mechanisms for cooperation and information sharing between relevant authorities in order to ensure that effective oversight is maintained where a fund is located in a different jurisdiction from the manager. We will, cooperating through the FSB, develop measures that implement these principles by the end of 2009. We call on the FSB to report to the next meeting of our Finance Ministers and Central Bank Governors;
- supervisors should require that institutions which have hedge funds as their counterparties have effective risk management. This should include mechanisms to monitor the funds' leverage and set limits for single counterparty exposures;
- we will promote the standardisation and resilience of credit derivatives markets, in particular through the establishment of central clearing counterparties subject to effective regulation and supervision. We call on the industry to develop an action plan on standardisation by autumn 2009; and

- we will each review and adapt the boundaries of the regulatory framework regularly to keep pace with developments in the financial system and promote good practices and consistent approaches at the international level.

Compensation

We have endorsed the principles on pay and compensation in significant financial institutions developed by the FSF to ensure compensation structures are consistent with firms' long-term goals and prudent risk taking. We have agreed that our national supervisors should ensure significant progress in the implementation of these principles by the 2009 remuneration round. The BCBS should integrate these principles into their risk management guidance by autumn 2009. The principles, which have today been published, require:

- firms' boards of directors to play an active role in the design, operation, and evaluation of compensation schemes;
- compensation arrangements, including bonuses, to properly reflect risk and the timing and composition of payments to be sensitive to the time horizon of risks. Payments should not be finalised over short periods where risks are realised over long periods; and
- firms to publicly disclose clear, comprehensive, and timely information about compensation. Stakeholders, including shareholders, should be adequately informed on a timely basis on compensation policies to exercise effective monitoring.

Supervisors will assess firms' compensation policies as part of their overall assessment of their soundness. Where necessary they will intervene with responses that can include increased capital requirements.

Tax havens and non-cooperative jurisdictions

It is essential to protect public finances and international standards against the risks posed by non-cooperative jurisdictions. We call on all jurisdictions to adhere to the international standards in the prudential, tax, and AML/CFT areas. To this end, we call on the appropriate bodies to conduct and strengthen objective peer reviews, based on existing processes, including through the FSAP process.

We call on countries to adopt the international standard for information exchange endorsed by the G20 in 2004 and reflected in the UN Model Tax Convention. We note that the OECD has today published a list of countries assessed by the Global Forum against the international standard for exchange of information. We welcome the new commitments made by a number of jurisdictions and encourage them to proceed swiftly with implementation.

We stand ready to take agreed action against those jurisdictions which do not meet international standards in relation to tax transparency. To this end we have agreed to develop a toolbox of effective counter measures for countries to consider, such as:

- increased disclosure requirements on the part of taxpayers and financial institutions to report transactions involving non-cooperative jurisdictions;
- withholding taxes in respect of a wide variety of payments;
- denying deductions in respect of expense payments to payees resident in a non-cooperative jurisdiction;
- reviewing tax treaty policy;
- asking international institutions and regional development banks to review their investment policies; and,
- giving extra weight to the principles of tax transparency and information exchange when designing bilateral aid programs.

We also agreed that consideration should be given to further options relating to financial relations with these jurisdictions

We are committed to developing proposals, by end 2009, to make it easier for developing countries to secure the benefits of a new cooperative tax environment.

We are also committed to strengthened adherence to international prudential regulatory and supervisory standards. The IMF and the FSB in cooperation with international standard-setters will provide an assessment of implementation by relevant jurisdictions, building on existing FSAPs where they exist. We call on the FSB to develop a toolbox of measures to promote adherence to prudential standards and cooperation with jurisdictions.

We agreed that the FATF should revise and reinvigorate the review process for assessing compliance by jurisdictions with AML/CFT standards, using agreed evaluation reports where available.

We call upon the FSB and the FATF to report to the next G20 Finance Ministers and Central Bank Governors' meeting on adoption and implementation by countries.

Accounting standards

We have agreed that the accounting standard setters should improve standards for the valuation of financial instruments based on their liquidity and investors' holding horizons, while reaffirming the framework of fair value accounting.

We also welcome the FSF recommendations on procyclicality that address accounting issues. We have agreed that accounting standard setters should take action by the end of 2009 to:

- reduce the complexity of accounting standards for financial instruments;
- strengthen accounting recognition of loan-loss provisions by incorporating a broader range of credit information;
- improve accounting standards for provisioning, off-balance sheet exposures and valuation uncertainty;

- achieve clarity and consistency in the application of valuation standards internationally, working with supervisors;
- make significant progress towards a single set of high quality global accounting standards; and,
- within the framework of the independent accounting standard setting process, improve involvement of stakeholders, including prudential regulators and emerging markets, through the IASB's constitutional review.

Credit Rating Agencies

We have agreed on more effective oversight of the activities of Credit Rating Agencies, as they are essential market participants. In particular, we have agreed that:

- all Credit Rating Agencies whose ratings are used for regulatory purposes should be subject to a regulatory oversight regime that includes registration. The regulatory oversight regime should be established by end 2009 and should be consistent with the IOSCO Code of Conduct Fundamentals. IOSCO should coordinate full compliance;
- national authorities will enforce compliance and require changes to a rating agency's practices and procedures for managing conflicts of interest and assuring the transparency and quality of the rating process. In particular, Credit Rating Agencies should differentiate ratings for structured products and provide full disclosure of their ratings track record and the information and assumptions that underpin the ratings process. The oversight framework should be consistent across jurisdictions with appropriate sharing of information between national authorities, including through IOSCO; and,
- the Basel Committee should take forward its review on the role of external ratings in prudential regulation and determine whether there are any adverse incentives that need to be addressed.

Next Steps

We instruct our Finance Ministers to complete the implementation of these decisions and the attached action plan. We have asked the FSB and the IMF to monitor progress, working with the FATF and the Global Forum, and to provide a report to the next meeting of our Finance Ministers and Central Bank Governors.

G20 GERMANY 2017
HAMBURG

G20 Leaders´ Declaration

Shaping an interconnected world

Hamburg, 7/8 July 2017

Preamble:

We, the Leaders of the G20, met in Hamburg, Germany on 7-8 July 2017 to address major global economic challenges and to contribute to prosperity and well-being.

Mastering the challenges of our age and shaping an interconnected world is the common goal of the G20 as our premier forum for international economic cooperation. The G20 revealed its strength during the global economic and financial crisis some ten years ago when it played a crucial role in stabilising economies and financial markets. What was true then continues to hold: We can achieve more together than by acting alone.

Progressing our joint objective in the G20 – strong, sustainable, balanced and inclusive growth – remains our highest priority.

Globalisation and technological change have contributed significantly to driving economic growth and raising living standards across the globe. However, globalisation has created challenges and its benefits have not been shared widely enough. By bringing together developed and emerging market economies, the G20 is determined to shape globalisation to benefit all people. Most importantly, we need to better enable our people to seize its opportunities.

We are resolved to tackle common challenges to the global community, including terrorism, displacement, poverty, hunger and health threats, job creation, climate change, energy security, and inequality including gender inequality, as a basis for sustainable development and stability. We will continue to work together with others, including developing countries, to address these challenges, building on the rules-based international order.

Expanding on the results of previous presidencies, in particular the 2016 G20 Summit in Hangzhou, we decide today to take concrete actions to advance the three aims of building resilience, improving sustainability and assuming responsibility.

Sharing the Benefits of Globalisation

1. Prospering Global Economy: Current growth prospects are encouraging, though the pace of growth is still weaker than desirable. We reaffirm our commitment to international economic and financial cooperation to further strengthen growth and safeguard against downside risks. We will continue to use all policy tools – monetary, fiscal and structural – individually and collectively to achieve our goal of strong, sustainable, balanced and inclusive growth, while enhancing economic and financial resilience. Monetary policy will continue to support economic activity and ensure price stability, consistent with central banks' mandates. Fiscal policy will be used flexibly and be growth-friendly while ensuring debt as a share of GDP is on a sustainable path. We reinforce our commitment to structural reforms. We reaffirm our previous exchange rate commitments. We will strive to reduce excessive global imbalances in a way that supports global growth. We will promote greater inclusiveness, fairness and equality in our pursuit of economic growth and job creation. To these ends, we endorse the Hamburg Action Plan.

2. Trade and Investment: International trade and investment are important engines of growth, productivity, innovation, job creation and development. We will keep markets open noting the importance of reciprocal and mutually advantageous trade and investment frameworks and the principle of non-discrimination, and continue to fight protectionism including all unfair trade practices and recognise the role of legitimate trade defence instruments in this regard. We will strive to ensure a level playing field, in particular by promoting a favourable environment for trade and investment in this regard. We further reaffirm the importance of transparency for predictable and mutually beneficial trade relations. To this end, we value the monitoring activities by the WTO, UNCTAD and OECD within their existing mandates. We commit to further strengthen G20 trade and investment cooperation. We call on the OECD, WTO, World Bank Group and IMF to continue their work to better understand trade impacts and report back to G20 Leaders in 2018.

3. We recognise that the benefits of international trade and investment have not been shared widely enough. We need to better enable our people to seize the opportunities and benefits of economic globalisation. We agree to exchange experiences on the mitigation of the adjustment costs of trade and investment liberalisation and technological change, and on appropriate domestic policies, as well as to enhance international cooperation towards inclusive and sustainable global growth.

4. We underline the crucial role of the rules-based international trading system. We note the importance of bilateral, regional and plurilateral agreements being open, transparent, inclusive and WTO-consistent, and commit to working to ensure they complement the multilateral trade agreements. We welcome the entry into force of the WTO Trade Facilitation Agreement and call for its full implementation including technical assistance to developing countries. We commit to work together with all WTO members to make the eleventh WTO Ministerial Conference a success. To further improve the functioning of the WTO, we will cooperate to ensure the effective and timely enforcement of trade rules and commitments as well as improve its negotiating, monitoring and dispute settlement functions.

5. International investment can play an important role in promoting inclusive economic growth, job creation and sustainable development, and requires an open, transparent and conducive global policy environment. We will seek to identify strategies to facilitate and retain foreign direct investment.

6. Excess Capacities: Recognising the sustained negative impacts on domestic production, trade and workers due to excess capacity in industrial sectors, we commit to further strengthening our cooperation to find collective solutions to tackle this global challenge. We urgently call for the removal of market-distorting subsidies and other types of support by governments and related entities. Each of us commits to take the necessary actions to deliver the collective solutions that foster a truly level playing field. Therefore, we call on the members of the Global Forum on Steel Excess Capacity, facilitated by the OECD, as mandated by the Hangzhou Summit, to fulfil their commitments on enhancing information sharing and cooperation by August 2017, and to rapidly develop concrete policy solutions that reduce steel excess capacity. We look forward to a substantive report with concrete policy solutions by November 2017, as a basis for tangible and swift policy action, and follow-up progress reporting in 2018.

7. Sustainable Global Supply Chains: Global Supply Chains can be an important source of job creation and balanced economic growth. However challenges for achieving an inclusive, fair and sustainable globalisation remain. In order to achieve sustainable and inclusive supply chains, we commit to fostering the implementation of labour, social and environmental standards and human rights in line with internationally recognised frameworks, such as the UN Guiding Principles on Business and Human Rights and the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. Those countries that adhere to the OECD Guidelines for Multinational Enterprises (OECD MNE Guidelines) commit to fostering them and welcome others to follow.

8. We will work towards establishing adequate policy frameworks in our countries such as national action plans on business and human rights and underline the responsibility of businesses to exercise due diligence. We will take immediate and effective measures to eliminate child labour by 2025, forced labour, human trafficking and all forms of modern slavery. We welcome the Vision Zero Fund for to prevent work-place related deaths and injuries and encourage enterprises and others to join.

9. We emphasise that fair and decent wages as well as social dialogue are other key components of sustainable and inclusive global supply chains. We support access to remedy and, where applicable, non-judicial grievance mechanisms, such as the National Contact Points for the OECD MNE Guidelines (NCPs). We will encourage multinational companies to conclude international framework agreements as appropriate. Recognising the ongoing work of the Global Partnership for Financial Inclusion (GPFI), we promote better access to financing, technology, and training facilities that help improve the capacity of micro, small and medium enterprises to integrate into sustainable and inclusive global supply chains.

10. Harnessing Digitalisation: Digital transformation is a driving force of global, innovative, inclusive and sustainable growth and can contribute to reducing inequality and achieving the goals of the 2030 Agenda for Sustainable Development. To this end, we need to bridge digital divides along multiple dimensions, including income, age, geography and gender. We will strive to ensure that all our citizens are digitally connected by 2025 and especially welcome infrastructure development in low-income countries in that regard. We will promote digital literacy and digital skills in all forms of education and life-long learning. We recognise that information and communication technology (ICT) plays a crucial role in modernizing and increasing efficiency in public administration. We recognise the important role that SMEs and start-ups play in the development of a full range of new and innovative business models and will promote better access to financial resources and services and a more entrepreneurial friendly environment.

11. We aim to foster favourable conditions for the development of the digital economy and recognise the need to ensure effective competition to foster investment and innovation. We will continue to promote effective cooperation of all stakeholders and encourage the development and use of market- and industry-led international standards for digitised production, products and services that are based on the principles of openness, transparency and consensus and standards should not act as barriers to trade, competition or innovation. They can promote interoperability and security in the use of ICT.

12. Trust in digital technologies requires effective consumer protection, intellectual property rights, transparency, and security in the use of ICT. We support the free flow of information while respecting applicable legal frameworks for privacy, data protection and intellectual property rights. The G20 Roadmap for Digitalisation will help us guide our future work.

13. We are committed to help ensure a secure ICT environment in which all sectors are able to enjoy its benefits and reaffirm the importance of collectively addressing issues of security in the use of ICTs.

14. We will constructively engage in WTO discussions relating to E-commerce and in other international fora with responsibilities related to various aspects of digital trade to foster digital economy development and trade. We will sustain and improve, as appropriate, predictable and transparent frameworks on digital trade. Intensified and concerted action is needed to enhance the ability of developing and least developed countries to more fully engage in digital trade.

15. Boosting Employment: Well-functioning labour markets contribute to inclusive and cohesive societies and resilient economies. Digitalisation offers the opportunity for creating new and better jobs, while at the same time raising challenges regarding skills, social protection and job quality. We therefore recognise the need to educate and train people with the necessary skills for the future of work, the importance of opportunities to re- and upskill throughout their working lives, and assist them to successfully adapt to change, in accordance with each member´s domestic social framework.

16. Acknowledging the increasing diversity of employment, we will assess its impact on social protection and working conditions and continue to monitor global trends, including the impact of new technologies, demographic transition, globalisation and changing working relationships on labour markets. We will promote decent work opportunities during the transition of the labour market. We look forward to a continuous exchange on national experiences and practices.

17. We recognise the important role of vocational education and training, including quality apprenticeship in integrating young people into the labour market. In this regard, we acknowledge that it is particularly effective when it provides coordinated high quality school- and work-based learning and when it is built on cooperation among governments, business communities and social partners.

Building Resilience

18. Resilient Global Financial System: An open and resilient financial system, grounded in agreed international standards, is crucial to supporting sustainable growth. We remain committed to the finalisation and timely, full and consistent implementation of the agreed G20 financial sector reform agenda. We will work to finalise the Basel III framework without further significantly increasing overall capital requirements across the banking sector, while promoting a level playing field. We will continue to closely monitor and, if necessary, address emerging risks and vulnerabilities in the financial system. We emphasise the considerable progress made towards transforming shadow banking into resilient market based finance since the financial crisis and welcome the FSB assessment of the monitoring and policy tools available to address risks from shadow banking. We support the FSB's work to analyse the effects of financial regulatory reforms and the structured framework for post-implementation evaluation. Acknowledging that malicious use of ICT could endanger financial stability, we welcome the progress of the FSB's work and look forward to a stock-take report in October 2017.

19. International Financial Architecture: We need strong, effective and representative global economic and financial institutions to underpin growth and sustainable development. As laid out in the Hamburg Action Plan, we will continue to improve the system underpinning international capital flows and emphasise the need to promote sound and sustainable financing practices. We will enhance the international financial architecture and the global financial safety net with a strong, quota-based and adequately resourced IMF at its centre. We look forward to the completion of the 15th General Review of IMF Quotas, including a new quota formula, by the Spring Meetings 2019 and no later than the Annual Meetings 2019, and support ongoing work to further enhance the effectiveness of its lending toolkit. We endorse the MDBs' Joint Principles and Ambitions on Crowding-In Private Finance ("Hamburg Principles and Ambitions") and welcome their work on optimising balance sheets and boosting investment in infrastructure and connectivity.

20. International Tax Cooperation and Financial Transparency: We will continue our work for a globally fair and modern international tax system and welcome international cooperation on pro-growth tax policies. We remain committed to the implementation of the Base Erosion and Profit Shifting (BEPS) package and encourage all relevant jurisdictions to join the Inclusive Framework. We look forward to the first automatic exchange of financial account information under the Common Reporting Standard (CRS) in September 2017. We call on all relevant jurisdictions to begin exchanges by

September 2018 at the latest. We commend the recent progress made by jurisdictions to meet a satisfactory level of implementation of the agreed international standards on tax transparency and look forward to an updated list by the OECD by our next Summit reflecting further progress made towards implementation. Defensive measures will be considered against listed jurisdictions. We continue to support assistance to developing countries in building their tax capacity. We are also working on enhancing tax certainty and with the OECD on the tax challenges raised by digitalisation of the economy. As an important tool in our fight against corruption, tax evasion, terrorist financing and money laundering, we will advance the effective implementation of the international standards on transparency and beneficial ownership of legal persons and legal arrangements, including the availability of information in the domestic and cross-border context.

21. Safeguarding against Health Crises and Strengthening Health Systems: The G20 has a crucial role in advancing preparedness and responsiveness against global health challenges. With reference to the results of the G20 health emergency simulation exercise, we emphasise the value of our ongoing, trust-building, cross-sectoral cooperation. We recall universal health coverage is a goal adopted in the 2030 Agenda and recognize that strong health systems are important to effectively address health crises. We call on the UN to keep global health high on the political agenda and we strive for cooperative action to strengthen health systems worldwide, including through developing the health workforce. We recognise that implementation of and compliance with the International Health Regulations (IHR 2005) is critical for efficient prevention, preparedness and response efforts. We strive to fully eradicate polio. We also acknowledge that mass movement of people can pose significant health challenges and encourage countries and International Organisations to strengthen cooperation on the topic. We support the WHO´s central coordinating role, especially for capacity building and response to health emergencies, and we encourage full implementation of its emergency reform. We advocate for sufficient and sustainable funding to strengthen global health capacities, including for rapid financing mechanisms and the WHO’s Health Emergencies Programme. Furthermore, we see a need to foster R&D preparedness through globally coordinated models as guided by the WHO R&D Blueprint, such as the Coalition for Epidemic Preparedness Innovations (CEPI).

22. Combatting Antimicrobial Resistance (AMR): AMR represents a growing threat to public health and economic growth. To tackle the spread of AMR in humans, animals and the environment, we aim to have implementation of our National Action Plans, based on a One-Health approach, well under way by the end of 2018. We will promote the prudent use of antibiotics[1] in all sectors and strive to restrict their use in veterinary medicine to therapeutic uses alone. Responsible and prudent use of antibiotics in food producing animals does not include the use for growth promotion in the absence of risk analysis. We underline that treatments should be available through prescription or the veterinary equivalent only. We will strengthen public awareness, infection prevention and control and improve the understanding of the issue of antimicrobials in the environment. We will promote access to affordable and quality antimicrobials, vaccines and diagnostics, including through efforts to preserve existing therapeutic options. We highlight the importance of fostering R&D, in particular for priority pathogens as identified by the WHO and tuberculosis. We call for a new international R&D Collaboration Hub to maximise the impact of existing and new anti-microbial basic and clinical research initiatives as well as product development. We invite all interested countries and partners to join this new initiative. Concurrently, in collaboration with relevant experts including from the OECD and the WHO, we will further examine practical market incentive options.

Improving Sustainable Livelihoods

23. Energy and Climate: A strong economy and a healthy planet are mutually reinforcing. We recognise the opportunities for innovation, sustainable growth, competitiveness, and job creation of increased investment into sustainable energy sources and clean energy technologies and infrastructure. We remain collectively committed to mitigate greenhouse gas emissions through, among others, increased innovation on sustainable and clean energies and energy efficiency, and work towards low greenhouse-gas emission energy systems. In facilitating well-balanced and economically viable long-term strategies in order to transform and enhance our economies and energy systems consistent with the 2030 Agenda for Sustainable Development, G20 members will collaborate closely. Recalling the G20 Principles on Energy Collaboration, we regard energy security as one of the guiding principles for the transformation of our energy systems, and we will continue to work on open, flexible, and transparent markets for energy commodities and technologies. We welcome international cooperation on the development, deployment, and commercialisation of sustainable and clean energy technologies and support financing by Multilateral Development Banks to promote universal access to affordable, reliable, sustainable and clean energy.

[1] Noting differences in the G20 country definitions of the term "antibiotics" and referring here to those antibiotics with an impact on human health, including those antimicrobials that are critically important for human medicine as defined by the WHO.

24. We take note of the decision of the United States of America to withdraw from the Paris Agreement. The United States of America announced it will immediately cease the implementation of its current nationally-determined contribution and affirms its strong commitment to an approach that lowers emissions while supporting economic growth and improving energy security needs. The United States of America states it will endeavour to work closely with other countries to help them access and use fossil fuels more cleanly and efficiently and help deploy renewable and other clean energy sources, given the importance of energy access and security in their nationally-determined contributions.

25. The Leaders of the other G20 members state that the Paris Agreement is irreversible. We reiterate the importance of fulfilling the UNFCCC commitment by developed countries in providing means of implementation including financial resources to assist developing countries with respect to both mitigation and adaptation actions in line with Paris outcomes and note the OECD's report "Investing in Climate, Investing in Growth". We reaffirm our strong commitment to the Paris Agreement, moving swiftly towards its full implementation in accordance with the principle of common but differentiated responsibilities and respective capabilities, in the light of different national circumstances and, to this end, we agree to the G20 Hamburg Climate and Energy Action Plan for Growth as set out in the Annex.

26. Leading the Way towards Sustainable Development: The adoption of the 2030 Agenda represented a milestone towards global sustainable development. We call on countries to work with stakeholders to strive towards its ambitious and integrated implementation and timely realisation in accordance with national circumstances. We commit to further align our actions with the 2030 Agenda for Sustainable Development and its integral part, the Addis Ababa Action Agenda on Financing for Development, domestically and internationally, including in support of developing countries and the provision of public goods.

27. Building on the G20's Action Plan on the 2030 Agenda for Sustainable Development, the Hamburg Update emphasises our collective and concrete commitments. We support the central role of the high-level political forum on sustainable development and other key UN processes towards achieving the Sustainable Development Goals. We will also engage in voluntary peer learning on the implementation of the 2030 Agenda and call upon others to join this important exercise as a complementary action towards Voluntary National Reviews.

28. The Annual Progress Report documents for the first time progress on selected prior G20 commitments on the implementation of the 2030 Agenda. Recognising the importance of financial inclusion as a multiplier for poverty eradication, job creation, gender equality, and women's empowerment, we support the ongoing work of the Global Partnership for Financial Inclusion and welcome the 2017 G20 Financial Inclusion Action Plan. We note the UN Secretary-General´s proposal to establish an International Finance Facility for education taking into account other existing initiatives, such as the Global Partnership for Education and Education Cannot Wait, and look forward to examining it in further detail under Argentina's Presidency with a view to making recommendations on it.

29. Women's Empowerment: Enhanced equal access to the labour market, property, quality employment and financial services for women and men are fundamental for achieving gender equality and full realisation of their rights as well as a prerequisite for sustainable and inclusive growth. We are making progress in achieving our 2014 Brisbane commitment to reduce the gender gap in labour force participation by 25 percent by 2025 but agree that more needs to be done. We also commit to take further action to improve the quality of female employment and eliminate employment discrimination, and reduce gender compensation gaps and provide women with protection from all forms of violence. We will improve women´s access to labour markets through provision of quality education and training, supporting infrastructure, public services and social protection policies and legal reforms, where appropriate.

30. Digitalisation and access to ICT serve as powerful catalysts for the economic empowerment and inclusion of women and girls. Access to STEM (Science, Technology, Engineering and Mathematics) related trainings and occupations is therefore key to establish an enabling environment for women's empowerment. We welcome the launch of the #eSkills4Girls initiative to promote opportunities and equal participation for women and girls in the digital economy, in particular in low income and developing countries (see Annex).

31. In order to scale up support for women´s entrepreneurship, we welcome the launch of the Women Entrepreneurs Financing Initiative (We-Fi), housed at the World Bank Group (see Annex). The We-Fi will support ongoing G20 efforts to reduce barriers to financial inclusion and increase women´s access to capital, markets and technical assistance as well as contribute to achieving the goals of the G20 Africa Partnership and the G20 Entrepreneurship Action Plan. We will also establish a Business Women Leaders' Taskforce, which will, in close cooperation with the W20 and B20, bring together business women from G20 countries to examine ways to increase women´s

participation in the economy and will make recommendations at next year's summit on the implementation of G20 commitments regarding the economic empowerment of women.

32. Towards Food Security, Water Sustainability and Rural Youth Employment: Water is an essential and precious resource. In order to achieve food security, we are committed to increase agricultural productivity and resilience in a sustainable manner, while aiming to protect, manage and use efficiently water and water-related ecosystems. In order to harness the potential of ICT, we stress the need for strengthened cooperation on ICT in agriculture and underline the importance of access to high-speed digital services for farmers and of adequately serving rural areas. To enhance transparency in global food markets, we call for a strengthening of the Agricultural Market Information System (AMIS) and an active engagement of its entire membership. We underline that making markets function better can contribute to reducing food price volatility and enhance food security. It is vital for farmers to be profitable and, along with consumers, have access to national, regional and international markets.

33. We launch the G20 Initiative for Rural Youth Employment in developing countries with a focus on Africa. This Initiative will, in alignment with developing countries' strategies, contribute to creating 1.1 million new jobs by 2022 and to providing innovative skills development programmes for at least 5 million young people over the next five years. Recognising the famine in some areas of South Sudan and risk of famine in Somalia, Yemen and North-Eastern Nigeria, we are more than ever committed to act with the required urgency, supporting UN agencies and other humanitarian and development organisations in a coordinated and comprehensive response to save lives and support conditions for sustainable development. We recognise the contributions made by different G20 members in line with the UN appeal for humanitarian assistance which represents over two thirds of the funding received for immediate requirements. We will further strengthen our humanitarian engagement and reaffirm our commitment to addressing the underlying causes of recurrent and protracted crises.

34. Resource Efficiency and Marine Litter: We launch two initiatives to contribute to the implementation of the 2030 Agenda and to reflect our commitment to sustainable development, as outlined in the Annexes. The G20 Resource Efficiency Dialogue will exchange good practices and national experiences to improve the efficiency and sustainability of natural resource use across the entire life cycle, and to promote sustainable consumption and production patterns. The G20 Marine Litter Action Plan seeks to prevent and reduce marine litter, including by considering its socio-economic aspects.

Assuming Responsibility

35. Africa Partnership: We launch the G20 Africa Partnership in recognition of the opportunities and challenges in African countries as well as the goals of the 2030 Agenda. Our joint efforts will foster sustainable and inclusive economic growth and development, in response to the needs and aspirations of African countries, contributing to create decent employment particularly for women and youth, thus helping to address poverty and inequality as root causes of migration. The Partnership includes related initiatives, such as #eSkills4Girls, Rural Youth Employment, African Renewable Energy and facilitates investment Compacts, as outlined in the Annex.

36. We welcome the outcomes of the G20 Africa Partnership Conference in Berlin, which highlighted the need for joint measures to enhance sustainable infrastructure, improve investment frameworks as well as support education and capacity building. Individual priorities for "Investment Compacts" were put forward by Côte d'Ivoire, Ethiopia, Ghana, Morocco, Rwanda, Senegal and Tunisia. Led by the respective African countries, the African Development Bank, IMF and WBG as well as the G20 and other partners, these Compacts aim to mobilise private investment as well as promote efficient use of public funding.

37. We are ready to help interested African countries and call on other partners to join the initiative. We support the goals of the Partnership through complementary initiatives as well as encourage the private sector to seize African economic opportunities in supporting sustainable growth and employment creation.

38. Based on equal partnership, we strongly welcome African ownership and commit to align our joint measures with regional strategies and priorities, in particular the African Union's Agenda 2063 and its Programme for Infrastructure Development in Africa (PIDA). The African Union and its specialised agency, the New Partnership for Africa's Development (NEPAD), are important partners in its implementation and monitoring.

39. Stepping up Coordination and Cooperation on Displacement and Migration: The world is experiencing historic levels of migration and forced displacement. While migration is influenced by many political, social and economic developments, the main drivers of forced displacement include conflicts, natural disasters as well as human rights violations and abuses. Migration and forced displacement trends are of major relevance for countries of origin, transit and destination. The social and economic benefits and opportunities of safe, orderly and regular migration can be substantial. Forced displacement and irregular migration in large movements, on the other hand, often present complex challenges.

40. We support those countries that choose to develop pathways for migration, underline the importance of nationally determined integration and endorse the G20 Policy Practices for the Fair and Effective Labour Market Integration of Regular Migrants and Recognised Refugees. We emphasise the sovereign right of states to manage and control their borders and in this regard to establish policies in their own national interests and national security, as well as the importance that repatriation and reintegration of migrants who are not eligible to remain be safe and humane. We commit to countering migrant smuggling and trafficking in human beings and we are determined to take action against people smugglers and traffickers.

41. We seek to address the root causes of displacement. We call for concerted global efforts and coordinated and shared actions, in particular with respect to countries and communities that are under high social, political and financial pressure, and for combining both an emergency approach and a long-term one. To this end, we acknowledge the importance of establishing partnerships with countries of origin and transit. We will promote sustainable economic development in those countries.

42. We commit to addressing the distinct needs of refugees and migrants, in particular close to their region of origin and, when applicable, to enable them to return home safely. At the same time, we place special emphasis on vulnerable groups, including women at risk and children, particularly those unaccompanied, and to protecting the human rights of all persons regardless of their status.

43. We call for improving the governance of migration and providing comprehensive responses to displacement and recognise the need to develop tools and institutional structures accordingly. Therefore, we look forward to the outcome of the UN process towards Global Compacts on Refugees and for Safe, Orderly and Regular Migration, both envisaged to be adopted in 2018. We emphasise the need for monitoring global displacement and migration, as well as its economic consequences. To this end, we ask the OECD, in cooperation with ILO, IOM and UNHCR, to update us annually on trends and policy challenges.

44. Fighting Corruption: We remain committed to fighting corruption, including through practical international cooperation and technical assistance, and will continue to fully implement the G20 Anti-Corruption Action Plan 2017-18. We endorse four sets of High Level Principles aimed at fostering integrity in the public and private sector. By endorsing the High Level Principles on the Liability of Legal Persons, we commit to ensuring that not only individual perpetrators but also companies benefitting from corruption can be held liable. We commit to organising our public administrations to be more resilient against corruption. We will intensify our fight against corruption related to illegal trade in wildlife and wildlife products. Wildlife trafficking is a threat to the planet's biodiversity, economic development, and, among others, health and security, and is facilitated by high levels of corruption, which the G20 cannot tolerate. We also endorse the High Level Principles on Countering Corruption in Customs and publish a guide on requesting international cooperation in civil and administrative proceedings. We will continue our work to address integrity in sports and urge international sports organisations to intensify their fight against corruption by achieving the highest global integrity and anti-corruption standards. In this respect, we strive for a common understanding regarding corruption risks in bids to host major sport events. We are also committed to fighting corruption in contracts, including in the natural resources sector. We call for ratification and implementation by all G20 members of the UN Convention against Corruption and for a strong involvement in its review process.

45. We thank Germany for hosting a successful Hamburg Summit and its contribution to the G20 process, and look forward to meeting again in Argentina in 2018, in Japan in 2019 and in Saudi Arabia in 2020.

AGREED DOCUMENTS

Hamburg Action Plan

G20 Hamburg Climate and Energy Action Plan for Growth

Hamburg Update: Taking forward the G20 Action Plan on the 2030 Agenda

Annual Progress Report 2017

G20 Action Plan on Marine Litter

G20 Africa Partnership

G20 Initiative for Rural Youth Employment

High Level Principles on the Liability of Legal Persons for Corruption

High Level Principles on Organizing against Corruption

High Level Principles on Countering Corruption in Customs

High Level Principles on Combatting Corruption related to Illegal Trade in Wildlife and Wildlife Products

G20 Initiative #eSkills4Girls

Women Entrepreneurs Financing Initiative

G20 Resource Efficiency Dialogue

MINISTERIAL STATEMENTS

Agriculture Ministers, 22 January 2017, Berlin

Finance Ministers and Central Bank Governors, 17-18 March 2017, Baden-Baden

Digital Ministers, 6 - 7 April 2017, Düsseldorf

A Roadmap for Digitalisation: Policies for a Digital Future

- Digital skills in vocational education and training
- G20 Priorities on Digital Trade

Chair's Summary of the Meeting of the Finance Ministers and Central Bank Governors, 20-21 April, Washington D.C.

Labour and Employment Ministers, 18 - 19 May 2017, Bad Neuenahr

- G20 Priorities on the Future of Work
- G20 Policy Recommendation to reduce gender gaps in labour force participation and pay by improving women´s job quality
- G20 Policy practices for the fair and effective labour market integration of regular migrants and refugees
- G20 Statement on the Global Prevention Inititiative "Vision Zero Fund"

Health Ministers, 19-20 May, Berlin

G20 WORKING GROUP DOCUMENTS

Hamburg Accountability Assessment Report (FWG)

G20 Green Finance Synthesis Report (Green Finance Study Group)

Chair's Summary on the Meetings of the G20 Trade and Investment Working Group

International Financial Architecture Working Group Report

Principles of MDBs' strategy for crowding-in Private Sector Finance for growth and sustainable development

Joint MDB Statement of Ambitions for Crowding in Private Finance

Women's Pathways to the Digital Sector: Stories of Opportunities and Challenges

Global Partnership for Financial Inclusion (GPFI)

- G20 2017 Financial Inclusion Action Plan
- GPFI 2017 Annual Report to the Leaders
- G20 Financial Inclusion Action Plan Progress Report 2014-2017
- G20 Action Plan on SME Financing Implementation Framework: Credit Infrastructure Country Self Assessment Consolidated Report
- GPFI Report 2017 Update to Leaders on Progress Towards the G20 Remittance Target
- GPFI Report Digital Financial Inclusion: Emerging Policy Approaches
- GPFI Report Alternative Data transforming SME Finance
- GPFI Guidance Note on Building Inclusive Digital Ecosystems
- GPFI Policy Paper Financing Climate Smart Rural MSMEs: Enabling Policy Frameworks
- G20 OECD/ INFE Report Ensuring financial education and consumer protection for all in a digital age

Anti-Corruption Working Group

- ACWG Interim Report 2016-17
- G20 Guide on Requesting International Cooperation in Civil and Administrative Proceedings relating to Corruption
- ACWG/OECD Compendium Customs Integrity: Taking Stock of Good Practices
- ACWG/OECD Compendium of Good Practices on the Publication and Reuse of Open Data for Anti-corruption across G20 Countries: Towards data-driven public sector integrity and civic auditing

INTERNATIONAL ORGANISATIONS REPORTS

IMF Surveillance Note – Global Prospects and Policy Challenges

OECD – Investing in Climate, investing in Growth

IMF and OECD - Quantifying the Implementation and Impact of G20 Member's Growth Strategies

OECD/WBG Framework and Policy Tools to Achieve Inclusive Growth in the G20

IMF Paper Fostering Inclusive Growth

IMF/WTO/WBG staff report "Making Trade an Engine of Growth for All"

WTO/OECD/UNCTAD 17th G20 Report on Trade and Investment Measures

OECD Report Key Issues for Digital Transformation in the G20

OECD/IMF joint interim report on the impact of digitalisation on measures of GDP

OECD INFE Report Ensuring financial education and consumer protection for all in the digital age

3rd Annual Report of the FSB on Implementation and Effects of the G20 Financial Regulatory Reforms

FSB Assessment of shadow banking activities, risks and the adequacy of post-crisis policy tools to address financial stability concerns

FSB Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms

FSB Review of OTC derivatives market reforms – Effectiveness and broader effects of the reforms

FSB Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

FSB Report on Financial Stability Implications from FinTech - Supervisory and Regulatory Issues that Merit Authorities' Attention

FSB – Recommendations of the Task Force on Climate-related Financial Disclosures

OECD/FSB Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance

FSB/IOSCO/CPMI Policies on resilience and recovery of central counterparties

FSB Progress Update on Cybersecurity Stock-Take

FSB Progress report to G20 Leaders on Reducing misconduct risks in the financial sector

OECD Secretary-General's Report to G20 Leaders/Interim report on BEPS + Annex – Report by Global Forum on Transparency and Exchange of Information on Tax Purposes

FATF Report to the G20 Leaders Summit

OECD/ GIFT Network Budget Transparency Toolkit

OECD, WHO, FAO, OIE – Tackling Antimicrobial Resistances, Ensuring Sustainable R&D

OECD/INFE Report on Adult Financial Literacy in G20 Countries

World Bank/IFAD report "Rural Youth Employment"

AfDB, IMF and WBG Report on the Compact with Africa

OECD – G20 global displacement and migration trends

THE G20 SEOUL SUMMIT
LEADERS' DECLARATION
NOVEMBER 11 – 12, 2010

1. We, the Leaders of the G20, are united in our conviction that by working together we can secure a more prosperous future for the citizens of all countries.

2. When we first gathered in November 2008 to address the most severe world recession our generation has ever confronted, we pledged to support and stabilize the global economy, and at the same time, to lay the foundation for reform, to ensure the world would never face such upheaval again.

3. Over the past four Summits, we have worked with unprecedented cooperation to break the dramatic fall in the global economy to establish the basis for recovery and renewed growth.

4. The concrete steps we have taken will help ensure we are better prepared to prevent and, if necessary, to withstand future crises. We pledge to continue our coordinated efforts and act together to generate strong, sustainable and balanced growth.

5. We recognize the importance of addressing the concerns of the most vulnerable. To this end, we are determined to put jobs at the heart of the recovery, to provide social protection, decent work and also to ensure accelerated growth in low income countries (LICs).

6. Our relentless and cooperative efforts over the last two years have delivered strong results. However, we must stay vigilant.

7. Risks remain. Some of us are experiencing strong growth, while others face high levels of unemployment and sluggish recovery. Uneven growth and widening imbalances are fueling the temptation to diverge from global solutions into uncoordinated actions. However, uncoordinated policy actions will only lead to worse outcomes for all.

8. Since 2008, a common view of the challenges of the world economy, the necessary responses and our determination to resist protectionism has enabled us to both address the root causes of the crisis and safeguard the recovery. We are agreed today to develop our common view to meet these new challenges and a path to strong, sustainable and balanced growth beyond the crisis.

9. Today, the Seoul Summit delivers:

   - the Seoul Action Plan composed of comprehensive, cooperative and country-specific policy actions to move closer to our shared objective. The Plan includes our commitment to:

     - undertake macroeconomic policies, including fiscal consolidation where necessary, to ensure ongoing recovery and sustainable growth and enhance the stability of financial markets, in particular moving toward more market-determined exchange rate systems, enhancing exchange rate flexibility to reflect underlying economic fundamentals, and refraining from competitive devaluation of currencies. Advanced economies, including those with reserve currencies, will be vigilant against excess volatility and disorderly movements in exchange rates. These actions will help mitigate the risk of excessive volatility in capital flows facing some emerging countries;

- implement a range of structural reforms that boost and sustain global demand, foster job creation, and increase the potential for growth; and

- enhance the Mutual Assessment Process (MAP) to promote external sustainability. We will strengthen multilateral cooperation to promote external sustainability and pursue the full range of policies conducive to reducing excessive imbalances and maintaining current account imbalances at sustainable levels. Persistently large imbalances, assessed against indicative guidelines to be agreed by our Finance Ministers and Central Bank Governors, warrant an assessment of their nature and the root causes of impediments to adjustment as part of the MAP, recognizing the need to take into account national or regional circumstances, including large commodity producers. These indicative guidelines composed of a range of indicators would serve as a mechanism to facilitate timely identification of large imbalances that require preventive and corrective actions to be taken. To support our efforts toward meeting these commitments, we call on our Framework Working Group, with technical support from the IMF and other international organizations, to develop these indicative guidelines, with progress to be discussed by our Finance Ministers and Central Bank Governors in the first half of 2011; and, in Gyeongju, our Finance Ministers and Central Bank Governors called on the IMF to provide an assessment as part of the MAP on the progress toward external sustainability and the consistency of fiscal, monetary, financial sector, structural, exchange rate and other policies. In light of this, the first such assessment, to be based on the above mentioned indicative guidelines, will be initiated and undertaken in due course under the French Presidency.

- a modernized IMF that better reflects the changes in the world economy through greater representation of dynamic emerging markets and developing countries. These comprehensive quota and governance reforms, as outlined in the Seoul Summit Document, will enhance the IMF's legitimacy, credibility and effectiveness, making it an even stronger institution for promoting global financial stability and growth.

- instruments to strengthen global financial safety nets, which help countries cope with financial volatility by providing them with practical tools to overcome sudden reversals of international capital flows.

- core elements of a new financial regulatory framework, including bank capital and liquidity standards, as well as measures to better regulate and effectively resolve systemically important financial institutions, complemented by more effective oversight and supervision. This new framework, complemented by other achievements as outlined in the Seoul Summit Document, will ensure a more resilient financial system by reining in the past excesses of the financial sector and better serving the needs of our economies.

- the Seoul Development Consensus for Shared Growth that sets out our commitment to work in partnership with other developing countries, and LICs in particular, to help them build the capacity to achieve and maximize their growth potential, thereby contributing to global rebalancing. The Seoul Consensus complements our commitment to achieve the Millennium Development Goals (MDGs) and focuses on concrete measures as summarized in our Multi-Year Action Plan on Development to make a tangible and significant difference in people's lives, including in particular through the development of infrastructure in developing countries.

- the Financial Inclusion Action Plan, the Global Partnership for Financial Inclusion and a flexible SME Finance Framework, all of which will significantly contribute to improving access to financial services and expanding opportunities for poor households and small and medium enterprises.

- our strong commitment to direct our negotiators to engage in across-the-board negotiations to promptly bring the Doha Development Round to a successful, ambitious, comprehensive, and balanced conclusion consistent with the mandate of the Doha Development Round and built on the progress already achieved. We recognize that 2011 is a critical window of opportunity, albeit narrow, and that engagement among our representatives must intensify and expand. We now need to complete the end game. Once such an outcome is reached, we commit to seek ratification, where necessary, in our respective systems. We are also committed to resisting all forms of protectionist measures.

10. We will continue to monitor and assess ongoing implementation of the commitments made today and in the past in a transparent and objective way. We hold ourselves accountable. What we promise, we will deliver.

11. Building on our achievements to date, we have agreed to work further on macro-prudential policy frameworks; better reflect the perspective of emerging market economies in financial regulatory reforms; strengthen regulation and oversight of shadow banking; further work on regulation and supervision of commodity derivatives markets; improve market integrity and efficiency; enhance consumer protection; pursue all outstanding governance reform issues at the IMF and World Bank; and build a more stable and resilient international monetary system, including by further strengthening global financial safety nets. We will also expand our MAP based on the indicative guidelines to be agreed.

12. To promote resilience, job creation and mitigate risks for development, we will prioritize action under the Seoul Consensus on addressing critical bottlenecks, including infrastructure deficits, food market volatility, and exclusion from financial services.

13. To provide broader, forward-looking leadership in the post-crisis economy, we will also continue our work to prevent and tackle corruption through our Anti-Corruption Action Plan; rationalize and phase-out over the medium term inefficient fossil fuel subsidies; mitigate excessive fossil fuel price volatility; safeguard the global marine environment; and combat the challenges of global climate change.

14. We reaffirm our resolute commitment to fight climate change, as reflected in the Leaders' Seoul Summit Document. We appreciate President Felipe Calderón's briefing on the status of the UN Framework Convention on Climate Change negotiations, as well as

Prime Minister Meles Zenawi's briefing on the report of the High-Level Advisory Group on Climate Change Financing submitted to the UN Secretary-General. We will spare no effort to reach a balanced and successful outcome in Cancun.

15. We welcome the Fourth UN LDC Summit in Turkey and the Fourth High-Level Forum on Aid Effectiveness in Korea, both to be held in 2011.

16. Recognizing the importance of private sector-led growth and job creation, we welcome the Seoul G20 Business Summit and look forward to continuing the G20 Business Summit in upcoming Summits.

17. The actions agreed today will help to further strengthen the global economy, accelerate job creation, ensure more stable financial markets, narrow the development gap and promote broadly shared growth beyond crisis.

18. We look forward to our next meeting in 2011 in France, and subsequent meeting in 2012 in Mexico.

19. We thank Korea for its G20 Presidency and for hosting the successful Seoul Summit.

20. The **Seoul Summit Document**, which we have agreed, follows.

G20 Leaders Declaration

1. We, the Leaders of the G20, convened in Los Cabos on 18-19 June 2012.
2. We are united in our resolve to promote growth and jobs.
3. Since we last met, the global recovery has continued to face a number of challenges. Financial market tensions are high. External, fiscal and financial imbalances are still prevalent, having a major impact on growth and employment prospects and confidence. Clearly, the global economy remains vulnerable, with a negative impact on the everyday lives of people all over the world, affecting jobs, trade, development, and the environment.
4. We will act together to strengthen recovery and address financial market tensions.
5. We will work collectively to strengthen demand and restore confidence with a view to support growth and foster financial stability in order to create high quality jobs and opportunities for all of our citizens. We have agreed today on a coordinated Los Cabos Growth and Jobs Action Plan to achieve those goals.
6. Euro Area members of the G20 will take all necessary policy measures to safeguard the integrity and stability of the area, improve the functioning of financial markets and break the feedback loop between sovereigns and banks. We look forward to the Euro Area working in partnership with the next Greek government to ensure they remain on the path to reform and sustainability within the Euro Area.
7. We are implementing our structural and regulatory reform agenda to enhance medium-term growth prospects and build more resilient financial systems. We remain committed to reduce imbalances by strengthening deficit countries' public finances with sound and sustainable policies that take into account evolving economic conditions and, in countries with large current account surpluses, by strengthening domestic demand and moving toward greater exchange rate flexibility.
8. Despite the challenges we all face domestically, we have agreed that multilateralism is of even greater importance in the current climate, and remains our best asset to resolve the global economy's difficulties.
9. Recognizing the impact of the continuing crisis on developing countries, particularly low income countries, we will intensify our efforts to create a more conducive environment for development, including supporting infrastructure investment. Our policy actions will improve living conditions across the globe and protect the most vulnerable. In particular, by stabilizing global markets and promoting stronger growth, we will generate significant positive effects on development and poverty reduction across the globe.

Supporting economic stabilization and the global recovery

10. Strong, sustainable and balanced growth remains the top priority of the G20, as it leads to higher job creation and increases the welfare of people across the world. We are committed to adopting all necessary policy measures to strengthen demand, support global growth and restore confidence, address short and medium-term risks, enhance job creation and reduce unemployment, as reflected in the Los Cabos Growth and Jobs Action Plan (see Annex). We will implement all our commitments in a timely manner and rigorously monitor their implementation.

11. Against the background of renewed market tensions, Euro Area members of the G20 will take all necessary measures to safeguard the integrity and stability of the area, improve the functioning of financial markets and break the feedback loop between sovereigns and banks. We welcome the significant actions taken since the last summit by the Euro Area to support growth, ensure financial stability and promote fiscal responsibility as a contribution to the G20 framework for strong, sustainable and balanced growth. In this context, we welcome Spain's plan to recapitalize its banking system and the Eurogroup's announcement of support for Spain's financial restructuring authority. The adoption of the Fiscal Compact and its ongoing implementation, together with growth-enhancing policies and structural reform and financial stability measures, are important steps towards greater fiscal and economic integration that lead to sustainable borrowing costs. The imminent establishment of the European Stability Mechanism is a substantial strengthening of the European firewalls. We fully support the actions of the Euro Area in moving forward with the completion of the Economic and Monetary Union. Towards that end, we support the intention to consider concrete steps towards a more integrated financial architecture, encompassing banking supervision, resolution and recapitalization, and deposit insurance. Euro Area members will foster intra Euro Area adjustment through structural reforms to strengthen competitiveness in deficit countries and to promote demand and growth in surplus countries. The European Union members of the G20 are determined to move forward expeditiously on measures to support growth including through completing the European Single Market and making better use of European financial means, such as the European Investment Bank (EIB), pilot project bonds, and structural and cohesion funds, for more targeted investment, employment, growth and competitiveness, while maintaining the firm commitment to implement fiscal consolidation to be assessed on a structural basis. We look forward to the Euro Area working in partnership with the next Greek government to ensure they remain on the path to reform and sustainability within the Euro Area.

12. All G20 members will take the necessary actions to strengthen global growth and restore confidence. Advanced economies will ensure that the pace of fiscal consolidation is appropriate to support the recovery, taking country-specific circumstances into account and, in line with the Toronto commitments, address concerns about medium term fiscal sustainability. Those advanced and emerging economies which have fiscal space will let the automatic fiscal stabilizers to operate taking into account national circumstances and current demand conditions. Should economic conditions deteriorate significantly further, those countries with sufficient fiscal space stand ready to coordinate and implement discretionary fiscal actions to support domestic demand, as appropriate. In many countries, higher investment in education, innovation and infrastructure can support the creation of jobs now while raising productivity and future growth prospects. Recognizing the need to pursue growth-oriented policies that support demand and recovery, the United States will calibrate the pace of its fiscal consolidation by ensuring that its public finances are placed on a sustainable long-run path so that a sharp fiscal contraction in 2013 is avoided.

13. Monetary policy will maintain price stability over the medium term while continuing to support the economic recovery. We will strengthen confidence in our banks, maintaining momentum on the financial sector reforms needed to safeguard our financial systems over the medium term while taking appropriate actions to protect credit channels and the integrity of the global payment and settlement systems. Healthy banks, with an ability to lend, are critical to the global recovery.

14. G20 members will remain vigilant of the evolution of oil prices and will stand ready to carry out additional actions as needed, including the commitment by producing countries to continue to

ensure an appropriate level of supply consistent with demand. We welcome Saudi Arabia's readiness to mobilize, as necessary, existing spare capacity to ensure adequate supply. We will also remain vigilant of other commodity prices.

15. A number of emerging markets are now also experiencing a slowdown in growth. In response, these countries are appropriately directing monetary and fiscal policies to support growth while ensuring stability and, in some cases, introducing new measures to boost their economies, in particular through strengthening domestic demand in a context of weaker external demand.

16. We welcome progress by countries with large current account surpluses to increase domestic demand and actions by countries with large current account deficits to increase national savings. Emerging surplus economies will carry out further actions to increase domestic consumption, including by removing price and tax distortions and strengthening social safety nets, while advanced surplus economies or those with relatively weak private demand will promote domestic demand, notably through the liberalization of service sectors and the promotion of investment, including through the removal of inefficiencies. Higher national savings in countries with current account deficits will contribute to a lasting reduction in global imbalances. We recognize the special circumstances of large commodity exporters with regard to current account surpluses. We reaffirm our commitment to move more rapidly toward market-determined exchange rate systems and exchange rate flexibility to reflect underlying fundamentals, avoid persistent exchange rate misalignments, and refrain from competitive devaluation of currencies. We also welcome the commitment by China to allow market forces to play a larger role in determining movements in the Remnimbi (RMB), continue to reform its exchange rate regime, and to increase the transparency of its exchange rate policy.

17. All G20 members have put forward structural reform commitments to strengthen and sustain global demand, foster job creation, contribute to global rebalancing and increase growth potential. These include product market reforms to increase competition, measures to stabilize the housing sector, labor market reforms to boost competitiveness and employment, as well as steps to strengthen social safety nets in a way that is fiscally responsible, advance tax reform to raise productivity, increase investment in infrastructure, and promote inclusive green growth and sustainable development as appropriate to country circumstances. We ask Finance Ministers and Central Bank Governors to consider ways in which the G20 can foster investment in infrastructure and ensure the availability of sufficient funding for infrastructure projects, including Multilateral Development Banks' (MDBs) financing and technical support.

18. In all policy areas, we commit to minimize the negative spillovers on other countries of policies implemented for domestic purposes. We reaffirm our shared interest in a strong and stable international financial system. While capital flows can be beneficial to recipient economies, we reiterate that excess volatility of financial flows and disorderly movements in exchange rates have adverse implications for economic and financial stability.

19. Recognizing the importance of transparency and accountability in reinforcing credibility and confidence, we have agreed on the Los Cabos Accountability Assessment Framework that accompanies the Growth and Jobs Action Plan. This Framework establishes the procedures we will follow to report on progress in implementing our policy commitments. We welcome the first Accountability Report under this new framework. We task our Finance Ministers and Central Bank Governors to present the second Accountability Report for the Leaders' Summit in St. Petersburg in 2013.

Employment and Social Protection

20. Quality employment is at the heart of our macroeconomic policies. Jobs with labor rights, social security coverage and decent income contribute to more stable growth, enhance social inclusion and reduce poverty. We therefore endorse the recommendations of our Labor and Employment Ministers to urgently combat unemployment through appropriate labor market measures and fostering the creation of decent work and quality jobs, particularly for youth and other vulnerable groups, who have been severely hit by the economic crisis. We reaffirm our commitment to youth to facilitate their access to quality jobs, which will boost their life prospects. We welcome the work of the G20 Task Force on Employment and extend its mandate for an additional year in the terms proposed by our Ministers. Consistent with the Los Cabos Growth and Jobs Action Plan, we consider that structural reforms, in full respect of the fundamental principles and rights at work, can play an important role in lifting economic growth to generate labor market opportunities, mobility and jobs. We also commit to intensify our efforts to strengthen cooperation in education, skills development and training policies, including internship and on-the-job training, which support a successful school-to-work transition.

21. Creating jobs and reducing unemployment, particularly among our youth and those most affected by the crisis, is central to all our countries. We welcome the report by the International Labour Organization (ILO), Organisation for Economic Cooperation and Development (OECD), International Monetary Fund (IMF) and World Bank on boosting jobs and living standards in G20 countries. We will continue to focus on measures to accelerate the pace of the recovery in jobs and the reduction in unemployment.

22. We recognize the importance of establishing nationally determined social protection floors. We will continue to foster inter-agency and international policy coherence, coordination, cooperation and knowledge sharing to assist low-income countries in capacity building for implementing nationally determined social protection floors. We ask international organizations to identify policy options with low-income countries on how to develop effective sustainable protection floors.

23. We commit to take concrete actions to overcome the barriers hindering women's full economic and social participation and to expand economic opportunities for women in G20 economies. We also express our firm commitment to advance gender equality in all areas, including skills training, wages and salaries, treatment in the workplace, and responsibilities in care-giving.

24. We ask our Labor Ministers to review progress made on this agenda and we welcome consultations with social partners. In this regard, we appreciate the contribution of the Business-20 (B20) and Labor-20 (L20) to the process of the G20 under the Mexican Presidency.

25. We recognize the role of travel and tourism as a vehicle for job creation, economic growth and development, and, while recognizing the sovereign right of States to control the entry of foreign nationals, we will work towards developing travel facilitation initiatives in support of job creation, quality work, poverty reduction and global growth.

Trade

26. We are firmly committed to open trade and investment, expanding markets and resisting protectionism in all its forms, which are necessary conditions for sustained global economic recovery, jobs and development. We underline the importance of an open, predictable, rules-based, transparent multilateral trading system and are committed to ensure the centrality of the World Trade Organization (WTO).

27. Recognizing the importance of investment for boosting economic growth, we commit to maintaining a supportive business environment for investors.

28. We are deeply concerned about rising instances of protectionism around the world. Following up our commitment made in Cannes, we reaffirm our standstill commitment until the end of 2014

with regard to measures affecting trade and investment, and our pledge to roll back any new protectionist measure that may have arisen, including new export restrictions and WTO-inconsistent measures to stimulate exports. We also undertake to notify in a timely manner trade and investment restrictive measures. We uphold the inventory and monitoring work of the WTO, OECD and United Nations Conference on Trade and Development (UNCTAD) on trade and investment measures and encourage them to reinforce and deepen the work in these areas, consistent with their respective mandates.

29. We value the discussion held by our Trade Ministers in Puerto Vallarta on the relevance of regional and global value chains to world trade, recognizing their role in fostering economic growth, employment and development and emphasizing the need to enhance the participation of developing countries in such value chains. We encourage a deepening of these discussions in the WTO, UNCTAD and OECD within their respective mandates, and we call on them to accelerate their work on analyzing the functioning of global value chains and their relationship with trade and investment flows, development and jobs, as well as on how to measure trade flows, to better understand how our actions affect our countries and others, and to report on progress under Russia's Presidency.

30. In line with the Cannes Communiqué, we stand by the Doha Development Agenda mandate and reaffirm our commitment to pursue fresh, credible approaches to furthering trade negotiations across the board. We will continue to work towards concluding the Doha Round negotiations, including outcomes in specific areas where progress is possible, such as trade facilitation, and other issues of concern for least developed countries. We urge progress in streamlining WTO accession procedures for the world's poorest countries.

31. We support strengthening the WTO through improving the way it conducts its regular business, and its dispute settlement system. We also direct our representatives to further discussions on challenges and opportunities for the multilateral trading system in a globalized economy.

Strengthening the international financial architecture

32. We recognize the importance of effective global and regional safety nets. We welcome the firm commitments to increase the resources available to the IMF. This is the result of a broad international cooperative effort that includes a significant number of countries. The commitments exceed $450 billion and are in addition to the quota increase under the 2010 Reform. These resources will be available for the whole membership of the IMF, and not earmarked for any particular region. These resources, which qualify as reserve assets, would be channeled through bilateral loans and investments such as note purchase agreements to the IMF's General Resources Account under the modalities which have been approved by the IMF Executive Board. This effort shows the G20 and the international community's commitment to take the steps needed to safeguard global financial stability and enhance the IMF's role in crisis prevention and resolution.

33. We reaffirm our commitment to implement in full the 2010 Quota and Governance Reform by the agreed date of the 2012 IMF/World Bank Annual Meetings. These reforms are crucial to enhancing the IMF's legitimacy, relevance and effectiveness, and will support efforts to further strengthen Fund surveillance and to ensure that the IMF is adequately resourced to play its systemic role. As part of these reforms, we are committed to completing the comprehensive review of the quota formula, to address deficiencies and weaknesses in the current quota formula, by January 2013 and to complete the next general review of quotas by January 2014. We agree that the formula should be simple and transparent, consistent with the multiple roles of quotas, result in calculated shares that are broadly acceptable to the membership, and be feasible to implement based on timely, high quality and widely available data. We reaffirm that the

distribution of quotas based on the formula should better reflect the relative weights of IMF members in the world economy, which have changed substantially in view of strong GDP growth in dynamic emerging markets and developing countries. We reaffirm the importance of continuing to protect the voice and representation of the poorest members of the IMF. We ask our Finance Ministers and Central Bank Governors to review progress on this issue when they meet in November.

34. We agreed that the current surveillance framework should be significantly enhanced, including through a better integration of bilateral and multilateral surveillance with a focus on global, domestic and financial stability, including spillovers from countries' policies. We welcome the work of the IMF to advance considerations for a proposed integrated surveillance decision and commit to support the decision process. We underscore the importance of rigorous surveillance on exchange rate policies and support a more ample coverage of surveillance activities, where relevant, including global liquidity, capital flows, capital account measures, reserve and fiscal, monetary and financial sector policies that could have an impact on external stability. We welcome the IMF's ongoing work to produce an external sector report, which would strengthen multilateral analysis and enhance the transparency of surveillance. We also recognize that political ownership and traction is critical to effective surveillance, and that the International Monetary and Financial Committee (IMFC) has a role in facilitating the active involvement of all IMF members. We look forward to substantial progress by the next IMF/World Bank Annual Meetings.

35. We welcome the interim progress report and look forward to the joint annual progress report to support the development of local currency bond markets to be prepared by the World Bank, Regional Development Banks, IMF, OECD and the Bank of International Settlements (BIS). The full report will be presented at the November meeting of G20 Finance Ministers and Central Bank Governors. This issue is of great importance to emerging markets and developing countries, recognizing that the liquidity, efficiency and operation of these markets are being challenged by the current global financial situation.

Reforming the financial sector and fostering financial inclusion

36. We welcome the progress report by the Financial Stability Board (FSB) on taking forward the G20 commitments for strengthening financial stability and the FSB's enhanced monitoring of implementation at the national level. We are committed to the timely, full and consistent implementation of agreed policies in order to support a stable and integrated global financial system and to prevent future crises.

37. We welcome the publication of the traffic lights scoreboard to track progress in the implementation of all our financial reform recommendations and pledge to take all necessary actions to make progress in the areas where difficulties in policy development or implementation have been identified.

38. In particular, we recognize the substantial progress to date in the priority reform areas identified by the FSB's Coordination Framework for Implementation Monitoring (CFIM): the Basel capital and liquidity framework; the framework for global systemically important financial institutions (G-SIFIs), resolution regimes, over-the-counter (OTC) derivatives reforms, shadow banking, and compensation practices. We commit to complete work in these important areas to achieve full implementation of reforms.

39. We reaffirm our commitment that all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012, OTC derivative contracts should be reported to trade repositories and non-centrally cleared contracts should be subject to higher capital requirements. We

welcome the FSB progress report on implementation. Now that substantial progress has been achieved in the four safeguards for a resilient and efficient global framework for central clearing, jurisdictions should rapidly finalize their decision-making and put in place the needed legislation and regulations to meet the G20 commitment for central clearing. We acknowledge the progress made to develop the key principles to promote internationally consistent minimum standards for the margining of non-centrally cleared derivatives and encourage international standard setters to finalize the proposed global margin standards by the end of this year, to match the implementation deadline for other OTC derivatives reforms and for the Basel capital framework.

40. We welcome progress in implementing Basel II, 2.5 and III and urge jurisdictions to fully implement the standards according to the agreed timelines. We welcome the Basel Committee's consultative proposals for a fundamental review of the market risk framework. We welcome the FSB's progress report on the implementation of the principles and standards for sound compensation practices, reaffirm our commitment to ensure that these are followed and ask the FSB to continue its ongoing monitoring.

41. We reiterate our commitment to make our national resolution regimes consistent with the FSB Key Attributes of Effective Resolution Regimes so that no bank or other financial institution is "too big to fail". To this end, we also support the ongoing elaboration of recovery and resolution plans and institution-specific cross-border cooperation agreements for all G-SIFIs. We reiterate our commitment to strengthen the intensity and effectiveness of the supervision of SIFIs and ask the FSB to report on further progress in this area to the November 2012 G20 Finance Ministers and Central Bank Governors' meeting.

42. We welcome progress on developing a set of principles as a common framework for the identification of, and policy measures relating to, domestic systemically important banks (D-SIBs) and ask our Finance Ministers and Central Bank Governors to review recommendations in these areas at their meeting in November. We support continuing work for the strengthening of the oversight and regulation of the shadow banking system, and look forward to our Finance Ministers and Central Bank Governors reviewing recommendations in these areas at their meeting in November. We ask the FSB in consultation with the International Association of Insurance Supervisors (IAIS) to complete their work on identification and policy measures for global systemically important insurers by April 2013. Towards reducing systemic risk, we look forward to the preparation by the FSB in consultation with International Organization of Securities Commissions (IOSCO) of methodologies to identify other systemically important non-bank financial entities by end-2012 and call on Committee on Payment and Settlement Systems (CPSS) and IOSCO to continue their work on systemically important market infrastructures. We also ask the IAIS to continue its work to develop a common framework for the supervision of internationally active insurance groups by end-2013.

43. We call for accelerated progress by national authorities and standard setting bodies in ending the mechanistic reliance on credit ratings and encourage steps that would enhance transparency of and competition among credit rating agencies. We support continuing work to achieve convergence to a single set of high-quality accounting standards. We welcome IOSCO's report on the functioning of the credit default swap markets and ask IOSCO to report on next steps by the November 2012 Finance Ministers and Central Bank Governors' meeting.

44. We endorse the FSB recommendations regarding the framework for development of a global legal entity identifier (LEI) system for parties to financial transactions, with a global governance framework representing the public interest. The LEI system will be launched by March 2013 and we ask the FSB to report on implementation progress by the November 2012 Finance Ministers and Central Bank Governors' meeting. We encourage global adoption of the LEI to support authorities and market participants in identifying and managing financial risks.

45. We welcome the FSB study, prepared in coordination with the IMF and the World Bank, to identify potential unintended consequences of the agreed financial regulatory reforms for Emerging Markets and Developing Economies (EMDEs). We encourage continued monitoring analysis and reporting by the FSB and dialogue among the FSB, standard-setters, international financial institutions and national authorities of EMDEs, to address material unintended consequences as appropriate without prejudice to our commitment to implement the agreed reforms.

46. We endorse the recommendations and the revised FSB Charter for placing the FSB on an enduring organizational footing, with legal personality, strengthened governance, greater financial autonomy and enhanced capacity to coordinate the development and implementation of financial regulatory policies, while maintaining strong links with the BIS. We call for a full implementation of the recommendations by our next meeting and substantial progress by the November 2012 Finance Ministers and Central Bank Governors' meeting. We call on the FSB to continue to keep under review the structure of its representation.

47. We welcome the ongoing work by the FSB on adherence to supervisory and regulatory information exchange and cooperation standards and look forward to a further public statement on progress under the initiative ahead of the Finance Ministers and Central Bank Governors' meeting in November 2012.

48. In the tax area, we reiterate our commitment to strengthen transparency and comprehensive exchange of information. We commend the progress made as reported by the Global Forum and urge all countries to fully comply with the standard and implement the recommendations identified in the course of the reviews, in particular the 13 jurisdictions whose framework does not allow them to qualify to phase 2 at this stage. We expect the Global Forum to quickly start examining the effectiveness of information exchange practices and to report to us and our finance ministers. We welcome the OECD report on the practice of automatic information exchange, where we will continue to lead by example in implementing this practice. We call on countries to join this growing practice as appropriate and strongly encourage all jurisdictions to sign the Multilateral Convention on Mutual Administrative Assistance. We also welcome the efforts to enhance interagency cooperation to tackle illicit flows including the outcomes of the Rome meeting of the Oslo Dialogue. We reiterate the need to prevent base erosion and profit shifting and we will follow with attention the ongoing work of the OECD in this area.

49. We support the renewal of the Financial Action Task Force (FATF) mandate, thereby sustaining global efforts to combat money laundering and the financing of terrorism and proliferation of weapons of mass destruction. G20 members also welcome the adoption of the revised FATF standards and look forward to their implementation. We welcome the progress made by FATF in identifying and monitoring high-risk jurisdictions with strategic Anti-Money Laundering/Counter-Terrorist Financing (AML/CFT) deficiencies, using AML/CFT tools in the fight against corruption, improving transparency of corporate vehicles and increasing cooperation against tax crimes, addressing the risks posed by tax havens, as well as in increasing the reach and the effectiveness of AML/CFT measures by also considering financial inclusion efforts. We look forward to the completion in 2013 of the update of the FATF assessment process for the next round of mutual evaluations.

50. We welcome the progress made by the Global Partnership for Financial Inclusion (GPFI) on implementing the five recommendations set out in its 2011 report and call on the GPFI to continue working towards their full implementation. We endorse the G20 Basic Set of financial inclusion indicators developed by the GPFI. Recognizing the key role that SMEs play in economic development, and poverty reduction, we welcome the launch of the SME Finance Compact that will support developing innovative models and approaches to address the specific access to

finance challenges and constraints faced by developing countries with regards to SME finance. We welcome the forthcoming GPFI conference on standard setting bodies and financial inclusion as a means of helping to create an enabling regulatory environment, and we call on the GPFI to report progress to our Finance Ministers and Central Bank Governors in November. Finally, we support the ongoing effort to create a fourth GPFI subgroup that will focus on consumer protection and financial literacy issues.

51. We acknowledge the efforts of those G20 and non-G20 countries committed to national coordination platforms and strategies for financial inclusion under the "G20 Financial Inclusion Peer Learning Program" and encourage similar efforts to advance effective implementation of the G20 Principles for Innovative Financial Inclusion such as the commitments to concrete actions to promote financial inclusion made by developing and emerging countries under the Maya Declaration, recognizing the ongoing efforts and the support by the World Bank Group and the Alliance for Financial Inclusion, and other stakeholders including the United Nations (UN), and bilateral donors to foster financial inclusion.

52. On financial education, we endorse the OECD/International Network on Financial Education (INFE) High Level Principles on National Strategies for Financial Education, and call on the OECD/INFE and the World Bank in cooperation with the GPFI to deliver further tools to promote financial education, with a progress report to the next Summit. For advancing the financial consumer protection agenda, we take note of the discussion on the Statutes of the International Financial Consumer Protection Network (FinCoNet) and on the issues of formal structure and financial support to ensure the exchange of best practices. We also endorse the Action Plan presented by the G20/OECD Task Force on Financial Consumer Protection to develop effective approaches to support the implementation of the High Level Principles on Financial Consumer Protection, and look forward to an update report by the Leaders' Summit in St. Petersburg in 2013.

53. We recognize the need for women and youth to gain access to financial services and financial education, ask the GPFI, the OECD/INFE, and the World Bank to identify barriers they may face and call for a progress report to be delivered by the next Summit.

54. We welcome the launch of the Mexico Financial Inclusion Challenge: Innovative Solutions for Unlocking Access, a call for innovations that address barriers to financial inclusion through the creation of valuable, affordable, secure, and comprehensive financial services.

Enhancing food security and addressing commodity price volatility

55. The Action Plan on Food Price Volatility and Agriculture adopted by the Ministers of Agriculture in 2011 underlined that to feed a world population expected to exceed 9.3 billion by 2050, agricultural production will have to increase between 50 and 70 percent, and by almost 100 percent in developing countries. We recognize that increasing production and productivity on a sustainable basis while considering the diversity of agricultural conditions is one of the most important challenges that the world faces today. The crisis in the Sahel and the Horn of Africa also underscores that strengthening emergency and long-term responses to food insecurity remains a pressing challenge. We also note that chronic malnutrition is an enormous drain on a country's human resources, and we therefore support the Scaling Up Nutrition movement and encourage wider involvement of G20 members.

56. We welcome the considerable progress made in implementing the Action Plan and the food security pillar of the Seoul Multi-Year Action Plan on Development. We support the G20 Agriculture Vice-Ministers' Report annexed to this Declaration, on the progress made on previous commitments and key recommendations on sustainably increasing agricultural productivity, containing inputs from several international organizations coordinated by the Food and

Agriculture Organization (FAO) and the OECD, in addition to other recommendations from B20 and civil society.

57. To fight hunger, we commit to continue our efforts on our initiatives, including the Tropical Agriculture Platform, the Platform for Agricultural Risk Management, the GEO Global Agriculture Monitoring, research initiatives for wheat, rice and corn, the Rapid Response Forum, regional emergency food reserves, the Global Agriculture and Food Security Program and support for the Principles of Responsible Agriculture Investment. Recognizing the important contribution of greater transparency to reducing food price volatility, we welcome the progress made in the implementation of the Agricultural Market Information System (AMIS). We recognize that a more stable, predictable, distortion-free, open and transparent trading system, including as regards agriculture, has a critical role to play to promote food security.

58. We reaffirm our commitment to remove export restrictions and extraordinary taxes on food purchased for non-commercial humanitarian purposes by the World Food Programme (WFP). We encourage the implementation of the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security.

59. We strongly welcome the launch of the “AgResults” Initiative, aimed at improving food security for the poor and vulnerable by encouraging private sector innovation of new agricultural products and systems constrained by market failures in agriculture. We look forward to the launch of the pilot projects focused on innovations in nutrient-fortified crops, post-harvest waste-reducing storage solutions and crop quality technologies in Sub-Saharan Africa. We commend those who have already committed or signaled their intention to commit funding to this initiative and encourage broader participation.

60. We recognize the need to adapt agriculture to climate change and we recognize the importance of improving the efficiency of water and soil use in a sustainable manner. To this end, we support the development of and a greater use of available technologies, well-known practices and techniques such as soil fertility enhancement, minimum tillage and agroforestry, and call upon international organizations to provide a report on science-based options to improve the efficiency of water use in agriculture including in ways particularly suitable for small farms.

61. We recognize the importance to the global economic recovery of maintaining stability in international commodity markets. We stress the importance of well-functioning and transparent physical and financial commodities’ markets and reduced excessive price volatility to achieve food security and strong growth that is both sustainable and inclusive. We recognize that excessive commodity price volatility has significant implications for all countries, increasing uncertainty for actors in the economy and potentially hampering stability of the budgets, and predictability of economic planning. We recognize that mitigating the negative effects of commodity price volatility on the most vulnerable is an important component of reducing poverty and boosting economic growth. We therefore endorse the conclusions of the G20 report on the macroeconomic impacts of excessive commodity price volatility on growth and its identification of policy options that countries could consider, taking account of national circumstances to mitigate any such effect. We also acknowledge and appreciate the participation and valuable inputs of the IMF, World Bank and UNCTAD. We ask our Finance Ministers to report in 2013 on progress on the G20’s contribution to facilitate better functioning of these physical markets, taking note of possible areas of further work outlined in the report. We reaffirm our commitment to enhance transparency and avoid abuse in financial commodity markets, including OTC, with effective intervention powers for market regulators and authorities and an appropriate regulation and supervisory framework. In this regard we look forward to IOSCO’s report on the implementation of its recommendations on commodity derivatives markets by November 2012.

62. We recognize that excessive price volatility in energy commodities is also an important source of economic instability. We remain committed to well-functioning and transparent energy markets. We will continue to work to improve the timeliness, completeness and reliability of JODI-Oil and look forward to a progress report next year. We will work on the JODI-Gas database on the same principles. We expect the International Energy Forum (IEF) report on improving the reliability of the JODI-Oil database and the report on transparency in international gas and coal markets submitted by the International Energy Agency (IEA), IEF, and Organization of the Petroleum Exporting Countries (OPEC) to be discussed by our Finance Ministers in November. We also look forward to IOSCO's recommendations to improve the functioning and oversight of Price Reporting Agencies in November 2012, which will be produced in collaboration with other mandated organizations (IEF, IEA and OPEC), and task Finance Ministers to take concrete measures in this area as necessary.

Meeting the Challenges of Development

63. Eradicating poverty and achieving strong, inclusive, sustainable and balanced growth remain core objectives of the G20 development agenda. We reaffirm our commitment to work with developing countries, particularly low income countries, and to support them in implementing the nationally driven policies and priorities which are needed to fulfill internationally agreed development goals, particularly the Millennium Development Goals (MDGs) and beyond.

64. We welcome the initiative of the Development Working Group to build upon the work of previous G20 presidencies, and its focus on three priorities during the Mexican Presidency - food security, infrastructure and inclusive green growth. We commend the progress achieved against our commitments in the Seoul Multi-Year Action Plan, and support the 2012 Development Working Group progress report annexed to this Declaration. We invite the Development Working Group to explore putting in place a process for ensuring assessment and accountability for G20 development actions by the next Summit.

65. Investment in infrastructure is critical for sustained economic growth, poverty reduction, and job creation. We therefore welcome the strong progress made under the Multi-Year Action Plan, including in implementing the recommendations of the Multilateral Development Banks' (MDBs) Action Plan and the High Level Panel on Infrastructure.

66. While recognizing that public financing of infrastructure development projects in developing countries remains essential, we consider it should be complemented by private sector investment. We encourage MDBs to continue progress under the Action Plan, and welcome the report on addressing Misperception of Risk and Return in Low Income Countries. This contains important messages about properly perceiving the risks posed, as well as the opportunities offered, by long-term infrastructure investment in low income countries. Recognizing the challenge that rapid urbanization poses and the need to make cities more sustainable, we welcome the report on Best Practices for Urban Mass Transport Infrastructure Projects in Medium and Large Cities in Developing Countries, and support the follow-up actions as set out in the Development Working Group report.

67. We reaffirm our commitments to the global partnership for development, as set out in the MDGs, and welcome efforts to contribute to this end, including the Global Partnership for Effective Development Cooperation to be launched with voluntary participation under the auspices of the broad consensus achieved at the 4th High Level Forum on Aid Effectiveness held in Busan, Korea.

68. We recognize the value of Disaster Risk Management (DRM) tools and strategies to better prevent disasters, protect populations and assets, and financially manage their economic impacts. We appreciate World Bank and OECD combined efforts, with the UN's support, to

provide inputs and broaden participation in the discussion on DRM. We welcome the World Bank's and Mexico's joint publication on country experiences in this area with the support of G20 members, and look forward to the OECD voluntary framework to facilitate implementation of DRM strategies, to be completed by November.

<u>Promoting longer-term prosperity through inclusive green growth</u>

69. The long-term development and prosperity of current and future generations requires us to look beyond the immediate economic crisis. We acknowledge the importance of finding ways in which economic growth, environmental protection and social inclusion can complement and reinforce each other. Inclusive green growth in the context of sustainable development and poverty eradication can help achieve our development and economic goals, while protecting our environment, and improving social well-being on which our future depends. Inclusive green growth should not be used to introduce protectionist measures.

70. We commit to continue to help developing countries sustain and strengthen their development through appropriate measures, including those that encourage inclusive green growth. We will reaffirm our commitment to sustainable development at the 2012 United Nations Conference on Sustainable Development (Rio+20). We commit to maintaining a focus on inclusive green growth as part of our G20 agenda and in the light of agreements reached at Rio+20 and the United Nations Framework Convention on Climate Change (UNFCCC).

71. Climate change will continue to have a significant impact on the world economy, and costs will be higher to the extent we delay additional action. We reiterate our commitment to fight climate change and welcome the outcome of the 17th Conference of the Parties to the UN climate change conferences. We are committed to the full implementation of the outcomes of Cancun and Durban and will work with Qatar as the incoming Presidency towards achieving a successful and balanced outcome at COP-18. We emphasize the need to structurally transform economies towards a climate-friendly path over the medium term. We welcome the creation of the G20 study group on climate finance, in order to consider ways to effectively mobilize resources taking into account the objectives, provisions and principles of the UNFCCC in line with the Cancun Agreement and ask to provide a progress report to Finance Ministers in November. We support the operationalization of the Green Climate Fund.

72. The Development Working Group discussed a broad set of practical, voluntary measures and actions that have the potential to help countries define their paths towards sustainable development based on their own circumstances and priorities. We believe that developing countries should have access to institutions and mechanisms that can facilitate knowledge sharing, resource mobilization and building technical and institutional capacity to design and implement inclusive green growth strategies and policies. We welcome international efforts in launching the Green Growth Knowledge Platform and will continue exploring options to provide appropriate support to interested developing countries. We welcome the delivery of a non-prescriptive, voluntary toolkit of policy options for inclusive green growth and encourage efforts to promote its implementation. We encourage further exploration of effective mechanisms to mobilize public and private funds for inclusive green growth investment in developing countries, including through the public-private Dialogue Platform on Inclusive Green Investments. We welcome the B20's Green Growth Action Alliance.

73. We highlight that green growth and sustainable development have strong potential to stimulate long term prosperity and well being. We welcome the report prepared by the OECD, the World Bank and the UN on incorporating green growth and sustainable development policies into structural reform agendas, tailored to specific country conditions and level of development. We also acknowledge the G20 efforts to voluntarily self-report on current actions taken to integrate

green growth and sustainable development into structural reform agendas. We will self-report again in 2013, on a voluntary basis, and ask appropriate officials to report back on countries' efforts and progress on incorporating green growth policies in structural reform agendas and in relevant national plans to promote sustainable development.

74. We welcome the progress report on fossil fuel subsidies, and we reaffirm our commitment to rationalize and phase out inefficient fossil fuel subsides that encourage wasteful consumption over the medium term while providing targeted support for the poorest. We ask Finance Ministers to report back by the next Summit on progress made, and acknowledging the relevance of accountability and transparency, to explore options for a voluntary peer review process for G20 members by their next meeting. We also welcome a dialogue on fossil fuel subsidies with other groups already engaged in this work.

75. In Cannes we committed to promote low-carbon development strategies in order to optimize the potential for green growth and ensure sustainable development in our countries and beyond. We therefore welcome the report on clean energy and energy efficiency technologies and acknowledge the G20 countries' efforts to foster investment in these technologies through the sharing of national experiences regarding challenges for technology deployment.

76. We welcome the establishment of a Global Marine Environment Protection Best Practices Sharing Mechanism website, and look forward to its launch in accordance with the Cannes mandate.

Intensifying the fight against corruption

77. Corruption impedes economic growth, threatens the integrity of markets, undermines fair competition, distorts resource allocation, destroys public trust and undermines the rule of law. We call on all relevant stakeholders to play an active role in fighting corruption.

78. Closing the implementation and enforcement gap remains an important priority, and we continue to make significant progress towards the full implementation of the Seoul G20 Anti-Corruption Action Plan, and the commitments made in the Cannes Monitoring Report. We reiterate our commitment to the ratification and full implementation of the United Nations Convention against Corruption (UNCAC), and to more active engagement with the OECD working group on bribery on a voluntary basis. We welcome continuing engagement from the B20 in the fight against corruption and, in accordance with the Terms of Reference of the review mechanism, will involve the private sector and civil society in the UNCAC review process on a voluntary basis. We endorse today the G20 Anti-Corruption Working Group principles for denial of entry to our countries of corrupt officials, and those who corrupt them, and will continue to develop frameworks for cooperation. We also endorse the Working Group's principles for financial and asset disclosure systems for relevant officials to prevent, identify and appropriately manage conflicts of interest.

79. We commit to enforcing anti-corruption legislation, and we will pursue those who receive and solicit bribes as well as those who pay them in line with our countries' legislation. To help facilitate international cooperation among G20 and non-G20 governments in their investigation and prosecution of corruption, we will publish a guide on Mutual Legal Assistance from G20 countries, as well as information on tracing assets in G20 jurisdictions. We renew our commitment to deny safe haven to the proceeds of corruption and to the recovery and restitution of stolen assets.

80. We extend the mandate of the Anti-Corruption Working Group for two years to the end of 2014 and request the Working Group to prepare a comprehensive action plan, as well as a second Working Group Monitoring Report, both to be presented for consideration and adoption by Sherpas by the end of 2012.

Other paragraphs

81. In light of the interconnectedness of the world economy, the G20 has led to a new paradigm of multilateral co-operation that is necessary in order to tackle current and future challenges effectively. The informal and flexible character of the G20 enables it to facilitate international economic and financial cooperation, and address the challenges confronting the global economy. It is important that we continue to further improve the transparency and effectiveness of the G20, and ensure that it is able to respond to pressing needs. As a contribution to this, in line with the commitment made in Cannes, Sherpas have developed a set of evolving G20 working practices.

82. An informal meeting of G20 Ministers of Foreign Affairs was held in Los Cabos in February, which explored the ways in which G20 member countries could contribute more effectively to address key challenges in global governance.

83. Recognizing the far-reaching impact of G20 decisions, we welcome the extensive outreach efforts undertaken by the Mexican Presidency, including the meetings of Business-20, Labor-20, Youth-20, and Think-20. We will continue developing efforts with non-members, regional and international organizations, including the UN and other actors. In line with the Cannes mandate, in order to ensure our outreach remains consistent and effective, we welcome a set of principles in this area, developed by Sherpas.

84. We thank international organizations, including the UN, IMF, World Bank, WTO, FSB, ILO, FAO, and OECD, as well as civil society, for their input into the G20 process. Their reports and recommendations have provided valuable inputs to G20 discussions, in areas ranging from sustainable development to financial regulation.

Conclusion

85. We look forward to the rest of the work that will take place during Mexico's Presidency until November 30. On 1 December, 2012, Russia will start chairing the G20. We will convene in St. Petersburg, under the Chairmanship of Russia. We thank Mexico for hosting a successful Los Cabos Summit.

G20 LEADERS' DECLARATION

September, 2013

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G20 LEADERS' DECLARATION

Saint Petersburg Summit

5-6 September 2013

Preamble

1. We, the Leaders of the G20, met in St Petersburg on 5-6 September 2013, united by our continued commitment to work together to strengthen the global economy.

2. Strengthening growth and creating jobs is our top priority and we are fully committed to taking decisive actions to return to a job-rich, strong, sustainable and balanced growth path.

3. In the five years since we first met, coordinated action by the G20 has been critical to tackling the financial crisis and putting the world economy on a path to recovery. But our work is not yet complete and we agreed that it remains critical for G20 countries to focus all our joint efforts on engineering a durable exit from the longest and most protracted crisis in modern history.

4. Our most urgent need is to increase the momentum of the global recovery, generate higher growth and better jobs, while strengthening the foundations for long-term growth and avoiding policies that could cause the recovery to falter or promote growth at other countries' expense.

5. We understand that sound and sustainable economic growth will be firmly based on increased and predictable investments, trust and transparency, as well as on effective regulation as part of the market policy and practice.

6. As Leaders of the world's largest economies, we share responsibility for reinforcing the open and rules-based global economic system. We are committed to working cooperatively to address key global economic challenges:

- Achieving a stronger recovery while ensuring fiscal sustainability. We have today agreed the St Petersburg Action Plan, which sets out our strategies to achieve strong, sustainable and balanced growth.

- Unemployment and underemployment, particularly among young people. We are united in the resolve to achieve better quality and more productive jobs. Coordinated and integrated public policies (macroeconomic, financial, fiscal, education, skills development, innovation, employment and social protection) are key to reach this goal. We today committed to continue our efforts to support inclusive labour markets, with the exchange of country-specific plans or sets of actions, developed as appropriate according to our different constitutional circumstances.

- Importance of long-term financing for investment, including for infrastructure and SMEs to boost economic growth, job creation and development. Today we endorsed the work plan that helped us to assess factors affecting the availability and accessibility of long-term financing for investment and committed to identify and start to implement a set of collective and country-specific measures that tangibly improve our domestic investment environments.

- Free and rules-based trade fosters economic opportunities. We stress the crucial importance of strong multilateral trading system and call on all the WTO members to show the necessary flexibility and reach a successful outcome in this year's multilateral trade negotiations. We extend our commitment to refrain from protectionist measures and aim at enhancing transparency in trade, including in regional trade agreements.

- Cross-border tax evasion and avoidance undermine our public finances and our people's trust in the fairness of the tax system. Today, we endorsed plans to address these problems and committed to take steps to change our rules to tackle tax avoidance, harmful practices, and aggressive tax planning.

- We have agreed and are implementing a broad range of financial reforms to address the major fault lines that caused the crisis. We are building more resilient financial institutions, making substantial progress towards ending too-big-to-fail, increasing transparency and market integrity, filling regulatory gaps and addressing the risks from shadow banking. We will pursue our work to build a safe, reliable financial system responsive to the needs of our citizens.

- G20 countries have a responsibility to ensure that all people have an opportunity to gain from strong, sustainable and balanced growth. We endorse the St Petersburg Development Outlook to focus our efforts on concrete steps to improve food security, financial inclusion, infrastructure, human resource development and domestic resource mobilization.

- Corruption impedes sustainable economic growth and poverty reduction, threatening financial stability and economy as a whole. We will hold ourselves to our commitment to implement the G20 Anti-Corruption Action Plan, combating domestic and foreign bribery, tackling corruption in high-risk sectors, strengthening international cooperation and promoting public integrity and transparency in the fight against corruption. Recognizing the need for sustained and concerted efforts we endorse the St Petersburg Strategic Framework.

- We share a common interest in developing cleaner, more efficient and reliable energy supplies, as well as more transparent physical and financial commodity markets. We commit to enhance energy cooperation, to make energy market data more accurate and available and to take steps to support the development of cleaner and more efficient energy technologies to enhance the efficiency of markets and shift towards a more sustainable energy future. We underscore our commitment to work together to address climate change and environment protection, which is a global problem that requires a global solution.

- We will continue to develop comprehensive growth strategies to achieve stronger, more sustainable and balanced growth in the context of fiscal sustainability.

7. Too many of our citizens have yet to participate in the economic global recovery that is underway. The G20 must strive not only for strong, sustainable and balanced growth but also for a more inclusive pattern of growth that will better mobilize the talents of our entire populations.

8. Cooperation, Coordination and Confidence is what we will continue to strive for.

Global Economy and G20 Framework for Strong, Sustainable and Balanced Growth

9. We have taken a number of important policy actions that have helped to contain key tail risks, improve financial market conditions and sustain the recovery. Private demand has strengthened in the U.S. and growth has picked up in Japan and the U.K. There are signs of recovery in the euro area. While growth has continued in emerging market economies, it has slowed down in some of them. Global growth prospects for 2013 have been marked down repeatedly over the last year, global rebalancing is incomplete, regional growth disparities remain wide, and unemployment, particularly among youth, remains unacceptably high. Despite our actions, the recovery is too weak, and risks remain tilted to the downside. In the last months financial market volatility has increased.

10. We consider the main challenges to the global economy to be:

- Weak growth and persistently high unemployment, particularly among youth, and the need for more inclusive growth in many economies;

- Financial market fragmentation in Europe and the decisive implementation of banking union;

- Slower growth in some emerging market economies, reflecting in some cases the effect of volatile capital flows, tighter financial conditions and commodity price volatility, as well as domestic structural challenges;

- Insufficient levels of private investment in many countries, in part due to continuing market uncertainties, as well as internal rigidities;

- High public debt and its sustainability in some countries that need to be addressed while properly supporting the recovery in the near-term, especially in countries with the highest actual and projected debt to GDP levels;

- Volatility of capital flows as growth strengthens and there are expectations of eventual monetary policy recalibration in advanced economies;

- An incomplete rebalancing of global demand; and

- Continued uncertainties about fiscal policy deliberations.

11. To address these challenges and to place the global economy on a stronger, more sustainable and balanced growth path, we have built on our previous actions with new measures as set out in the St Petersburg Action Plan (Annex). The Action Plan is designed to boost economic activity and job creation, support the recovery, and address near-term risks to the outlook, while strengthening the foundations for strong, sustainable and balanced growth through ambitious and well-targeted reforms. We will act together and implement all our commitments in a timely manner and rigorously monitor this process.

12. Our immediate focus is on creating the conditions to increase growth and employment with timely actions that build on the signs of a recovery in advanced economies to make it durable to the benefit of the whole global economy.

13. In this respect, the euro area commits to strengthen the foundations for economic and monetary union, including through further efforts to strengthen bank balance sheets, reduce financial fragmentation and moving ahead decisively and without delay toward a banking union. Advanced G20 countries agree to maintain a flexible approach in implementing their fiscal strategies, while remaining committed to sustainable public finances. Facing increased financial volatility, emerging markets agree to take the necessary actions to support growth and maintain stability, including efforts to improve fundamentals, increase resilience to external shocks and strengthen financial systems.

14. Monetary policy will continue to be directed towards domestic price stability and supporting the economic recovery according to the respective mandates of central banks. We recognize the support that has been provided to the global economy in recent years from accommodative monetary policies, including unconventional monetary policies. We remain mindful of the risks and unintended negative side effects of extended periods of monetary easing. We recognize that strengthened and sustained growth will be accompanied by an eventual transition toward the normalization of monetary policies. Our central banks have committed that future changes to monetary policy settings will continue to be carefully calibrated and clearly communicated.

15. We reiterate that excess volatility of financial flows and disorderly movements in exchange rates can have adverse implications for economic and financial stability, as observed recently in some emerging markets. Generally stronger policy frameworks in these countries allow them to better deal with these challenges. Sound macroeconomic policies, structural reforms and strong prudential frameworks will help address an increase in volatility. We will continue to monitor financial market conditions carefully.

16. We commit to cooperate to ensure that policies implemented to support domestic growth also support global growth and financial stability and to manage their spillovers on other countries.

17. We reiterate our commitments to move more rapidly toward more market-determined exchange rate systems and exchange rate flexibility to reflect underlying fundamentals, and avoid persistent exchange rate misalignments. We will refrain from competitive devaluation and will not target our exchange rates for competitive purposes. We will resist all forms of protectionism and keep our markets open.

18. We are also committed to strengthening the foundations for long-term growth through implementing ambitious and targeted reforms designed to ensure fiscal sustainability, boost investment, increase productivity and labor force participation, and address internal and external imbalances.

19. Achieving a stronger and sustainable recovery, while ensuring fiscal sustainability in advanced economies remains critical. As agreed, all advanced economies have developed credible, ambitious, and country-specific medium-term fiscal strategies. These strategies will be implemented flexibly to take into account near-term economic conditions, so as to support economic growth and job creation, while putting debt as a share of GDP on a sustainable path. A number of emerging market economies have also laid out key elements of their strategies to promote fiscal sustainability.

20. Recognizing the need to push ahead more urgently with important structural reforms, we have reset our reform agenda along more relevant, concrete and well-targeted lines. Members have committed to a wide range of reforms to strengthen the foundations for strong, sustainable and balanced growth over the long term by boosting investment, addressing fundamental weaknesses, enhancing productivity and competitiveness, increasing labour force participation, improving financial stability and credit access, and addressing internal and external imbalances. These reforms are key to achieving a lasting improvement in potential growth, job creation and rebalancing demand.

21. We are determined to achieve more progress toward broad based rebalancing of global demand. While global current account imbalances have declined, reflecting in part important reforms in a number of countries, a substantial part of this progress has occurred due to demand compression. In order to ensure a durable improvement as global growth strengthens, we are determined to undertake further policy adjustments toward rebalancing global demand between surplus and deficit countries, as well as internal rebalancing. In this respect, it is essential to achieve stronger domestic demand growth in large surplus economies, increased savings and enhanced competitiveness in deficit economies and more flexible exchange rates. We are committed to actions in all these areas and will regularly assess progress.

22. The St Petersburg Action Plan sets forth our reforms for achieving strong, sustainable and balanced growth. Further, our Accountability Assessment describes the progress we have made on past commitments. We will identify the remaining key obstacles to be addressed and reforms needed to achieve stronger, more sustainable and balanced growth in our economies. We ask our Finance Ministers to develop further the comprehensive growth strategies for presentation to the Brisbane Summit.

Growth through Quality Jobs

23. We remain united in our resolve to promote inclusive growth and more and better jobs.

24. Unemployment and underemployment in many countries, particularly among young people, remains one of the key challenges confronting the global economy and a top priority for the G20.

25. Creating more productive and better quality jobs is at the heart of our countries' policies aimed at achieving strong sustainable and balanced growth, poverty reduction and increasing social cohesion. We agree that strong and supportive macroeconomic, trade, investment, and labour market policies, sustainable public finance, a sound and well-regulated financial system, and resilient and effective social protection systems are the foundation for sustainable job-creating economic growth.

26. Policy reforms to support higher employment and facilitate job creation and better matching of skills with job opportunities are central in our growth strategies. We commit to take a broad-ranged action, tailored to national circumstances, to promote more and better jobs:

- Improve business environment and stimulate the creation of formal, more productive and rewarding jobs, through pro-growth structural reforms in product and labour markets, including by promoting labour market adaptability and efficiency, ensuring adequate labour protection, as well as appropriate tax regimes and other government initiatives that may be required according to national circumstances.

- Invest in our people's skills, quality education and life-long learning programs to give them skill portability and better prospects, to facilitate mobility and enhance employability.

- Foster targeted investments to ensure that labour market infrastructure and effective labour activation policies are in place to help jobseekers find work and bring under-represented and vulnerable groups into the labour market and reduce informality.

- Improve job quality, including through working conditions, wage bargaining frameworks, national wage-setting systems, and access to social protection.

- Develop country-specific plans or sets of actions on employment and we will discuss the progress in Brisbane.

27. Coordinated and integrated public policies are crucial to achieving strong, sustainable, and balanced growth, and restoring confidence in the global economy. We endorse the recommendations of our Labour and Employment and Finance Ministers to mobilize, coordinate and integrate, our national policies (macroeconomic, financial, fiscal, education, skills development, innovation, employment, social protection) to promote the creation of quality jobs, while increasing productivity with full respect for Fundamental Principles and Rights at Work, to ensure higher employment levels and a sustained decline in unemployment, underemployment and informal employment.

28. The joint meeting of our Labour and Employment and Finance Ministers, organized for the first time, was a welcome step towards coordination and integration of labour, employment and social policies with our macroeconomic and financial policies. We call upon our Ministers of Labour and Employment and our Ministers of Economy and Finance to continue to collaborate to promote quality job creation and job-rich and sustained growth. We encourage relevant international organizations including the ILO, the OECD, and the World Bank Group to analyze the recent experiences of the G20 countries and identify best practices that have been most successful in creating more and better jobs, promoting labour formalization, reducing inequality, ensuring effective social protection and labour market adaptability, as inputs to future deliberations of the G20 Labour and Employment Ministers.

29. Promoting youth employment is a global priority. We are committed to quality apprenticeship and vocational training programmes, finding innovative ways to encourage firms to hire youth for example by, where appropriate, reducing non-wage labour costs, moving towards early intervention measures and effective job-search assistance for different groups of youth, and motivating youth entrepreneurship and business start-ups. Tailored strategies including youth guarantee approaches, developing school and university curricula that support entrepreneurship, and facilitating exchange of best practices among the G20 countries and the social partners are crucial in this respect.

30. We commit to increase our efforts to support inclusive labour markets, better labour market information and effective employment services, which will contribute to higher employment levels along with a sustained decline in unemployment, underemployment and informal employment. We agree that appropriate labour market and social policies can ensure better social cohesion, economic stabilization, support aggregate demand and medium to longer-term growth. Sound national social protection floors are needed, which are affordable, effective, efficient, and socially adequate. Our social protection policies should encourage employment and job-search, providing help if necessary. We commit to encourage the private sector, including small and medium sized enterprises as one of our most important partners, in fostering inclusive economic growth including for job creation and labour absorption. We encourage the IMF as well as other relevant international organizations to continue their research in the area of growth, employment and income distribution.

31. We recognize the importance of ensuring that underrepresented and vulnerable groups are given both incentives and support to find productive and rewarding jobs. Special attention must be given to those groups facing the greatest barriers to finding or remaining in employment such as youth, women, long-term unemployed, low skilled workers, single parents, people with disabilities and older workers. We are committed therefore to develop and strengthen tailored activation strategies for these groups that combine income support for those out of work with measures to improve their employability through job search assistance, work experience, public employment programs, hiring subsidies, conditional transfers and training as well as reduced obstacles for employment as per country's circumstances. These measures should be linked to more general efforts to provide better opportunities to gain formal employment. We call upon our Ministers of Labour and Employment and Ministers of Finance to work together to exchange best practices and to deliver on implementation of this commitment with the support of the ILO, the OECD and the World Bank Group in identifying good practices and effective measures for more inclusive labour markets.

32. We confirm the importance of reporting progress in meeting our commitments and of sharing our experience of effective policies and measures. We consider the database prepared by the G20 Task Force on Employment as an important tool, which allows sharing best practices and ways to address labour market and employment challenges, and serves as an important source of information for the economic analyses and decision-making. This is particularly important for the employment and skills development of young people. We commit to continue to work and to broaden this approach including the scope of the database, to develop country owned and country specific monitoring methodologies, where necessary, and use the database when building upon our country owned and country specific policies.

33. We appreciate the contribution of the B20 and the L20 and acknowledge the crucial role of social dialogue as a means to achieve the G20 objectives of fostering growth, employment, and social cohesion.

34. We thank the G20 Task Force on Employment for its work, and extend its mandate for another year. We ask the G20 Task Force on Employment to continue exploring the issues related to economic and labour and employment policies, and to focus on strategies to address structural unemployment, especially among youth and the long-term unemployed, and on national social protection systems. This will build on the terms proposed by our Labour and Employment Ministers including for sharing of

best practices and reviewing progress on the key elements identified on quality apprenticeships. We ask the Task Force to coordinate the exchange of country-specific plans or sets of actions on employment, developed as appropriate according to our different constitutional circumstances, working with the ILO, OECD and the World Bank Group. These reports should include information on the mix of policies and programs that will be used by participating G20 members to address their respective employment challenges. In addition, given the recurring loss to human life and assets across the world on account of unsafe working places, we direct the Task Force to partner with ILO in consultation with countries, and to consider how the G20 might contribute to safer workplaces. We encourage further cooperation and coordination between the Task Force on Employment and Framework and Development Working Groups on the activities related to the labour issues under the G20.

Financing for Investment

35. We recognize the key role of long-term investment for sustainable growth and job creation, as well as the importance of putting in place conditions that could promote long-term financing for investment, including in infrastructure and small and medium-sized enterprises (SMEs), taking into consideration country-specific circumstances. In particular, we recognize the paramount importance of the investment climate in attracting long-term financing and will take a comprehensive approach to identifying and addressing impediments to the mobilization of private capital and improving underlying investment conditions and the efficiency of public investment.

36. To lift growth and create jobs by boosting investment, we commit to identify and start to implement by the Brisbane Summit a set of collective and country-specific actions that tangibly improve our domestic investment environments such that they are more favorable to long-term investment financing and can lead to an effective increase of implemented projects, particularly in infrastructure and for SMEs. These actions will be part of our country-growth strategies.

37. We endorse the Work plan prepared by the G20 Study Group on Financing for Investment (Annex). We call on our Finance Ministers and Central Bank Governors with input from relevant international organizations and in cooperation with other relevant G20 working groups to extend the analysis of the challenges associated with the availability of financing for long-term investment to drive well-founded, evidence-based policy initiatives. We look forward to the recommendations by our Finance Ministers at our next Summit informed by the reports of the relevant international organizations.

38. We agree in particular on the need for governments to promote policies that facilitate and encourage institutional investors to finance long-term investment consistent with their mandates and prudent risk-taking. We endorse the G20/OECD High-Level Principles of Long-Term Investment Financing by Institutional Investors (Annex) and ask our Finance Ministers and Central Bank Governors to identify approaches to their implementation working with the OECD and other interested participants by the next Summit. We look forward to the FSB's ongoing monitoring of the impact of financial regulatory reforms on the supply of long-term investment financing.

39. We call on our Finance Ministers to identify measures by the next Summit to facilitate domestic capital market development and improve the intermediation of global savings for productive long-term investments, including in infrastructure, and to improve access to financing for SMEs. We ask Finance Ministers and Central Bank Governors to explore the ways in which private financing and capital markets can be better mobilized. We also look forward to building on the ongoing work of the Multilateral Development Banks to develop new approaches in order to optimize the use of existing resources, including through leveraging private capital, and to strengthen their lending capacity. We take note of the work underway by the World Bank Group and Regional Development Banks to mobilize and catalyze additional financing for infrastructure investment, particularly in emerging markets and developing countries.

40. We recognize the importance of improving processes and transparency in the prioritization, planning, and funding of investment projects, especially in infrastructure, and in making better use of project preparation funds. Particular attention will also be given to ways to improve the design of and conditions for productive public-private partnership (PPP) arrangements.

Enhancing Multilateral Trade

41. Free trade and investment, and achieving the open, rules-based, transparent and non-discriminatory WTO-based trading system are crucial for restoring global growth. We underline the importance of trade as a key to economic growth, sustainable development and job creation globally and at national level.

42. We reaffirm the significance of the successful functioning of the multilateral trading system and its importance in ensuring proper rules enforcement. A successful outcome at the WTO Ministerial Conference (MC9) in Bali in December 2013 on trade facilitation, and some elements of agriculture and development issues, would be a stepping stone to further multilateral trade liberalization and progress in Doha Development Agenda negotiations, providing new confidence in successful post-Bali Doha round negotiations.

43. We call on all WTO members to show the necessary flexibilities in order to bridge existing gaps and deliver positive and balanced results at MC9. We stand ready to make significant contributions in these negotiations to achieve such results, delivering an early harvest at MC9 and demonstrating the credibility of the negotiating function of the WTO.

44. We recognize the risks of economic slowdown and trade weakening posed by protectionism. We extend until the end of 2016 our standstill commitment; being fully committed to further progress in removing barriers and impediments to global trade and investment, we reaffirm commitment to roll back new protectionist measures. With these commitments we stress the importance of further curbing protectionism through the WTO, and to this end we will endeavor to make MC9 successful as a step towards a successful conclusion of the Doha Development Round and as an impetus for negotiations on a roadmap to reach this goal.

45. We value monitoring of trade and investment restrictive/opening measures by the WTO, the OECD and the UNCTAD. We call on them to continue and reinforce this work

consistent with their respective mandates so as to better resist protectionism and promote liberalization of global trade and investment. We welcome the WTO's public website providing transparency over these measures for the benefit of governments, private sector, and civil society.

46. Transparency is a cornerstone of the multilateral trading system. We are committed to timely complying with WTO notification requirements and enhancing transparency through the existing WTO rules.

47. We understand the importance of regional trade agreements (RTAs) and their contribution to trade and investment liberalization. We commit to ensure that RTAs support the multilateral trading system. Realizing that enhancing transparency in RTAs and understanding of RTAs and their effects on the further development of multilateral rules are of systemic interest to all G20 members, we are committed to continue our work on RTAs in the WTO, and share our approach for Advancing Transparency in Regional Trade Agreements (Annex).

48. We support the Transparency in Trade (TNT) Initiative, a partnership between the African Development Bank, the International Trade Centre (ITC), the United Nations Conference on Trade and Development (UNCTAD), and the World Bank, which will provide for open use of the trade policy data and analysis system to identify new trade opportunities and facilitate trade flows. We also welcome the WTO's Integrated Trade Information Portal (I-TIP).

49. We recognize the importance of better understanding the rapid expansion of global value chains (GVCs) and impacts of participation in GVCs for growth, industrial structure, development and job creation. In this regard, we welcome the work done by the OECD, the WTO and the UNCTAD and ask them to seek the views of governments and continue their research on the impact of GVCs, particularly in relation to the influence of GVCs on trade, economic growth, development, job creation and distribution of value-added along GVCs. Identifying the opportunities and challenges of participation in GVCs and making available value-added trade statistics may help countries in due course to decide upon appropriate policymaking options to benefit from GVCs. . We call for the OECD in cooperation with the WTO and the UNCTAD to deliver a report in the first half of 2014.

Addressing Base Erosion and Profit Shifting, Tackling Tax Avoidance, and Promoting Tax Transparency and Automatic Exchange of Information

50. In a context of severe fiscal consolidation and social hardship, in many countries ensuring that all taxpayers pay their fair share of taxes is more than ever a priority. Tax avoidance, harmful practices and aggressive tax planning have to be tackled. The growth of the digital economy also poses challenges for international taxation. We fully endorse the ambitious and comprehensive Action Plan – originated in the OECD – aimed at addressing base erosion and profit shifting with mechanism to enrich the Plan as appropriate. We welcome the establishment of the G20/OECD BEPS project and we encourage all interested countries to participate. Profits should be taxed where economic activities deriving the profits are performed and where value is created. In order to minimize BEPS, we call on member countries to examine how our own

domestic laws contribute to BEPS and to ensure that international and our own tax rules do not allow or encourage multinational enterprises to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions. We acknowledge that effective taxation of mobile income is one of the key challenges. We look forward to regular reporting on the development of proposals and recommendations to tackle the 15 issues identified in the Action Plan and commit to take the necessary individual and collective action with the paradigm of sovereignty taken into consideration.

51. We commend the progress recently achieved in the area of tax transparency and we fully endorse the OECD proposal for a truly global model for multilateral and bilateral automatic exchange of information. Calling on all other jurisdictions to join us by the earliest possible date, we are committed to automatic exchange of information as the new global standard, which must ensure confidentiality and the proper use of information exchanged, and we fully support the OECD work with G20 countries aimed at presenting such a new single global standard for automatic exchange of information by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014. In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015. We call on all countries to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters without further delay. We look forward to the practical and full implementation of the new standard on a global scale. We encourage the Global Forum to complete the allocation of comprehensive country ratings regarding the effective implementation of information exchange upon request and ensure that the implementation of the standards are monitored on a continuous basis. We urge all jurisdictions to address the Global Forum recommendations in particular those 14 that have not yet moved to Phase 2. We invite the Global Forum to draw on the work of the FATF with respect to beneficial ownership. We also ask the Global Forum to establish a mechanism to monitor and review the implementation of the new global standard on automatic exchange of information.

52. Developing countries should be able to reap the benefits of a more transparent international tax system, and to enhance their revenue capacity, as mobilizing domestic resources is critical to financing development. We recognize the importance of all countries benefitting from greater tax information exchange. We are committed to make automatic exchange of information attainable by all countries, including LICs, and will seek to provide capacity building support to them. We call on the Development Working Group in conjunction with the Finance Track, to work with the OECD, the Global Forum and other IOs to develop a roadmap showing how developing countries can overcome obstacles to participation in the emerging new standard in automatic exchange of information, and to assist them in meeting the standard in accordance with the action envisaged in the St Petersburg Development Outlook. The Working Group should report back by our next meeting. Working with international organizations, we will continue to share our expertise, help build capacity, and engage in long-term partnership programmes to secure success. In this respect, we welcome the OECD Tax Inspectors without Borders initiative, which aims to share knowledge and increase domestic capacities in developing countries in the tax area. Finally, we are committed to continue to assist developing countries, including through the IOs, in identifying individual country needs and building capacity in the area of tax administration (in addition to automatic exchange of information) and encourage such support to be developing country led.

International Financial Architecture

53. Completing the ongoing reforms of IMF governance is indispensable for enhancing the Fund's credibility, legitimacy and effectiveness. For this reason, the ratification of the 2010 IMF Quota and Governance Reform is urgently needed. We continue to support the IMF Executive Board's decision to integrate the process of reaching a final agreement on a new quota formula with the 15th General Review of Quotas. We remain committed, together with the whole IMF membership, to agree on the quota formula and complete the 15th General Quota Review by January 2014 as agreed at the Seoul Summit and reiterated in Cannes and Los Cabos. We attach high importance to securing continued progress in meeting this objective, including by the time of the October 2013 G20 Ministerial and IMFC meetings. We reaffirm our previous commitment that the distribution of quotas based on the formula should better reflect the relative weights of IMF members in the world economy, which have changed substantially in view of strong GDP growth in dynamic emerging market and developing countries. We reaffirm the need to protect the voice and representation of the IMF poorest members as part of this General Review of Quotas.

54. Recognizing the importance of effective global safety nets, in Los Cabos we welcomed the commitments to increase temporary resources available to the IMF by US$ 461 billion made by a significant number of countries. Today we are pleased to announce that the vast majority of these committed resources have been made available to the IMF through bilateral loan or note purchase agreements. This broad cooperative effort demonstrates the international community's determination to enhance the IMF's role in crisis prevention and resolution and thus contribute to safeguarding global financial stability.

55. We also reiterate that Regional Financing Arrangements (RFAs) can play an important role in the existing global financial safety net. We reaffirm the common principles for cooperation between the IMF and RFAs that we adopted in Cannes, which emphasize the importance of cooperation while safeguarding the mandate and independence of the respective institutions. Recognizing recent work undertaken in this area by both the IMF and G20, we look forward to a flexible and voluntary dialogue between the IMF and RFAs on an ongoing basis through well-established communication channels. We take note of the importance of a dialogue among RFAs to foster an informal exchange of views and experiences in a flexible and voluntary way. In this context, we ask our Finance Ministers and Central Bank Governors to follow the developments and progress in the IMF-RFA cooperation, as well as the dialogue among RFAs.

56. Strengthening existing public debt management practices is important to achieve more resilient public finances. We welcome the ongoing work by the IMF and World Bank Group to review and update the "Guidelines for Public Debt Management" in light of recent experiences. We ask our Finance Ministers to consider, at their October meeting, progress in updating the Guidelines, and review the OECD's interim report on updating its leading practices for raising, managing, and retiring public debt, including on state guarantees.

57. Events in recent years have shown the importance of debt sustainability for all. We, therefore, endorse continued attention to this issue by the IMF and the World Bank. We also support the implementation of the IMF-World Bank Debt Sustainability

Framework for Low-Income Countries and will take the Framework into consideration in order to better inform our practices and promote sustainable financing and sustainable growth and development through appropriate channels. We agree that further inclusive discussions with low-income countries are needed on these issues, including on the possibility of developing guidelines for sustainable financing. We ask the IMF and the World Bank to continue assisting low-income countries at their request in developing prudent medium-term debt management strategies and enhancing their debt management capacity.

58. We note the work undertaken by the IMF and BIS in developing indicators that reflect global liquidity conditions, looking both at price and quantity-based measures. We call on the Fund to carry out further research with a view to develop proposals on how to incorporate global liquidity indicators more broadly into the Fund's surveillance work.

59. We reiterate that well developed local currency bond markets (LCBMs) play an important role in improving the resilience of the domestic economy and financial systems. We welcome the work of the IMF, the World Bank Group, the EBRD OECD and other IOs to implement the G20 Action Plan on the Development of LCBMs, including through the creation of a Diagnostic Framework on LCBM. We encourage International Organizations, other technical assistance providers, and country authorities to consider the use of the Diagnostic Framework in identifying and setting reform and capacity building priorities in support of LCBM development.

60. We will fulfill our commitment to contribute to a successful International Development Association (IDA) 17 Replenishment, as well as African Development Fund (AfDF) 13 Replenishment.

Financial Regulation

Achievements to date and a road ahead

61. In the past five years, we have made substantial progress in implementing internationally consistent reforms to our financial systems. All major jurisdictions, in part or in full, have:

- implemented new global capital standards (Basel 3);
- completed the necessary frameworks for OTC derivatives to be traded on exchanges or electronic trading platforms, centrally cleared, and reported;
- identified global systemically important banks and insurers, and agreed to subject them to heightened prudential standards to mitigate the risks they pose;
- implemented agreed tools and procedures for the orderly resolution of large, complex financial institutions without taxpayer loss; and
- progressed in addressing potential systemic risks to financial stability emanating from the shadow-banking system.

The international coordination and commitment to the implementation of these reforms is unprecedented. But we have more work to do. We are committed to maintain the momentum of reform until the job is done.

Towards a financial system that supports strong, sustainable and balanced economic growth

62. Since our commitments in Washington in November 2008 we have agreed and are implementing a broad range of policy reforms that address the major fault lines that caused the crisis, and ensure that all financial institutions, markets and participants are regulated or subject to oversight appropriate to their circumstances in an internationally consistent and non-discriminatory way. Our work has advanced substantially, but is not yet complete. We are fully committed to tackling systemic risk. We are building more resilient financial institutions, making substantial progress towards ending too-big-to-fail, increasing transparency and market integrity, filling regulatory gaps and addressing the risks from shadow banking. We are promoting continuously functioning financial markets by making derivatives markets safer, strengthening market infrastructure and reforming credit rating agencies.

63. We are committed to fully realizing the benefits of an open, integrated and resilient global financial system. To this end, we will continue to take necessary actions in each of our jurisdictions to fully implement the agreed reforms in a consistent and non-discriminatory way. We will enhance cooperation and information sharing.

64. We are promoting financial regulatory reforms targeted at reducing moral hazard and systemic risk and fostering a stable financial system that supports sustainable and balanced economic growth. Thus, we welcome the establishment this year of the FSB as a legal entity with greater financial autonomy and enhanced capacity to coordinate the development and implementation of financial regulatory policies. We also welcome the FSB overall and narrative progress reports on financial regulatory reform, prepared for our Summit, and the substantial progress achieved to date. We support the FSB's intention to review the structure of its representation and ask the FSB to report on this review to our next Summit.

65. We commend the progress made by the FSB together with standard setting bodies and the IMF and the World Bank Group in monitoring the effects of evolving regulatory reforms on emerging markets and developing economies (EMDEs) with the view to address material unintended consequences without prejudice to our commitment to implement the agreed reforms. We ask the IMF, the World Bank Group and standard setting bodies to step up their monitoring, analysis and assistance in this area. Lastly, we encourage the FSB to continue to monitor, analyze and report on the effects of evolving regulatory reforms on EMDEs as a part of its overall implementation monitoring framework.

66. We are resolved to see the financial reform agenda through to its completion in a manner that avoids fragmenting the global financial system. We will continue to cooperate on all financial regulation issues and look forward to further progress by our Finance Ministers, Central Bank Governors and the FSB when we next meet. We will also continue to monitor and assess the impact of financial regulatory reforms on the robustness of the financial system, stability and on economic growth, and on the availability of long-term finance for investment.

Building resilient financial institutions and ending "too-big-to-fail"

67. We reiterate our commitment to implement Basel III according to internationally agreed timelines and welcome the progress that has been made since Los Cabos. It is imperative that the Basel III standards are consistently applied. We therefore welcome the work of the Basel Committee on Banking Supervision (BCBS) to assess the consistency of jurisdictions' rules with Basel III and their updated progress report on Basel III implementation. We also welcome the recent BCBS report on the regulatory consistency of risk-weighted assets. We look forward to the work by the BCBS to improve comparability of regulatory capital ratios. We expect the BCBS to finalize its proposals on the remaining components agreed to in the Basel III framework – the internationally harmonized leverage ratio and the net stable funding ratio - in line with agreed timelines and procedures.

68. We welcome the FSB report on the progress made and next steps towards ending "too big to fail". We renew our commitment to make any necessary reforms to implement fully the FSB's Key Attributes of Effective Resolution Regimes for all parts of the financial sector that could cause systemic problems. We will undertake the necessary actions to remove obstacles to cross-border resolution. We reaffirm our commitment to ensure that supervisors have strong mandates, adequate resources and independence to act. We call on the FSB, in consultation with standard setting bodies, to assess and develop proposals by end-2014 on the adequacy of global systemically important financial institutions' loss absorbing capacity when they fail. We recognize that structural banking reforms can facilitate resolvability and call on the FSB, in collaboration with the IMF and the OECD, to assess cross-border consistencies and global financial stability implications, taking into account country-specific circumstances, and report to our next Summit.

69. We welcome the publication of the initial list of global systemically important insurers (G-SIIs), to which resolution planning and enhanced group-wide supervision will initially apply. We look forward to its annual update and to the finalization of a straightforward, group-wide capital requirement by the International Association of Insurance Supervisors by the next G20 Summit in 2014 that will serve as a foundation for higher loss absorbency requirements for G-SIIs. In addition, we look forward to its further work to develop a comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups, including a quantitative capital standard.

70. We ask the FSB, in consultation with the International Organization of Securities Commissions (IOSCO) and other standard setting bodies, to develop for public consultation methodologies for identifying global systemically important non-bank non-insurance financial institutions by end-2013. We call on the Committee on Payment and Settlement Systems and IOSCO to continue their work on systemically important market infrastructures.

Promoting transparent, continuously functioning financial markets

71. We welcome the FSB's report on progress in over-the-counter (OTC) derivatives reforms, including members' confirmed actions and committed timetables to put the agreed OTC derivatives reforms into practice. We also welcome the recent set of understandings by key regulators on cross-border issues related to OTC derivatives reforms, as a major constructive step forward for resolving remaining conflicts,

inconsistencies, gaps and duplicative requirements globally, and look forward to speedy implementation of these understandings once regimes are in force and available for assessment. We agree that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes. We call on regulators in cooperation with the FSB and the OTC Derivatives Regulators Group to report on their timeline to settle the remaining issues related to overlapping cross-border regulatory regimes, and regulatory arbitrage.

72. We note the outcomes of the G20 high-level seminar on benchmarks and credit rating agencies. We call on national authorities and standard setting bodies to accelerate progress in reducing reliance on credit rating agencies, in accordance with the FSB roadmap. We encourage further steps to enhance transparency and competition among credit rating agencies and look forward to IOSCO's review of its

Code of Conduct for credit rating agencies. We support the establishment of the FSB's Official Sector Steering Group to coordinate work on the necessary reforms of financial benchmarks. We endorse IOSCO's Principles for Financial Benchmarks and look forward to reform as necessary of the benchmarks used internationally in the banking industry and financial markets, consistent with the IOSCO Principles.

73. We welcome the FSB's progress report on the implementation of the principles and standards for sound compensation practices. We reaffirm our commitment to ensure that these principles and standards are implemented in a consistent manner and ask the FSB to continue its ongoing monitoring.

74. We underline the importance of continuing work on accounting standards convergence in order to enhance resilience of financial system. We urge the International Accounting Standards Board and the US Financial Accounting Standards Board to complete by the end of 2013 their work on key outstanding projects for achieving a single set of high-quality accounting standards. We encourage further efforts by the public and private sector to enhance financial institutions' disclosures of the risks they face, including the ongoing work of the Enhanced Disclosure Task Force.

75. We reiterate our call for further progress and encourage adherence to international cooperation and information exchange standards for financial supervision and regulation.

Addressing risks posed by the shadow banking

76. We welcome the progress achieved in developing policy recommendations for the oversight and regulation of the shadow banking system, as an important step in mitigating the potential systemic risks associated with this market while recognizing that nonbank financial intermediation can provide an alternative to banks in extending credit to support the economy. We will work towards timely implementation of the recommendations while taking into account country specific circumstances. We welcome the respective FSB reports and agreed on a straightforward roadmap (Annex) for work on relevant shadow banking entities and activities with clear deadlines and actions to progress rapidly towards strengthened and comprehensive oversight and regulation appropriate to the systemic risks posed.

Tackling money laundering and terrorism financing

77. We reiterate our commitment to FATF's work in fighting money laundering and terrorism financing and its key contribution into tackling other crimes such as tax crimes, corruption, terrorism, and drug trafficking. In particular, we support the identification and monitoring of high-risk jurisdictions with strategic anti-money laundering (AML)/countering the financing of terrorism (CFT) deficiencies while recognizing the countries' positive progress in fulfilling the FATF's standards. We encourage all countries to tackle the risks raised by opacity of legal persons and legal arrangements, and we commit to take measures to ensure that we meet the FATF standards regarding the identification of the beneficial owners of companies and other legal arrangements such as trusts that are also relevant for tax purposes We will ensure that this information is available in a timely fashion to law enforcement, tax collection agencies and other relevant authorities in accordance with the confidentiality legal requirements, for example through central registries or other appropriate mechanisms. We ask our Finance Ministers to update us by our next meeting on the steps taken to meet FATF standards regarding the beneficial ownership of companies and other legal arrangements such as trusts by G20 countries leading by example.

Financial Inclusion, Financial Education, Consumer Protection

78. We welcome the progress made by the Global Partnership for Financial Inclusion (GPFI) on advancing financial inclusion and integrating consumer empowerment and protection, particularly through the establishment of the GPFI subgroup focused on Financial Consumer Protection and Financial Literacy. We endorse the extension of the G20 Basic Set into a more holistic set of the G20 Financial Inclusion Indicators, thereby enabling more informed financial inclusion target setting and monitoring. We acknowledge the support from the implementing partners, including the Alliance for Financial Inclusion (AFI), Consultative Group to Assist the Poor (CGAP), IFC, OECD and the World Bank. We endorse the recommendations laid out in the GPFI's report, annexed to this Declaration, and commit to further pursue these efforts under the Australian Presidency. We welcome the discussions of the AFI members to establish the organization as an independent international institution.

79. Recognizing the key role of small- and medium-size enterprises (SMEs) for promoting growth, job creation and poverty reduction, we welcome the progress made at the country level to address the specific challenges in access to finance faced by SMEs through the implementation of the SME Finance Challenge and the SME finance Initiative as well as the support for peer learning through the SME Finance Compact in cooperation with the Working Group on SME Finance of the AFI. As the SME finance gap remains large worldwide, we call upon the IFI/DFIs to further improve financial market infrastructure and to support the development of innovative tools to address the SMEs finance challenges and constraints.

80. We welcome practical tools to measure financial literacy and evaluate financial education programs, developed by the OECD/International Network for Financial Education (INFE) and the World Bank Group, support their widespread use in countries along with instruments to measure youth financial literacy such as the Programme for International Student Assessment (PISA). We also look forward to the development of international core competencies frameworks for adults and youth on financial literacy by

the OECD/INFE by our next Summit. We welcome progress reports on barriers for women and youth in financial inclusion and education prepared by the OECD/INFE and the World Bank Group and endorse the OECD/INFE policy guidance on addressing women and girls' needs for financial education. We endorse the recommendations of the progress report on women and finance, including that the GPFI, the OECD and the World Bank Group conduct a stocktaking of promising and successful initiatives to enhance women's financial inclusion. We welcome the G20 Russia's Presidency and the OECD publication on national strategies for financial education and look forward to the development by the OECD/INFE of a Policy Handbook on the Implementation of National Strategies for Financial Education by our next Summit. We support the work done by the G20/OECD Task Force on Financial Consumer Protection on the first set of effective approaches to support the implementation of the G20 High-Level Principles on Financial Consumer Protection and look forward to their report on other principles in 2014. We take note of the formalization process of the FinCoNet and look forward to its conclusion.

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Promoting Development for All

81. Supporting strong, sustainable, inclusive and resilient growth and narrowing the development gap remain critical to our overall objective for jobs and growth. In this regard, we welcome the progress within the forum achieved this year, in particular on:

- Food Security: Support to the Secure Nutrition Knowledge Platform, exchange of best practices through the seminar on "Food Security through Social Safety Nets and Risk Management", and convening the second G20 Meeting of Agricultural Chief Scientists, along with its ongoing work to identify global research priorities and targets and support results-based agricultural research in 2014.

- Infrastructure: Completion of the Assessment of Project Preparation Facilities (PPFs) for Infrastructure in Africa; a toolkit on Urban Mass Transportation Infrastructure Projects in Medium and Large Cities by the World Bank and the ADB; and a public-private partnerships (PPP) sourcebook by the World Bank, IDB and ADB, and progress in implementing the recommendations of the High Level Panel on Infrastructure.

- Financial Inclusion: Enhanced coherence with the G20 finance track through the Global Partnership for Financial Inclusion (GPFI) to pursue efforts to strengthen financial inclusion including work to further reducing the global average cost of transferring remittances to 5% including through innovative result-based mechanisms, to enhance financial literacy and consumer protection for the poor and to foster access to finance for investment, for SMEs for growth, job creation and poverty reduction; and together with the IFC launching the Women Finance Hub.

- Human Resource Development: Launch of a global public-private knowledge sharing platform on skills for employment and the development of national actions plans on skills for employment in LICs and of a database on skills indicators.

- Inclusive Green Growth: Further development, dissemination and implementation of the non-prescriptive, voluntary toolkit of policy options for inclusive green growth in the context of sustainable development, including a workshop with developing countries, and initiation of the G20 Dialogue Platform on Inclusive Green Investments for sustainable development and poverty eradication.

- Domestic Resource Mobilization: Continued work on strengthening tax administrations in developing countries, particularly LIC's, through both bilateral and multilateral programs, such as the work of the OECD and G20 members on BEPS, automatic exchange of information, the Global Forum on Transparency and Exchange of Information for Tax Purposes and "Tax Inspectors without Borders" and the expansion of the work of the World Bank Group and the IMF to support developing countries' ability to raise domestic resources.

82. We acknowledge that food security and nutrition will remain a top priority in our agenda. We recognize the importance of boosting agricultural productivity, investment and trade to strengthen the global food system to promote economic growth and job creation. We encourage all ongoing efforts in the agricultural sector to further reduce hunger, under-nutrition and malnutrition, through increased coordination in the G20 to promote the identification and implementation of effective actions in support of production and productivity growth as well as enhancement of food security and nutrition for vulnerable population through, among others, nutrition sensitive policies and comprehensive social protection systems, with particular emphasis on low income countries. We support discussions in the WTO to respond to legitimate food security concerns, without distorting trade, including those related to carefully targeted policies to protect vulnerable populations. We recognize that the agricultural market situation needs closer attention and that the Agricultural Market Information System (AMIS) is generating better transparency and still needs more efforts to be fully implemented. We reaffirm our determination to implement all previous G20 commitments and existing initiatives including that stated in the Action Plan on Food Price Volatility and Agriculture which the G20 endorsed in 2011.

83. We welcome the Saint Petersburg Accountability Report on G20 Development Commitments, which sets out the progress achieved since we adopted the 2010 Seoul Multi-Year Action Plan on Development (MYAP) (Annex). This report demonstrates that many of our development commitments have now been implemented and identifies lessons learned and it highlights the successes achieved. The Accountability Report underlines the importance of continued monitoring and identifies areas where we must continue to work and opportunities to strengthen and streamline the G20 development agenda.

84. In this spirit, we endorse the Saint Petersburg Development Outlook, which states our core priorities, new initiatives and ongoing commitments (Annex). Building on the foundation of the 2010 Seoul Development Consensus for Shared Growth, the Outlook frames the approach to our future work. We ask the Development Working Group to focus on concrete actions under the core priorities of food security, financial inclusion and remittances, infrastructure, human resource development and domestic resource mobilization, and to deliver specific outcomes at the Brisbane summit. We commit to improve working practices for more effective outcomes by:

- concentrating on fewer key areas where action and reform remain most critical to ensure inclusive and sustainable growth in developing countries;

- enhancing policy coordination across different G20 work streams in order to ensure greater impact on developing countries;

- implementing a forward accountability process to improve monitoring and coordination, and ensure greater transparency of our work;

- continuing to expand engagement and partnerships with stakeholders, including non-G20 countries (especially LICs), international organizations, the private sector and civil society;

- ensuring flexible approaches to respond to new priorities and circumstances.

85. We welcome the substantial progress towards achieving the Millennium Development Goals (MDGs) since 2000 and the success in galvanizing global action to reach specific targets globally, as well as in individual countries, particularly in eradicating extreme poverty and promoting development. However, the prospects for achieving all of the MDGs differ sharply across and within countries and regions. We remain committed to accelerating progress towards achieving the MDGs, particularly through the implementation of our development agenda and our focus on promoting strong, sustainable, inclusive and resilient growth.

86. We support the ongoing efforts in the UN for the elaboration of the post-2015 development agenda. We commit to participate actively in this process and engage in the discussion on the direction of the new framework and its key principles and ideas and effectively contribute to the timely conclusion of the process. The final outcome will be determined through an intergovernmental process in which we will all participate, but much preparatory work is still underway. We welcome the contribution of the report prepared by the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda, which sets out some illustrative goals We also welcome the ongoing work of the UN General Assembly Open Working Group on Sustainable Development Goals and Intergovernmental Committee of Experts on Sustainable Development Financing. We stress the crucial importance of collective action, including international development cooperation, based on the principles outlined in the Millennium Declaration, the 2012 Rio+20 outcome document “The Future We Want”, the Istanbul Declaration and Programme of Action of the Fourth UN Conference on Least Developed Countries and the outcomes of other relevant UN Conferences and Summits in the economic, social and environmental fields.

87. We call for an agreement on an integrated post-2015 development agenda with concise, implementable and measurable goals taking into account different national realities and levels of development and respecting national policies and priorities, focused both on the eradication of extreme poverty, promoting development and on balancing the environmental, economic and social dimensions of sustainable development. We commit to ensure that G20 activities beyond 2015 are coherent with the new development framework.

88. To improve rapid and effective responses to the outbreak of new diseases that threaten human life and disrupt economic activity, we call on countries to strengthen compliance with the World Health Organization’s International Health Regulations.

89. We acknowledge the progress already made by G20 members on duty-free and quota-free (DFQF) market access for the LDCs products.

Sustainable Energy Policy and Resilience of Global Commodity Markets

90. Access to energy is a key factor to achieve better quality of life and to improve global economic performance. Access to reliable and affordable energy is particularly critical to the development agenda, poverty eradication and social inclusion. Transparent, well-functioning, reliable energy markets and sufficient investment are needed to boost economic growth, job creation and sustainable development.

91. To promote market transparency and efficiency, we commit to strengthen Joint Organizations Data Initiative (JODI) - Oil by ensuring greater visibility, more complete and comprehensive data, enhanced access and improved availability, and by maintaining support for capacity building. We look forward to the launch of JODI-Gas at earliest date possible. We note the second report prepared by the International Energy Agency (IEA), the International Energy Forum (IEF) and the Organization of the Petroleum Exporting Countries (OPEC) in May 2013 on practical steps to increase transparency in international gas and coal markets. We ask the IEF to come back with a report on progress in these areas before the next G20 Ministers of Finance and Central Bank Governors meeting in October.

92. We welcome the Report on energy-related issues including on G20 work to facilitate better functioning of physical and financial commodity markets. We welcome Finance ministers' commitment to take actions on PRAs as set out in their Communique of July 20, 2013 with a view to improve their functioning through transparency and regulation as appropriate, and would welcome a further update in 2014. We also call on Finance ministers to monitor on a regular basis the proper implementation of IOSCO's principles for the regulation and supervision on commodity derivatives markets and encourage broader publishing and unrestricted access to aggregated open interest data.

93. We welcome efforts aimed at promoting sustainable development, energy efficiency, inclusive green growth and clean energy technologies and energy security for the long term prosperity and well being of current and future generations in our countries. We will continue in cooperation with international organisations sharing national experiences and case studies regarding sustainable development, clean energy, and energy efficiency as well as development, deployment and broader application of related technologies and will take forward work, on a voluntary basis, on corresponding policy options and technologies. We take note of the new World Bank report 'Toward a Sustainable Energy Future for All', which aims to promote access to reliable and affordable energy in developing countries and recognise the importance of the sustainable and responsible production and use of modern bioenergy and the role played by the Global Bioenergy Partnership (GBEP) in this regard.

94. We reaffirm our commitment to rationalise and phase out inefficient fossil fuel subsidies that encourage wasteful consumption over the medium term while being conscious of necessity to provide targeted support for the poorest. We welcome the efforts underway in some G20 countries as described in the country progress reports. We welcome the development of a methodology for a voluntary peer review process and the initiation of country-owned peer reviews and we encourage broad voluntary participation in reviews as a valuable means of enhanced transparency and accountability. We ask Finance Ministers to report back by the next Summit on

outcomes from the first rounds of voluntary peer reviews. Recognising the importance of providing those in need with essential energy services, we ask Finance Ministers to consider, in conjunction with the relevant international institutions, policy options for designing transitional policies including strengthening social safety nets to ensure access for the most vulnerable.

95. Sizable investment, including from private sources, will be needed in the G20 and other economies in energy infrastructure in the years ahead to support global growth and development. It is our common interest to assess existing obstacles and identify opportunities to facilitate more investment into more smart and low-carbon energy infrastructure, particularly in clean and sustainable electricity infrastructure where feasible. In this regard we encourage a closer engagement of private sector and multilateral development banks with the G20 Energy Sustainability Working Group (ESWG) and call for a dialogue to be launched on its basis in 2014 that will bring interested public sector, market players and international organizations together to discuss the factors hindering energy investment, including in clean and energy efficient technologies and to scope possible measures needed to promote sustainable, affordable, efficient and secure energy supply.

96. Regulation among other policy levers can play an important role in creating a proper context for investment. Noting that regulatory roles differ from country to country and that regulation remains a country-led process, but in some cases is shared within regional integration space, we welcome the dialogue between interested G20 national power sector regulators supported by regulatory associations and international organisations, and take note of the statement they have provided on sound regulation and promoting investment in energy infrastructure agreed at the G20 Outreach Energy Regulators Round Table in Kazan. In the context of our efforts to promote investment in energy infrastructure, notably in clean, affordable and sustainable energy, and in order to engage all interested parties, we encourage interested regulators to continue their dialogue and ask the ESWG to take note of this dialogue.

97. Many countries are trying to improve their energy mix and use, such as by promoting renewable and/or nuclear energy. Nuclear power is a low-carbon option, but it is capital intensive and comes with responsibilities for nuclear safety, security and safeguards/nonproliferation. G20 countries, whether nascent or established nuclear power producers should strive for the highest possible level of nuclear safety, to foster robust nuclear safety and nuclear security cultures and, as called for in the International Atomic Energy Agency (IAEA) Action Plan on Nuclear Safety, we encourage multilateral cooperation towards achieving a global nuclear liability regime.

98. We appreciate the progress achieved since the establishment of the G20 Global Marine Environment Protection (GMEP) Initiative and welcome the launch of the GMEP Initiative website as a key element of the GMEP Mechanism for the voluntary exchange of national best practices to protect the marine environment, in particular to prevent accidents related to offshore oil and gas exploration and development, as well as marine transportation, and to deal with their consequences. We encourage participants to make full use of the website and share relevant information under the auspices of the G20 in cooperation with relevant international organizations in accordance with the GMEP mandates.

99. We recognize the value of multilateral cooperation and coordination in advancing the global energy security agenda through resilient energy markets and welcome the

IEA's current efforts to deepen its engagement with non-members and will monitor progress in this regard.

Pursuing the Fight against Climate Change

100. Climate change will continue to have a significant impact on the world economy, and cost will be higher to the extent we delay additional actions. We reiterate our commitment to fight climate change and welcome the outcome of the 18th conference of the Parties to the UN climate change conferences. We are committed to a full implementation of the outcomes of Cancun, Durban and Doha and will work with Poland as the incoming presidency towards achieving a successful outcome at COP 19.

101. We are committed to support the full implementation of the agreed outcomes under the United Nations Framework Convention on Climate Change (UNFCCC) and its ongoing negotiations. We strongly welcome the efforts of the Secretary-General of the United Nations to mobilize political will through 2014 towards the successful adoption of a protocol, another legal instrument, or an agreed outcome with legal force under the convention applicable to all Parties by 2015, during COP-21 that France stands ready to host. We also support complementary initiatives, through multilateral approaches that include using the expertise and the institutions of the Montreal Protocol to phase down the production and consumption of hydrofluorocarbons (HFCs), based on the examination of economically viable and technically feasible alternatives. We will continue to include HFCs within the scope of UNFCCC and its Kyoto Protocol for accounting and reporting of emissions.

102. Taking note of the developments over the past year, we support the operationalization of the Green Climate Fund (GCF). We welcome the report of the G20 Climate Finance Study Group on G20 countries' experiences on ways to effectively mobilize climate finance taking into account the objectives, provisions, and principles of the UNFCCC. For the purpose of elaborating on the issues and identifying approaches to climate finance, we ask our Finance Ministers to continue the work building on the working group report and report back to us in one year.

Intensifying Fight Against Corruption

103. Corruption is a severe impediment to sustainable economic growth and poverty reduction and can threaten financial stability and the economy as a whole. Corruption is corrosive, destroying public trust, distorting the allocation of resources and undermining the rule of law. To provide a better understanding of the factors constraining the economic potential of countries affected by corruption, we make available the Issues Paper on Anti-Corruption and Economic Growth and encourage the OECD, in collaboration with the World Bank to continue work in this area.

104. As a group of the world's largest economies, the G20 has the potential to create unstoppable momentum towards a global culture of intolerance towards corruption. We will redouble our efforts to achieve this goal, in particular by enhancing transparency and closing implementation and enforcement gaps.

In this regard:

105. We warmly welcome the ratification by Saudi Arabia of the United Nations Convention against Corruption (UNCAC). We will continue to encourage all G20 member-countries to ratify and implement the UNCAC, and encourage engagement with the OECD Working Group on Bribery with a view to explore possible adherence to the OECD Anti-bribery Convention as appropriate. We commit to lead by example by enhancing the transparency and inclusivity of our UNCAC reviews by making use on a voluntary basis of the options in the Terms of Reference to the UNCAC Review Mechanism.

106. We reiterate our determination to combat domestic and foreign bribery, as well as solicitation, and endorse the non-binding Guiding Principles on Enforcement of the Foreign Bribery Offence and the Guiding Principles to Combat Solicitation.

107. We will continue to develop and strengthen frameworks to facilitate cooperation among G20 member-countries in the fight against corruption. We have established a G20 network to share information and cooperate in order to deny entry to our countries by corrupt officials and those who corrupt them, in accordance with national laws and regulations. To enhance international collaboration in the investigation and prosecution of corruption offences, as well as in the recovery of proceeds of corruption, we endorse the High-Level Principles on Mutual Legal Assistance.

108. We renew our commitment to ensure the independence of the judiciary, as well as to share best practices and enforce legislation to protect whistleblowers, ensure the effectiveness of anti-corruption authorities free from any undue influence, and promote the integrity of public officials.

109. We also place a high value on implementing and raising awareness regarding effective anti-corruption education programs to build and reinforce a culture of intolerance towards corruption.

110. We express support for the FATF's ongoing work in the anti-corruption field. Leveraging anti-money laundering (AML)/countering the financing of terrorism (CFT) measures to fight corruption will remain a significant area of growing cooperation between anti-corruption experts of the G20 and FATF as well as increasing cooperation against tax crimes, addressing the risks posed by tax havens.

111. We will pay special attention to combating corruption in high-risk sectors. We commend the efforts to fight corruption in organization of sporting, cultural and other major international events and welcome the initiative to develop a Global Alliance for Integrity in Sports. We also commit to promote integrity in buy-and-sell relations between the public and private sectors, including public procurement and privatization of state-owned property. We welcome initiatives aimed at increasing extractive transparency, including voluntary participation in the Extractives Industries Transparency Initiative (EITI) and take note of the progress. We ask the G20 Anti-Corruption Working Group to further follow this issue.

112. We recognize that a culture of intolerance towards corruption will only be achieved if we work in partnership with business and civil society. We commit to maintain and build on the enhanced dialogue between the G20 Anti-Corruption Working Group and the B20 and C20, and have taken note of the recommendations of these two groups. In particular, we welcome the business community's initiatives to enhance anti-

corruption collective actions and to develop institutional arrangements to promote anti-corruption compliance in the private sector.

113. We welcome the progress which the G20 Anti-Corruption Working Group is making to implement its 2013-14 Action Plan and commend its Progress Report which is annexed to this statement. Recognizing that the fight against corruption will require sustained, concerted effort, we endorse the St. Petersburg Strategic Framework to guide the work of the ACWG and provide a foundation for the Action Plans. In 2014, we will advance our existing commitments and consider further G20 actions on the global fight against corruption.

Conclusion

114. We thank Russia for its G20 Presidency and for hosting the successful Saint Petersburg Summit, and we look forward to our next meeting in Brisbane in November 2014 under the Australian Presidency.

Economic & Social Affairs

Committee for Development Policy

Global Governance and Global Rules for Development in the Post-2015 Era

United Nations

Committee for Development Policy

Policy Note

Global governance and global rules for development in the post-2015 era

United Nations
June 2014

DESA

The Department of Economic and Social Affairs of the United Nations Secretariat is a vital interface between global policies in the economic, social and environmental spheres and national action. The Department works in three main interlinked areas: (i) it compiles, generates and analyses a wide range of economic, social and environmental data and information on which States Members of the United Nations draw to review common problems and to take stock of policy options; (ii) it facilitates the negotiations of Member States in many intergovernmental bodies on joint courses of action to address ongoing or emerging global challenges; and (iii) it advises interested Governments on the ways and means of translating policy frameworks developed in United Nations conferences and summits into programmes at the country level and, through technical assistance, helps build national capacities.

Note

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

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The designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgment about the stage of development reached by a particular country or area in the development process.

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Foreword

As we quickly approach the target year for achieving the Millennium Development Goals (MDGs), Member States of the United Nations have initiated a process to identify approaches to development strategies and goals for the post-2015 era. Guided by the principles identified in the outcome document of the 2012 United Nations Conference on Sustainable Development (Rio+20), progress has been made in the intergovernmental deliberations on defining a set of sustainable development goals and on developing a financing strategy for sustainable development.

At the same time, the members of the Committee for Development Policy (CDP)—an expert body of the Economic and Social Council composed of 24 members serving in their personal capacity—have been providing intellectual leadership on the possible contours of the United Nations development agenda for the post-2015 era. Previous work of the Committee focused on the delineation of the national strategies necessary for achieving the internationally agreed development goals. At its plenary meeting in 2014, the Committee shifted its attention to the international dimensions of the development agenda. In particular, it considered how global governance and global rules could be strengthened to make them more conducive to development in the post-2015 era. For the CDP, MDG 8 on the global partnership for development—addresses global governance in an incomplete way. In the Committee's opinion, intergovernmental cooperation is at the centre of the global partnership for development, and its role in the achievement of global development goals goes beyond the resources and technical assistance it can provide. Intergovernmental cooperation is also required when global policy decisions are taken and when global rules and norms are set, especially by multinational institutions that are in need of reform. The Committee argues that strengthening global governance and global rules is necessary in order to manage the increasing interdependence among countries more efficiently, to reduce existing inequalities, and to guarantee the necessary policy space for countries to pursue their own priorities within the limits given by interdependence.

Existing proposals to reform the current global partnership are not truly comprehensive. The present Policy Note provides important input towards filling this gap. An expanded version of the 2014 report of the

Committee for Development Policy to the Economic and Social Council, the Note elaborates the arguments presented in that report and includes additional detailed information and analysis. It provides practical policy recommendations on the way forward and on strengthening the role of the United Nations in achieving sustainable development worldwide. I am confident that Member States, development practitioners and the international community at large will consider the findings contained in this Note an insightful contribution to their discussions on how to promote a sustainable world free of poverty and a life of dignity for all.

Wu Hongbo
Under-Secretary-General for Economic and Social Affairs
United Nations
May 2014

Summary

Intergovernmental cooperation is at the centre of the global partnership for development. It has a vital role to play in the achievement of global development goals, in terms not only of the resources and technical assistance it can provide, but also in the areas of policy decision-making and norm-setting. Global governance encompasses the totality of institutions, policies, norms, procedures and initiatives through which States and their citizens try to bring more predictability, stability and order to their responses to transnational challenges. Effective global governance can only be achieved with effective international cooperation. Neither the existing proposals to strengthen global governance nor the global rules to support development are fully satisfactory; they have also not received sufficient attention by the intergovernmental processes addressing the development agenda for the post-2015 era. This Note presents comprehensive yet practical recommendations on how international cooperation, through its various institutions, arrangements and rules, could be reformed and strengthened to achieve and sustain development gains beyond post-2015.

It argues that international cooperation and the resulting governance mechanisms are not working well. First, the current global governance system is not properly equipped to manage the growing economic integration and interdependence among countries, both of which are compounded by the current globalization process. Globalization tends to accentuate interdependencies among countries. Second, global governance structures and rules are characterized by severe asymmetries in terms of access, scope and outcomes. While developing countries must abide by and/or shoulder the effects of global governance rules and regulations, they have limited influence in shaping them. Meanwhile, the unbalanced nature of globalization implies that important areas of common interest are currently not covered, or sparsely covered, by global governance mechanisms, while other areas are considered to be overdetermined or overregulated by a myriad of arrangements with different rules and provisions, causing fragmentation, increased costs and reduced effectiveness. These deficiencies have contributed to the generation of asymmetric outcomes among countries and have had important implications for inequality at the national level as well. Finally, current approaches to global governance and global rules have led to a greater shrinking of policy space for national Governments, par-

ticularly in the developing countries, than necessary for the efficient management of interdependence; this also impedes the reduction of inequalities within countries.

Five principles are critical to guiding the reforms of global governance and global rules:

(i) *Common but differentiated responsibilities and respective capacities*: This principle calls for recognizing differences among countries in terms of their contribution and historical responsibilities in generating common problems, as well as divergences in financial and technical capacities, in order to address shared challenges. This principle also acknowledges the diversity of national circumstances and policy approaches—a diversity which should be embedded in the architecture of global governance as an intrinsic feature of the global community, not as an exception to general rules.

(ii) *Subsidiarity*: Issues ought to be addressed at the lowest level capable of addressing them. This principle implies that some problems can be handled well and efficiently at the local, national, subregional and regional levels reducing the number of issues that need to be tackled at the international and supranational level. Subsidiarity suggests an important role for regional cooperation in addressing issues of mutual concern.

(iii) *Inclusiveness, transparency, accountability*: Global governance institutions need to be representative of, and accountable to, the entire global community, while decision-making procedures need to be democratic, inclusive and transparent. Robust governance implies mutual accountability, verified by transparent and credible mechanisms and processes to ensure that agreed commitments and duties are fulfilled.

(iv) *Coherence*: Definitions of global rules and processes need to rest on comprehensive approaches, including the assessment of possible trade-offs, so that actions in different areas will not undermine or disrupt one another, but instead be mutually reinforcing. Enhanced coherence is also needed between the international and national spheres of policymaking. This also requires improved coordination among various stakeholders and enhanced information sharing.

(v) *Responsible sovereignty*: This principle recognizes that policy cooperation is the best way to achieve national interests in the global public domain. It also requires Governments and States to be fully respectful of the sovereignty of other nations so as to fulfil agreed policy outcomes.

After laying out these core principles, this Note then examines how the principles could be applied to strengthen key areas of international cooperation that are in need of reform. It identifies deficiencies in their respective governance structures and makes recommendations on how to address the shortcomings based on the five principles introduced above.

In the final section, the Note considers the role of the United Nations in the global governance architecture. It argues that the General Assembly, with its universal membership and democratic decision-making process, should function as the main political forum for managing global challenges, in close interaction with the Economic and Social Council and its subsidiary bodies on economic, social and environmental issues. For the Organization to utilize its distinct advantages, however, Member States need to strengthen its position in global governance. In particular, the Note suggests that the Economic and Social Council take on greater responsibility for advancing the global governance reform agenda, and that it provide guidance to the United Nations system in addressing current governance deficiencies in areas requiring improved international cooperation. These areas include the environment, international monetary and financial architecture, capital and labour flows, trade rules and inequality. Moreover, the Council's ability to coordinate and guide should be supported by appropriate follow-up and monitoring mechanisms for bridging the gap between commitments made and their implementation. The layout of such a system will require special attention in relation to the quantification of targets, data collection, and definitions and indicators measuring representativeness, inclusiveness, transparency and coherence of global governance.

The implementation of the post-2015 development agenda ultimately depends on the political will of Member States. Success will depend on whether all countries contribute to the reform of global governance and use their policy space to implement policies for achieving common goals. The probability of failing will remain high if global challenges continue to be approached from the narrow national perspective. It is therefore urgent that States cooperate in creating the conditions that will facilitate implementation of the current and future United Nations development agenda.

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Abbreviations

The following abbreviations have been used:

AEITs	automatic exchanges of information on taxation
ASEAN	Association of Southeast Asian Nations
BIT	bilateral investment agreement
CDP	Committee for Development Policy
CFC	chlorofluorocarbon
DSM	dispute settlement mechanism
ECOSOC	United Nations Economic and Social Council
EU	European Union
FCL	Flexible Credit Line
FDI	foreign direct investment
FSB	Financial Stability Board
G8	Group of Eight
G20	Group of Twenty
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GHG	greenhouse gas
GPGs	global public goods
GVCs	global value chains
IEG	international environmental governance
ILO	International Labour Organization
IMF	International Monetary Fund
IOM	International Organization for Migration
LDCs	least developed countries
MDB	multilateral development bank
MDGs	Millennium Development Goals
MFN	most favoured nation
MP	Montreal Protocol
NGOs	non-governmental organizations
ODA	official development assistance
ODS	ozone depleting substances
OECD	Organization for Economic Cooperation and Development
OWG	Open Working Group
RCPs	regional consultative processes
RTA	regional and bilateral preferential trade agreements
SDGs	Sustainable Development Goals
SDRs	special drawing rights
SDTs	special and differential treatment measures
TIEAs	tax information exchange agreements
TNC	transnational corporation
TRIPs	Agreement on Trade Related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

Global governance and global rules for development in the post-2015 era

I. Introduction

The Millennium Development Goals (MDGs) are an expression of the broader United Nations development agenda agreed to at several United Nations conferences and summits convened over many decades (United Nations, 2007). These goals, as well as the broader United Nations development agenda, underscore a global consensus, a shared vision of inclusive development, based on the three pillars of sustainable development: economic, social and environmental. They have also been instrumental in drawing attention to development as a global priority and have become reference points for development policy debates and practices worldwide. Yet, the MDGs address issues of global governance in an incomplete and limited way. Goal 8, the global partnership for development, is often recognized as the least satisfactory of the MDGs. In fact, the Committee for Development Policy (CDP) had already noted that the "MDG narrative… leaves out much of the important economic policy agenda of developing countries in international negotiations. Issues of asymmetric power and lack of voice in international rules related to trade, investments and finance as well as policy space and control over national economic policies are barely reflected in the MDGs. While they do include a specific goal on the building of a global partnership for development (Goal 8), its wording is weak and lacks quantitative targets in several aspects" (United Nations, 2012a, p.13).

Intergovernmental cooperation is at the centre of the global partnership for development and has a vital role to play in the achievement of global development goals, not only in terms of the resources and technical assistance it can provide, but also in policy decision-making and norm-setting. Existing proposals to strengthen global governance and global rules to support development do not seem to be truly comprehensive and have not received sufficient attention by the international community in discussions on the development agenda for the post-2015 era.

The “institutional view”, as embodied by various reports of the United Nations System Task Team and the Secretary-General, seems to reduce the tasks of the global partnership for development to goal setting, monitoring and the provision of means of implementation (with participation from several actors in addition to Governments), without, however, considering the adequacy of the rules and institutions that shape the environment where economies operate.

Deliberations at the General Assembly Open Working Group (OWG) on Sustainable Development Goals (SDGs) include consideration of the issue of governance, but its discussions are focused on rule of law, largely applicable to national contexts (particularly “failed” States) and in post-conflict situations. When transposed to the global level, the concept seems to apply to means of implementation, accountability and monitoring, with few isolated suggestions on the areas of technology transfer, trade and official development assistance (ODA).

Lastly, the High-level Panel of Eminent Persons on the Post-2015 Development Agenda seems to reduce the global partnership to a collection of multi-stakeholder partnerships contributing to the implementation of each specific goal.

All these conceptions are incomplete at best, and reflect the insufficient attention that current discussions on the post-2015 agenda have given to global governance. The present report aims to help fill this gap. It will look more specifically at how international cooperation, through its various institutions, arrangements and rules, could be reformed and strengthened for achieving and sustaining development gains in the post-2015 era.

The remainder of the report is organized as follows: Section II identifies the shortcomings and areas that need further strengthening in the current system of global governance. It also puts forward the necessary principles that should guide the reform process. Section III looks more closely at selected areas of global governance. On the basis of the guiding principles identified in the previous section, Section III also indicates the direction that reforms should take. Section IV examines the role of the United Nations in global governance. It recognizes key important features of the Organization in terms of its universality, inclusiveness and transparency. It stresses that the achievement of sustainable development worldwide requires a stronger and more effective United Nations at the centre of global governance, as opposed to a loosely defined, uncoordinated multi-stakeholder approach.

II. Global governance and global rules: why do they need reform?

Scholars have used the term “governance” to denote the regulation of interdependent relations in the absence of overarching political authority, such as in the international system. It encompasses the institutions, policies, norms, procedures and initiatives through which states and their citizens try to bring more predictability, stability, and order to their responses to transnational challenges. While the importance of global governance has been acknowledged, we are witnessing the increasing need to manage global problems more effectively in the face of increased interdependence.

Effective global governance cannot be achieved without effective international cooperation. Besides being a manifestation of international solidarity, international cooperation is a means to promote common interests and shared values and to reduce the vulnerabilities generated by increased interdependence. It is also a legal obligation. Already in 1945, Member States of the United Nations recognized the centrality of “international cooperation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights and for fundamental freedoms for all without distinction as to race, sex, language, or religion” (United Nations , 1945, Article III). With the adoption of the Universal Declaration of Human Rights in 1948, and the subsequent international treatises that put the Declaration into effect, there is legal obligation for States to facilitate the realization of human rights by all individuals through international cooperation. While the fulfillment of human rights is the primary responsibility of individual States, there is also an international obligation for States to remove those obstacles that are beyond the reach of individual nation states and that impede the creation of the conditions and social arrangements necessary for the fulfillment of human rights (Fukuda-Parr, 2006). Meanwhile, the Declaration on the Right to Development (United Nations, General Assembly, 1986) explicitly calls on States to act collectively, as well as individually, to create an enabling environment for development, particularly by removing obstacles and creating opportunities (Ibid., Preamble, articles 1, 2, 4, and 7).

International cooperation and the resulting governance mechanisms are not working adequately or effectively. Responses to common challenges have been mostly taken at the national level, with global responses being insufficient, incomplete or simply non-existent. Moreover, there has been growing tension between decision-making processes at the national and global level as local challenges “have become an integral part of global stakes” (Severino and Roy, 2009, p. 9). Domestic policies can have significant (positive and negative) spillover effects on global well-being, depending on the weight of a given economy and the pattern of its integration into the global economy. Thus, a main question is how to reform the institutions responsible for global governance. In this regard, three main issues emerge: (i) the current global governance system is not properly equipped to manage the growing integration and interdependence among countries; (ii) the current system is characterized by marked asymmetries in terms of access, processes and outcomes; and, (iii) global rules have led to a shrinking of the policy space of national Governments, particularly of developing countries, in ways that impede the reduction of inequalities within countries and is well beyond what is necessary for an efficient management of interdependence.

Interdependence and global public goods

The current globalization process tends to accentuate interdependencies among countries, widening the scope of global public goods (GPGs). Public goods and services are characterized by their non-rival consumption—peace and security, for example—and whose consumption is non-excludable. In other words, once they are supplied, public goods, such as early warning systems, benefit everyone. Typically, social or collective net benefits accruing from the provision of public goods are larger than private or individual benefits, leading to an undersupply of these goods by the market. GPGs are public goods that generate benefits (or costs) with global reach or of a transnational nature (i.e., regional and subregional). Accordingly, GPGs require collective action among countries, coordinated by Governments, to be delivered in sufficient quantities and in an efficient manner (Kaul, Grunberg and Stern, eds., 1999; World Bank, 2008). A strong relationship exists between GPGs and development agendas: failures in one domain can produce setbacks in the other (United Nations, Committee for Development Policy, 2013).

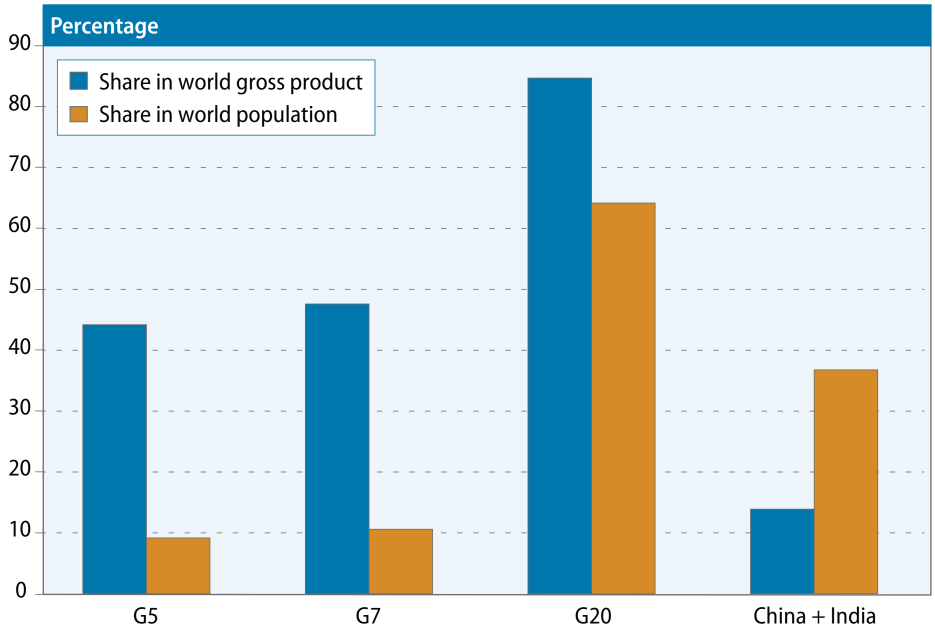
Currently, GPGs are insufficiently supplied, creating negative consequences for all. Meanwhile, the supply of global public “bads” (emission of greenhouse gases, tax havens, biodiversity losses, human trafficking, etc.), resulting from a lack of or ineffective collective action, is not adequately constrained or properly regulated. Some areas of common interest, such as commodity markets and migration, are sparsely or not at all covered by global governance mechanisms. Others are overdetermined or overregulated by a myriad of arrangements with different rules and provisions, causing fragmentation, increased costs and reduced efficiency. International trade is a case in point with the mushrooming of bilateral and regional free trade agreements that have differing rules of origin and standards requirements.

Globalization and its asymmetries

Global governance structures and rules are characterized by severe asymmetries. There are marked *asymmetries of access* to the various decision-making processes, with developing countries having to abide by and/or shoulder the effects of rules and regulations over which they have limited influence. While resolutions by the United Nations General Assembly reflect the rule of one country, one vote, they do not create binding obligations. Representation of developing countries' shares in International Monetary Fund (IMF) quotas does not reflect their shares in the world economy today, and the moderately ambitious 2010 reform has not yet been implemented. In any case, decisions on global monetary cooperation seemed to have bypassed the IMF and taken place in the "G sphere"— the 1985 Plaza Accord, the 1987 Louvre Accord and, more recently, the Group of Seven, for example. The creation of the Group of Twenty (G20) in the aftermath of the 2008 crisis includes some major developing countries and, in principle, may be a better reflection of power distribution in the world; these countries account for about 85 per cent of global gross domestic product (GDP) and about 65 per cent of the world's population (figure 1). However, the vast majority of developing countries are excluded. In reality, the G20 represents a continuation of a pattern that could be called "elite multilateralism" (Ocampo, 2011), a framework that raises serious concerns about representativeness, inclusiveness and accountability.

An important force shaping governance at national and international levels is big corporations, which lobby for laws and policies that serve their interests. For example, in the preparation of the Transatlantic Trade and Investment Partnership, the Commission of the European Union has held at least 119 closed-door meetings with large corporations and their

Figure 1
Share in world gross product and world population, selected country groupings, 2012



Source: World Bank, World Development Indicators online database.
Note: World gross product calculated on the basis of current United States dollar market exchange rates.

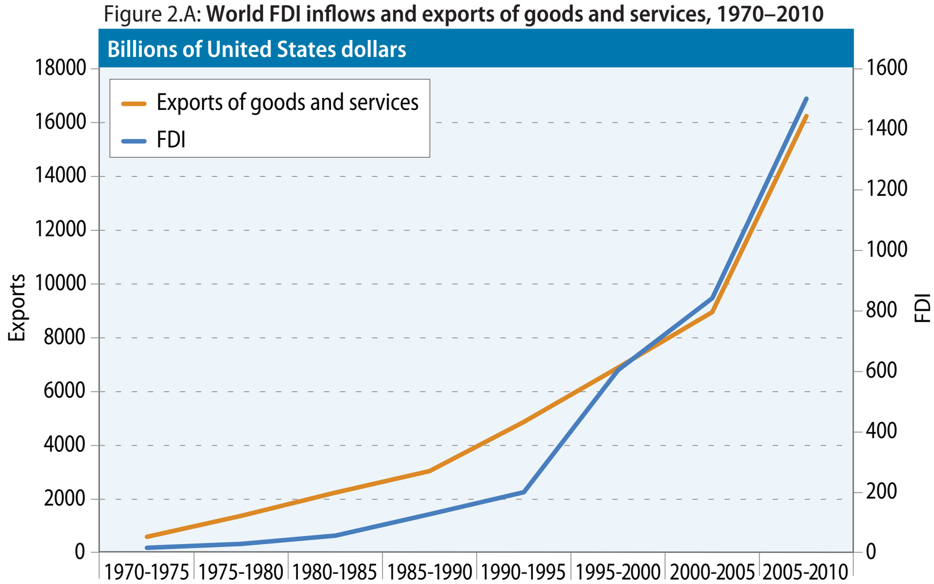
lobbying groups, but has only held a handful of meetings with trade unions and consumer groups (Transnational Institute, 2014). Some counterweight to corporate power is provided by public interest non-governmental organizations (NGOs). While today some NGOs have very significant influence, resources at their disposal are relatively small when compared to those of large corporations.

The current global governance structure also reflects the asymmetric character or the *unbalanced nature of globalization*. There have been important processes that facilitate the mobility of capital and of goods and services; other processes have restricted access to knowledge and innovation. There are only timid attempts to facilitate skilled-labour mobility and severe restrictions on the migration of unskilled labour. In fact, the average annual world inflows of foreign direct investment (FDI) jumped from US$ 200 billion in 1990-1995 to US$ 1500 billion in 2005-2010, a seven-fold increase. The corresponding figures for world exports of goods and services recorded a four-fold increase, from US$ 4.8 trillion to US$ 16.2 trillion. Meanwhile, the annual average net migratory outflows from developing countries are estimated to have increased from 12 million people in 1990-1995 to 17 million in 2005-2010 (figures 2.A and 2.B). The increasing mobility of capital has been associated with declining taxation on capital and corporations both in developed and emerging countries (Devereux, Lockwood and Redoano, 2008), while labour, the fixed factor of production, and consumers (most of whom are also workers) shoulder most of the tax burden. This is very costly, as tax revenues are the main source of revenue mobilization for financing delivery of public services and social protection.

Asymmetries in both decision-making and various processes related to global governance have important implications for *asymmetries of outcomes*. Within-country inequalities are primarily the responsibility of national Governments and national societies. Yet, global rules and cooperation, or the lack thereof, may facilitate or constrain government action at the national level. Thus, initiatives to promote internationally agreed minimum social standards in developing countries generate a positive effect, to the extent that they are supported by financial and technical resources provided through international cooperation. For example, international research institutions, supported by public funds, were active in agricultural innovation in developing countries in the past, leading to the Green Revolution of the 1960s and 1970s, which saved millions of people from starvation. More recently, the development of vaccines and improved medical treatments for tropical diseases as well as for global pandemics such as HIV/AIDS (United Nations, Committee for Development Policy, 2013) has greatly assisted countries in improving health conditions at the national level. At the same time, stringent patent protection increases the cost of essential medicines in developing countries, making it more difficult for them to improve the health of their populations, particularly the poor. Lack of international tax cooperation facilitates tax avoidance by transnational corporations (TNCs) and rich individuals and reduces the pool of resources available for Governments to implement poverty reduction and redistributive policies. In general, the forces pushing towards rising inequality have prevailed in recent decades, as reflected in the falling share of wage income and the rising share of capital income in most economies (figure 3), among other developments. Inequalities do not self-correct; instead, they perpetuate and reproduce over generations, cumulating and combining to recreate systematic disadvantages for particular groups and individuals.

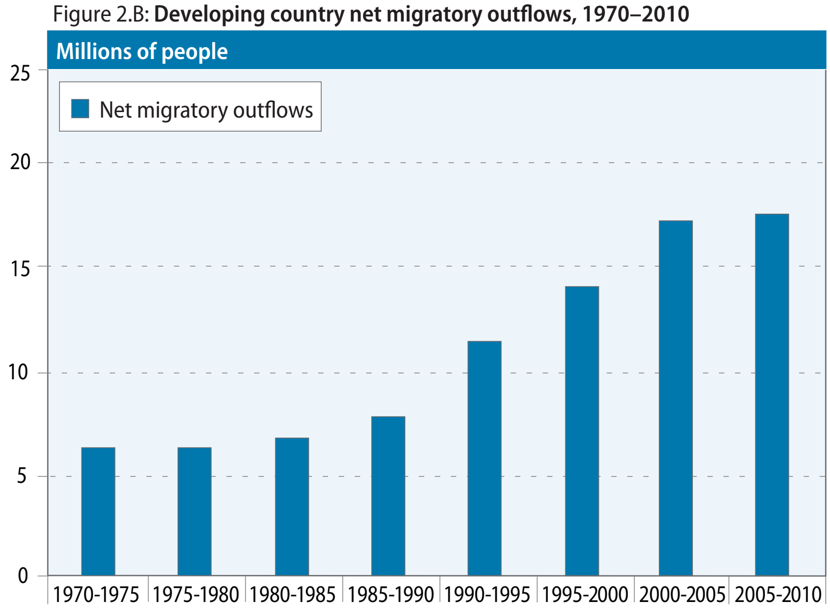
Figure 2
Mobility of capital, goods and services, and labour

Figure 2.A: **World FDI inflows and exports of goods and services, 1970–2010**



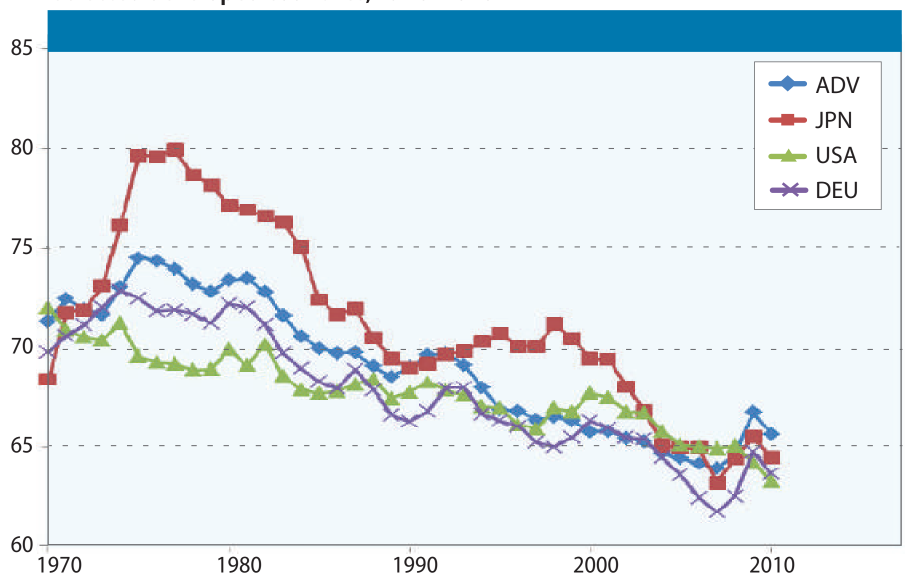
Source: World Bank,World Development Indicators online database and UNCTAD, UNCTADStat online database.
Note: Annual averages.

Figure 2.B: **Developing country net migratory outflows, 1970–2010**

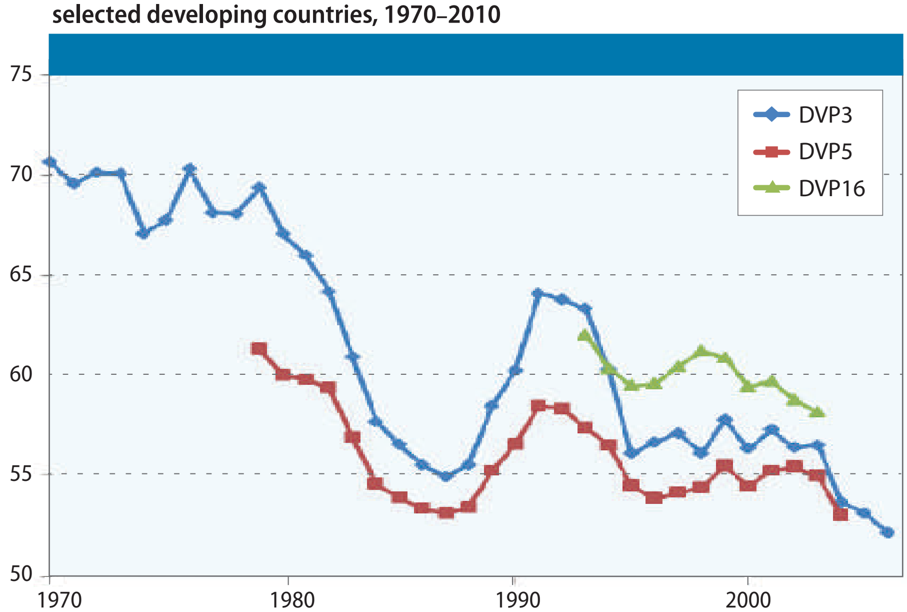


Source: United Nations, Department of Economic and Social Affairs, Population Division (2013). *World Population Prospects: The 2012 Revision*, DVD.
Note: Net migratory outflows are estimates.

Figure 3
Share of private sector adjusted wages in national income, selected developed countries, 1970–2010



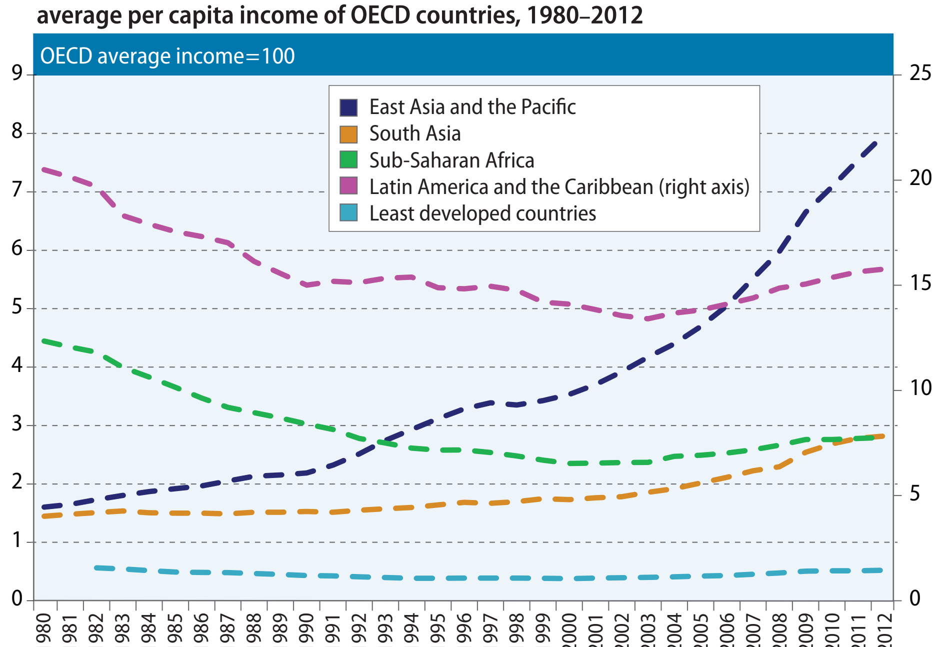
Share of adjusted wages in national income, selected developing countries, 1970–2010



Source: Stockhammer (2013), p.1 and p.3.
Note: Adjusted for self-employment, unweighted averages.
ADV: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Spain, Sweden, the United Kingdom of Great Britain and Northern Ireland and the United States of America.
DVP3: Mexico, Republic of Korea and Turkey.
DVP5: DVP3 plus China and Kenya.
DVP16: DVP5 plus Argentina, Brazil, Chile, Costa Rica, Namibia, Oman, Panama, Peru, Russian Federation, South Africa and Thailand.

While interdependence has increased, inequalities among countries have persisted and, in some cases, amplified. Countries and people have thus been left behind, participating at the margins of the global economy and/or unable to realize its potential benefits. At the global level, the income gap between the developed and the developing countries remains considerable; it has even deteriorated in the case of sub-Saharan Africa, Latin America and the least developed countries (LDCs) in the last two decades of the twentieth century, though with some improvement over the past decade (figure 4 and box 1). Those countries that succeeded in lowering the gap seem to have opted for strategic participation in international trade and tactical association with foreign investors, thereby promoting domestic backward and forward production linkages and the accompanying dynamic structural transformation of the economy from low- to higher-productivity sectors. These achievements often rested on the adoption of a wide range of policy instruments and innovative institutional arrangements. But many developing countries have not been able to do this, and continue to be trapped at low- or middle-income levels.

Figure 4
Average per capita income of selected developing regions as a share of average per capita income of OECD countries, 1980–2012



Source: World Bank, World Development Indicators online database.

Box 1

Increased inequalities amidst increasing interdependence

Increased interdependence between countries has been accompanied by persistently high and sometimes increasing inequality—both among and within countries—in income, wealth, capabilities, voice and power.

In 2010, high-income countries, accounting for only 16 per cent of the world's population, enjoyed 55 per cent of global income (at market prices). Low-income countries enjoyed just above one per cent of global income even though they contained 72 per cent of global population. In sub-Saharan Africa, average gross domestic product (GDP) per capita was $2,014[a] in 2010, compared to GDP per capita of $27,640 in the European Union and $41,399 in North America (United Nations, 2013a).

By some measures, international inequality in income is falling. For instance, based on a population-weighted Gini coefficient (which takes each country's per capita GDP as a point in the distribution), international income inequality has been declining since the early 1980s. Statistically, most of this decline has been due to the rapid growth of China (United Nations, 2013a). However, other measures show a less rosy picture. For instance, the absolute gaps in per capita income between high-income and low-income countries have increased, from $18,525 in 1980 to close to $32,900 in 2007, before falling slightly to $32,000 in 2010 (United Nations, 2013a).

Within countries, income inequality between households deteriorated in the 1980s and 1990s in most countries (73 out of 105 developed, developing and transition economies) and persisted in the 2000s (income distribution worsened or did not change in 57 out of 105 countries) (Cornia, 2013). Rising inequality in household income (as measured by the Gini coefficient) is correlated, in both developed and developing countries, with rising globalization (as measured by indicators of foreign trade, foreign direct investment, portfolio investment, income payments to foreign nationals, import barriers, tariffs, and capital-account restrictions) (United Nations Development Programme, 2013).

The changing distribution of income between labour and capital is one of the drivers of inequality in personal and household income, as capital is much more unevenly distributed than labour. Longitudinal data on this aspect of income inequality is not so widely available, but there is evidence for 16 developed countries that the average labour share declined from about 75 per cent

(cont'd)

a All dollars ($) are United States dollars.

Box 1 (cont'd)

of national income in the mid-1970s to 65 per cent just before the 2008 financial crisis; for 16 developed and emerging economies, labour's share declined from about 62 per cent of GDP in the early 1990s to 58 per cent just before the crisis (United Nations Development Programme, 2013). Globally, the share of wages and mixed incomes (or incomes of the self-employed) in GDP has declined since 1980; the same pattern is observed in Asia, with the decline being quite sharp after 2000 in China and East Asia, particularly in high-income countries in East Asia (Malaysia, Republic of Korea) (Chandrasekhar and Ghosh, 2013). The fall in labour's share of income is correlated with increasing financial globalization and external account openness (United Nations Development Programme, 2013).

In addition to the overall fall in labour's share, the gap between top and bottom earners has increased in the majority of developed and in many developing countries, for which there is data (United Nations, 2013a; Piketty, 2014). Moreover, there are persistent gender gaps in quality of employment, with women more likely than men to be in vulnerable employment (United Nations, 2012b).

Underlying the inequality in income is an inequality in wealth. The 2013 Credit Suisse Global Wealth Report shows that global wealth has more than doubled since 2000, reaching a new record-high of $241 trillion. The average wealth per adult has reached $51,600 per adult; personal wealth for the world as a whole increased by 4.9 percent from the year 2000. However, the bottom half of the global population owns less than 1 per cent of total wealth, while the richest 10 per cent hold 86 percent of the world's wealth; the top 1 per cent alone account for 46 per cent of global assets. The countries with the most wealth per adult over $100,000 are in North America, Western Europe and among the rich Asia-Pacific and Middle-Eastern countries. Sixty-eight per cent of world population has wealth below $10,000; in 2013, 30 per cent of the population in developed countries fell into this category and more than 90 per cent of the adult population in India and Africa. In some low-income African countries, the percentage of the population with wealth below $10,000 is close to 100 per cent (Credit Suisse AG, 2013).

Inequalities in income, wealth, health, education and employment are especially pronounced for social groups with less voice and power, such as women, youth, older people, disabled people and indigenous people (United Nations, 2013a). These forms of exclusion intersect: for example, women experience disadvantage not only on the basis of their gender, but also of their ethnicity and culture, as well as their age. Thus, there are persistent inequalities in capabilities, as measured, for instance, by education and health outcomes across social groups.

Interdependence and policy space

The above discussion takes us to the third main issue underlying the need for reforms in the current global governance system—the noticeable shrinking of policy space. The policy paradigm of deregulation and liberalization that has characterized the current globalization has led to constraints on government action and has promoted market mechanisms as the best approach to resource allocation and distribution. While some constraints to national policy space are necessary to guarantee an efficient functioning of the global economy, the reduction of the policy space of developing countries seems to have been exaggerated and applied in an unequal manner.

Global trade rules, for instance, while helping to make trade flows take place and expand in a predictable manner, have not been sufficiently flexible to allow for the implementation of national policies that facilitate structural change in developing countries. Indeed, recent evidence indicates that developed countries are using industrial policy more often than developing countries, especially since the financial crisis in 2008 when the United States of America and several European countries used various forms of stimulus and protective measures to bail out private firms. Large subsidies to agricultural producers in developed countries are probably the most emblematic case of the widespread use of industrial policies to support the competitive position of specific sectors vis-à-vis foreign competitors. This situation raises the concern of possible asymmetries in the use (or abuse) of industrial policy between the developed and developing countries under the World Trade Organization (WTO) regime.

There has been a noticeable trend towards the standardization of rules and disciplines, usually those prevailing in developed countries. Standardization has coincided with and facilitated the fragmentation of production and distribution worldwide and the emergence of global value chains (GVCs) as a main business model. GVCs have also contributed to the explosion of regional and bilateral preferential trade agreements (RTAs), which often go beyond what has been agreed at the multilateral level, further constraining policy space, and spreading over areas well beyond trade flows, such as labour and environmental standards and capital-account regulations. Further policy constraints originate in bilateral investment agreements (BITs), which regulate bilateral investment flows and go well beyond the obligation of providing prompt, effective and adequate compensation in case of expropriation. By encompassing financial flows, including short-term flows, under the concept of "investment", BITs restrict the capacity of countries to regulate volatile capital flows.

Principles for reform

Moving forward, strengthened mechanisms for global collective action should be built around the principles that support the development efforts of developing countries and environmental sustainability. Key principles of global governance include the following:

Common but differentiated responsibilities in accordance with respective capabilities: This principle embodies equity in the formulation of international law. It recognizes differences in the contribution and historical responsibilities in the generation of common problems as well as the divergences in financial and technical capacity across countries in order to equitably address shared challenges. It requires all States to participate in internationally agreed response measures for tackling common problems, while each country's contribution to the solution should be compatible with its individual capabilities. The principle also implies that recognition of the diversity of national circumstances and of policy approaches should be embedded as an intrinsic feature of the global community, not as an exception to general rules. In other words, global governance should cater to the fact that countries have a variety of initial conditions, and they will adopt a variety of pathways to achieving global development goals (Girvan and Cortez, 2013). The increased divergence among developing countries and the emergence of economic powers among them may complicate the political economy of finding acceptable solutions to current problems. The difficulty in reaching an agreed solution to lowering carbon emissions is a case in point. Nonetheless, the principle of matching responsibility with capability should be at the base of global governance to ensure equity. Accepting the differences in countries' capabilities is a way of incorporating emerging powers in the sharing of responsibilities.

Subsidiarity: This principle suggests that issues ought to be addressed at the lowest level capable of addressing them. It implies that some problems can be handled well and efficiently at the local or national level, reducing the number of issues that need to be tackled at the international and supranational level. In this sense, the report of the High-level Panel of Eminent Persons on the Post-2015 Development Agenda rightly recognizes an important role for national Governments in meeting the challenges for the post-2015 development agenda. At the same time, in the case of spillover effects from one country to another, or in the case of GPGs, international cooperation is imperative for addressing these concerns. But subsidiarity also sees a role for regional cooperation to address issues of global concern. In fact, the creation of any given global governance arrangement can be based on existing regional or subregional institutions and capitalize on their experiences and approaches in policy coordination and cooperation. Regional governance structures can thus be considered as building blocks for global governance structures. A greater role of regional institutions in global governance also facilitates the participation of developing and small countries, thus enabling more democratic global structures.

Inclusiveness, transparency, accountability: Global governance institutions need to represent and be accountable to the entire global community; moreover, decision-making procedures need to be democratic, inclusive and transparent. Absent these characteristics, global governance institutions will lack universal legitimacy and their effectiveness will be compromised. As already called for in the 2002 Monterrey Consensus (United Nations, 2002), developing countries need to have greater voice in relevant decision-making processes as well as in the formulation of global standards, codes and rules. Moreover, robust governance implies mutual accountability, which can be verified by transparent and credible mechanisms and processes to ensure that agreed commitments and duties are being fulfilled. As such, accountability depends on a clear definition of commitments and on agreed indicators and targets. But effective accountability is more than that; it also implies policy change and strong follow-up mechanisms to ensure compliance. Thus, accountability is not an end in itself, and it does not stop in the review processes it entails. Rather, it is an instrument for achieving agreed results.

Coherence: This principle calls for a holistic and comprehensive approach in defining global rules and processes, including the assessment of possible trade-offs, so that actions in one area will not undermine or disrupt progress in others; indeed, processes in all areas should be designed to reinforce one another. Enhanced coherence is also needed between the international and national spheres of policymaking. Coherence requires improved coordination among various stakeholders and enhanced information sharing. The recognition that the only durable development is sustainable development, and that the ultimate goal of international cooperation is the promotion of global sustainable development reinforces the importance of enhancing coherence across economic, environmental and social governance structures at the global, regional and local levels.

Responsible sovereignty: This principle should guide Governments to better exercise their policymaking sovereignty in an increasingly interdependent world. It implies the recognition that policy cooperation is the best way of achieving national interests in the global public domain. It also requires Governments and States to be fully respectful of the sovereignty of other nations so as to fulfil agreed policy outcomes (Kaul, 2013). Responsible sovereignty is necessary for the efficient delivery of the global public goods that are relevant for the management of interdependence and the achievement of global sustainable development.

Section III below identifies deficiencies in the current global governance framework and recommends approaches for addressing these shortcomings, according to these principles, in selected areas that require improved international cooperation.

III. Strengthening global governance and global rules

Global governance and the environmental agenda

The concept of sustainable development is built around three pillars that, for many years, have been perceived as separate silos. This framework has implied that environmental policies have been settled either in isolation from economic and social policies or have been designed in a way that has not promoted important changes in the other two pillars. This approach has failed to reduce environmental damage while at the same time risks social and economic gains.

International environmental governance (IEG) is complex. It includes agreements, international organizations, policy instruments, financing mechanisms, rules, procedures and norms. IEG also impacts other areas of global governance besides the environment, such as international trade. Outside the treaty realm, institutions have voluntarily developed mechanisms, such as the environmental and quality standards of the International

Organization for Standardization and codes of conduct for corporate social responsibility developed by various corporations.

Yet, in general, environmental degradation, particularly in areas that transcend individual countries, has not stopped. The phasing out of production of ozone depleting substances under the Montreal Protocol (MP) is arguably the only example where negative impacts are reversing. Overall, however, the environment continues to show signs of degradation (United Nations Environment Programme, 2013a). Environmental indexes for biodiversity loss and desertification continue to increase, while climate change remains possibly the most dangerous of all environmental threats. Regardless of countries' commitments to reduce greenhouse gas emissions (GHG), there is a significant gap between actual GHG emission trends and the pathways needed to keep the increase in global average temperature below 2°C to prevent dangerous climate change. Clearly, international efforts to reverse and prevent environmental degradation have been inadequate, have not been developed in the right direction or do not truly address the causes of environmental decline (Afionis, 2012).

The MP is often described as the international environmental agreement par excellence. The MP successfully led to the phasing out of 95-98 per cent of all chlorofluorocarbon (CFC) use (Gareau, 2010; Andersen, Halberstadt and Borgford-Parnell, 2013). Success is often attributed to a combination of factors, including the economic opportunities for certain multinational firms that were made available in phasing out CFCs. Big chemical corporations supported the MP, once they realized the economic opportunities that could result from phasing out the use of the ozone depleting substances (ODS). This raises the question regarding whether the MP approach could be used to address other environmental problems.

The technical and socioeconomic differences between the substitution of CFC and other ODS by other substances, and the changes that are needed to reduce GHG emissions, biodiversity loss and land degradation are significantly larger in terms of the wide range of stakeholders involved, the costs, and the levels of scale and intensity of required actions. This implies that the magnitude of organizational, technological and behavioral changes needed to overturn the global environmental damage goes beyond the ones observed in the MP. Environmental sustainability requires deeper changes in current production and consumption patterns—changes that constitute important threats and challenges for the way international corporations operate in energy, mining and chemical sectors, among others. Thus, global environmental problems reveal a deeper crisis in current approaches to growth, production and consumption, and in the presumption of no limits to the exploitation of natural resources.

Moving forward

The formulation of the post-2015 development agenda requires a new international consensus to incorporate environmental sustainability as an integral part of the development process. Greater acceptance of the concepts of green economy and sustainable development emerging from the follow-up to the Rio+20 Conference seems to indicate that there is progress in moving towards this consensus. However, further efforts are needed to fully modify the current economic model of development that wrongly assumes there are no ecological limits to growth. In this regard, and based on the principles discussed above, the following is required.

First, dramatic changes in sustainable consumption and production patterns are urgently needed. Advances in technology have enabled higher efficiency in resource use, and these advances need to be available worldwide. Technological innovation is essential to creating sustainable complementarities between production and the environment. However, there is a limit to enhancing efficiency. Thus, reducing the ecological footprint of current patterns of production of goods and services will not be enough to ensure environmental sustainability. Unsustainable lifestyles, particularly among the richer segments of the population, place enormous pressures on the environment (Allwood and others, 2013). According to current estimates of the ecological footprint, it would take three to four Earths for the average consumption level of the current world population to reach the level of average individual consumption in the United States of America (Wackernagel and Reese, 1996). GHG emissions could be 3.8 times as high as the level of current emissions if developing countries were to consume the same level of fossil fuels (measured in per capita terms) as consumed in developed countries (Intergovernmental Panel on Climate Change, 2007). The poorer segments, meanwhile, are unable to meet minimally required food, health care, shelter and educational needs. Taking the principles of inclusiveness and coherence into account, changing consumption patterns will require focusing on demand, meeting the needs of the poorest, and changing lifestyles and excessive material and energy consumption by the richest. It also requires a new paradigm of success that is not based on increasing consumption.

Second, it is necessary to move from per capita GDP as the measure of development to sustainable development indicators. So long as per capita GDP is the main indicator of development, the eradication of poverty, the promotion of equity and addressing the physical limits of growth will remain of secondary importance. Development goals must include environmental sustainability, poverty eradication and the reduction of inequalities as the focus of policy attention. Agreed targets in these fields must guide the actions of international development institutions, especially international financial institutions. Actions directed towards meeting agreed targets would increase the coherence of global governance for the environment. In this regard, public policies are needed to stimulate public, social and private investments that will reduce GHG emissions and pollution, restore ecosystem services, prevent biodiversity loss, and enhance energy, material and resource efficiency. These environmental objectives need to be consistent with job creation, poverty eradication, improved equity and the recognition of the strategic role of local producers and communities in sustainable agriculture, fisheries and resource management. The economic transition also requires different methodologies for estimating the costs of practices that place social benefits ahead of private profits.

Third, it is important to recognize that environmental problems do not have frontiers. Countries compete for foreign direct investment (FDI) by lowering environmental standards, while multinational corporations look for countries in which to place their investments on the basis of lax or "business-friendly" environmental standards. The IEG needs to develop a system—recognized by the World Trade Organization (WTO) and incorporated into bilateral investment agreements and free trade agreements—that promotes and enforces internationally agreed standards, regulations and codes of conduct on FDI, thereby discouraging investment and development activities based on lack of effective environmental protection regulation. Applying the subsidiarity principle discussed above, global governance arrangements should rely on regional or subregional structures or approaches of governance that need to be coherent across regions. European Union (EU)-wide environmental policies to mitigate climate change (including emission trading as well as EU-wide regulatory approaches) can offer lessons for other regions. Such experiences could be emulated in other regions and eventually scaled up at the global level. The new international role of the United Nations Environment Programme brings enormous opportunities in this matter.

Fourth, applying the principles of inclusiveness, transparency and accountability implies that the recognition of the linkages between environmental and human well-being leads to acknowledgement that the fundamental right to a healthy environment is a human right. Environmental law, jurisprudence and environmental governance are central to resolving problems of environmental justice. The recognition of environmental problems in current international justice institutions and even the possibility of an international environmental court are key considerations in strengthening global environmental governance (United Nations Environment Programme, 2013b). Today there is no dedicated international body with delegated authority to enforce international environmental regulations. The protection of fragile ecosystems, the sustainable use of natural resources in the global commons, and the improved management of transboundary resources are areas of special concern in the development of a global mechanism for environmental governance.

Finally, the increasing differentiation among developing countries is a new feature of the current international landscape. Mechanisms of global governance for sustainable development, particularly in reaching a new international consensus in the United Nations Framework Convention on Climate Change, will have to give proper interpretation to the concept of common but differentiated responsibilities. In this regard, it is necessary to recognize the variety of development trajectories across countries and determine responsibility based on historic emissions, current and projected total and per capita emissions. In this regard, capacity to innovate and access to technology are crucial for reducing the wide developmental gaps that exist between developing and developed countries. This requires strengthening the capacity of developing countries to develop, review and implement education, science, technology and innovation systems oriented towards nationally relevant responses to the challenges they face in relation to climate change, the preservation of biodiversity and the reduction and prevention of desertification. Therefore, it is important to recognize that the increasingly globalized protection of intellectual property rights is impacting developing countries' abilities to develop the necessary capabilities in basic research, education, public health and environmental protection (Maskus and Reichman, eds., 2005). A new international system is needed based on the recognition of the links between international public goods and transfer of technology. Similarly, the principle of common but differentiated responsibilities should be taken into account in the provision and allocation of financial resources to support sustainable development strategies. While estimates vary tremendously, there is general agreement that high levels of resources are needed. Several financing mechanisms have been discussed in recent years, but serious commitments are still to be made if environmental sustainability is to be effectively integrated into a new development paradigm. In the allocation of resources, clear priority should be given to the poorest countries with greater vulnerabilities to environmental degradation, as well as to those more likely to be affected by climate change. Additionally, the allocation of resources to meet traditional development goals, such as access to water and sanitation, electrification, etc., should be made compatible with and take into account the sustainable management of natural resources, both as a policy for poverty reduction and as a strategy for adaptation to climate change.

International monetary and financial architecture

The recent financial crisis—which originated in the North Atlantic but had worldwide ramifications for both developed and developing countries—underlined the need to deepen the reforms of the international monetary and financial architecture. Several initiatives have been undertaken since the crisis to strengthen prudential financial regulation and supervision, to improve countercyclical financing and to enhance macroeconomic policy cooperation. In contrast, steps to strengthen and improve the international monetary system have been more limited, those aimed at creating an international debt workout mechanism have been entirely absent, and only small steps have been taken to reform the governance of the system.

Financial regulation and supervision

Under the leadership of the Group of Twenty (G20) and the Financial Stability Board (FSB), which was created at the London Summit in April 2009, financial regulation and supervision has been strengthened and the regulatory perimeter has been expanded to include agents and transactions poorly regulated before the crisis (D'Arista and Griffith-Jones, 2010). Countercyclical prudential regulations—now generally referred to as macroprudential—were introduced, following proposals that had been made before the crisis (Griffith-Jones and Ocampo, 2010). The principle that standardized derivative contracts should be traded in exchanges was established, thus potentially increasing the transparency and reducing the counterparty risks of these transactions. In addition, consumer protection was enhanced, particularly in the United States, among other reforms.

The reforms increased capital and liquidity requirements, including an overall (risk-unweighted) capital requirement of 3 per cent. Systemically important agents ("too-big-to-fail" institutions, for example) were made subject to stricter rules, which included the obligation to simplify the structure of financial conglomerates and to draft "living wills" that address their potential bankruptcy. Parallel to global processes, national and regional regulations have been adopted in the United States and Europe to strengthen prudential regulation and to adopt macroprudential frameworks. But the uneven progress of these reforms and inadequate coordination of reforms between the two epicentres of the crisis may lead to important differences in regulatory frameworks.

Overall, efforts so far have been incomplete and insufficient to respond to the challenges posed by the current stage of global economic interdependence. Furthermore, the introduction period for these new norms began in 2013 and extends through 2019—an excessively long transition period—and some have already been weakened under the pressure of major financial institutions.

Capital-account regulation

Absent from the reforms proposed by the FSB was any consideration of the risks associated with cross-border capital flows. The issue is particularly critical for emerging and developing countries, as capital-account volatility plays a major role in determining boom-bust financial cycles and, therefore, macroeconomic risks and fluctuations. This issue was, nonetheless, taken up by the International Monetary Fund (IMF).

The guidelines proposed by the IMF (International Monetary Fund, 2011) and the IMF institutional view on the use of these regulations (International Monetary Fund, 2012) accept that capital-account regulations are part of the toolkit of macroprudential instruments, and should be seen as a complement and not as a substitute for macroeconomic policy. However, both (particularly the guidelines) view capital-account regulations as what might be called interventions of last resort—i.e., policies that should be introduced only after all other options to manage booms have been exhausted. In contrast to this view, they should be conceived as part of a continuum that goes from regulation of domestic finance in domestic currency to domestic financial transactions in foreign currencies and cross-border flows, which should be regulated in a way that is consistent with the characteristics of different financial systems and the policy objectives of macroeconomic authorities.

Official countercyclical finance

The financial crisis generated the most ambitious response of official countercyclical financing in history, including a rapid expansion of IMF financing and that of multilateral development banks (MDBs). Both benefitted developing countries, but IMF financing also helped some developed countries. This was accompanied by the largest issuance of special drawing rights (SDRs) in history. At the regional level, these efforts were reinforced by old and new mechanisms in Europe and by the Chiang Mai Initiative of ASEAN Plus Three (comprised of the ten ASEAN countries plus China, Japan and the Republic of Korea). At the national level, these actions were complemented by the expansion of financing by the major central banks and by an unprecedented increase of swap lines among central banks; this benefitted not only developed but also a few emerging economies.

Increased IMF financing was facilitated by a major redesign of its credit facilities in 2009-2010. This included the creation of a new preventive facility, the Flexible Credit Line (FCL), for countries with solid fundamentals but with risk of contagion, doubling the size of other credit lines, facilitating the use of stand-by facilities with preventive purposes, and determining that non-compliance with structural conditionality benchmarks could not be used to stop programme disbursements. In August 2010, the Precautionary Credit Line was created for countries with sound policies but which do not meet the requirements of the FCL. It was later transformed into the Precautionary and Liquidity Line, to allow countries to use it to obtain funds of rapid disbursement for six months. The IMF also reformed its concessional facilities for low-income countries, which moved from a single design to a menu of options, based on two factors: countries' debt vulnerability, and macroeconomic and public finance management capacity.

Additional official financings benefitted high- and middle-income countries to a larger extent than low-income countries (Griffith-Jones and Ocampo, 2012). This imbalance was worsened by reductions in ODA, following their peak in 2010 (United Nations, 2013c). Moreover, the World Bank's insufficient capitalization has compromised its capacity to provide adequate external financing to developing countries in the future. Finally, the expansion of official financing was smaller than the initial contraction of private-sector financing, indicating that official resources can only moderately smooth out boom-bust cycles in private financing, and that the main instrument to reduce the volatility of external financing should be capital-account regulations, particularly regulation on inflows during the boom phase of the financial cycle.

Absence of a debt workout mechanism

A major deficiency in the response to the financial crisis was the absence of steps to create a regular institutional debt workout mechanism for sovereign debts, similar to those that help manage bankruptcies in national economies. The major mechanism currently in place is the Paris Club, but it is limited to official financing; in the case of low-income countries, it has been complemented since the late 1990s by the Heavily Indebted Poor Countries and the Multilateral Debt Relief initiatives. For private obligations, the system has relied on ad-hoc mechanisms, such as the Baker and Brady Plans of the 1980s, but has essentially depended on traumatic individual debt renegotiations. Solutions generally come too late, after over-indebtedness has had devastating effects on countries; solutions are also horizontally inequitable, as they do not treat all debtors or all creditors with uniform rules.

A major attempt at reform took place in 2001-2003, when the IMF proposed the creation of a sovereign debt restructuring mechanism. These negotiations failed, but led to the spread of collective action clauses in international debt contracts. However, experience indicates that voluntary debt renegotiations pose serious problems in terms of aggregation of credit contracts and court demands by non-participants. This major gap in the international financial architecture has, therefore, come back to the global agenda in recent years.

Macroeconomic policy cooperation

Officially, the IMF is the major multilateral instrument of macroeconomic policy dialogue and cooperation. However, most forms of macroeconomic cooperation have tended to take place in ad-hoc arrangements outside the IMF. The original Bretton Woods international monetary arrangement collapsed after the United States unilaterally abandoned the convertibility of the dollar for gold in 1971, and the later collapse of the system of adjustable parities established at Bretton Woods. It was replaced by a "non-system", characterized by the central role played by the domestic fiduciary currency of the major economies (particularly the U.S. dollar), with countries being able to adopt any exchange-rate system they choose, so long as they guarantee a stable system (rather than stable exchange rates) and avoid manipulating the exchange rates—with no agreement, however, as to what "manipulation" means.

This system has faced several problems. First of all, the monetary policy of the major reserve-issuing country is adopted without taking into account its spillover effects on the rest of the world. Second, most advanced economies have opted for a flexible exchange-rate regime. However, exchange-rate volatility increases during crises, without any clear contribution to the correction of underlying imbalances. Third, the major emerging economy, China, continues to have limited exchange-rate flexibility, most major oil-exporting countries peg their currencies to the dollar, and most European countries lack exchange-rate flexibility among themselves. As a result, the system lacks sufficient adjustment mechanisms.

The major problem of the international monetary system continues to be the asymmetry between the need for deficit countries to adjust during crises and the lack of any pressure for surplus countries to do so, which generates a deflationary (or, more properly, recessionary) bias in the adjustment process (Keynes, 1942-1943). The system faces two additional deficiencies: (i) the problems generated by the dependence of the international reserve system on a national currency; and (ii) those problems associated with the need that emerging and developing countries face to accumulate large amounts of foreign-exchange reserves as "self-insurance", in the absence of proper global regulation and insurance against capital-account volatility (Ocampo, 2010 and 2011). To the extent that reserve accumulation reflects strong current accounts, it also contributes to the generation of a global recessionary bias. Despite these problems and several proposals under consideration (see below), no steps have been taken to reform the system. The most important action was the largest issuance of SDRs in history, agreed to in 2009, for the equivalent of US$ 250 billion.

Mechanisms of macroeconomic policy cooperation have been strengthened but have not been particularly effective. G20 macroeconomic cooperation worked relatively well in the early stages of the crisis, when it assumed the form of a Keynesian consensus. But at the Toronto G20 summit in June 2010, consensus had already eroded, as several developed countries decided to give priority to public sector debt sustainability over supporting the recovery. Meanwhile, multilateral and bilateral IMF surveillance was strengthened to a level never experienced before. But peer review pressures and surveillance are weak forces; this is particularly reflected in the limited attention given to the spillover effects of developed countries' expansionary monetary policies on emerging markets (and associated currency wars), and the incapacity to prevent austerity in the euro area from generating new global imbalances.

Moving forward

Several proposals for reform of the international monetary system were placed on the global debate early in the crisis (Zhou, 2009; United Nations, 2009a; Boorman and Icard, eds., 2012). Undoubtedly, the most promising way to reform the international monetary system, and to improve its stability and equity characteristics, is to fully employ the SDRs, which remain one of the most underutilized instruments of international economic cooperation.

Placing SDRs at the centre of the international monetary system could free the system from having to depend on the monetary policy of the leading country, whose policy tends to be managed without taking its international repercussions into account. By issuing SDRs in a countercyclical way, new SDR allocations during crises would have the potential of reducing the recessionary bias associated with the asymmetric adjustments of surplus and deficit countries. SDR allocations could also reduce the need for precautionary reserve accumulation by developing countries, and would represent a lower cost than self-insurance (Erten and Ocampo, 2014).

Policy space for developing countries should be enhanced by: fuller use of capital-account regulations; further improvements in unconditional counter-financing mechanisms, including through the expansion of regional financing networks; a better system of macroeconomic policy cooperation; and the creation of an effective international debt workout mechanism.

Needless to say, these actions have to be matched by changes in the governance of the system to "broaden and strengthen" the participation of emerging and developing countries in "international economic decision-making and norm-setting", as called forth by the Monterrey Consensus (United Nations, 2002, para. 92). This issue involves at least three elements.

The first element is the design of a more representative apex organization than the G20, possibly by transforming it into the Global Economic Coordination Council proposed by the United Nations Commission of Experts on the International Monetary and Financial System (United Nations, 2009a).

The second element is further reform of the voice and participation of developing countries in the Bretton Woods institutions and the FSB. However, even the limited 2010 IMF quota reform has not been fully completed, owing to the fact that the United States contribution has not been approved by its Congress.

The third element is the design of a multilayered architecture, with active participation of regional and subregional institutions—in a sense, reproducing the denser architecture that characterizes the system of MDBs. The essential advantages of the denser architecture are that it provides both more voice and more alternative financing opportunities for emerging and developing countries.

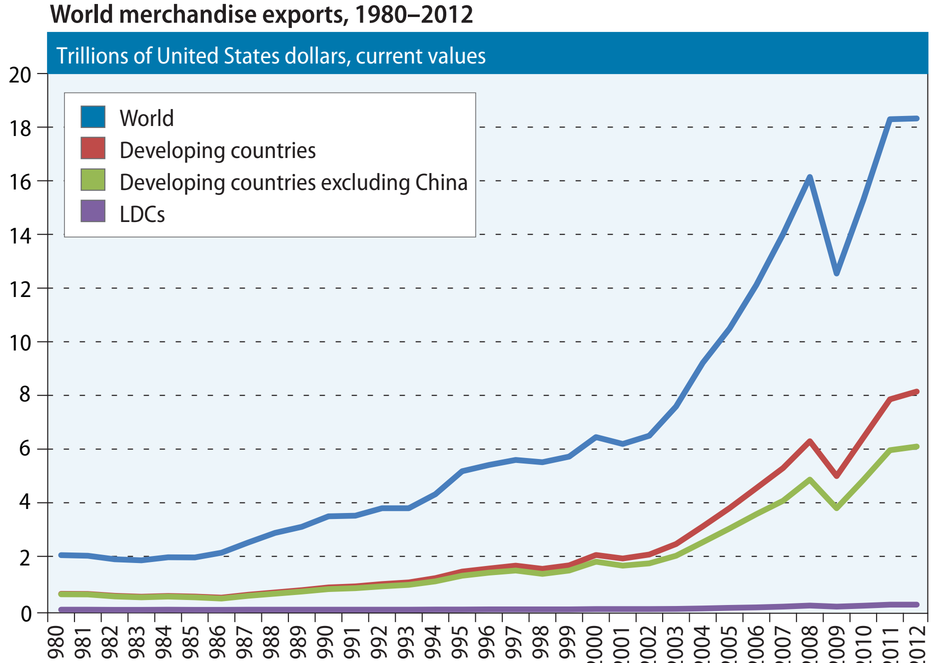
International trade rules: fostering development and preserving policy space

Development requires dynamic structural change based on continued technological upgrading of productive capacities and economy-wide increased productivity. International trade provides opportunities for realizing economies of scale, potential for increasing the efficiency of production, and facilitating the transfer of technology. The adequacy of global trade rules has to be assessed in terms of their efficiency in maintaining stable and predictable trade flows and in providing a transparent regulatory framework to the advantage of all participants. The framework includes not only the rules negotiated multilaterally but also those disciplines agreed among regional and bilateral partners.

Overall, the system has succeeded in keeping trade open and predicable, and flows have grown steadily, with occasional sharp contractions, as in the aftermath of the 2008 crisis. As a group, developing countries have increased their participation in world trade (figure 5), a trend that is most noticeable in manufactures. However, at the individual country level, trade performance has been rather diversified, and not all countries are participating in world trade and receiving its benefits.

From the individual country perspective, integration into the global economy should not be an end in itself, but rather a strategic component of the path to development. Yet, as liberalization has progressed, the policy space of developing countries has been reduced. While both the WTO and the General Agreement on Tariffs and Trade (GATT) have recognized that countries are at different stages of development and therefore have different financial and trade needs, the pre-WTO regime included provisions that could be used to support structural change, while the WTO regime is increasingly moving towards flexibilities that facilitate the implementation of its rules, rather than supporting structural change. Moreover,

Figure 5
World merchandise exports, 1980–2012



Source: UNCTADStat.

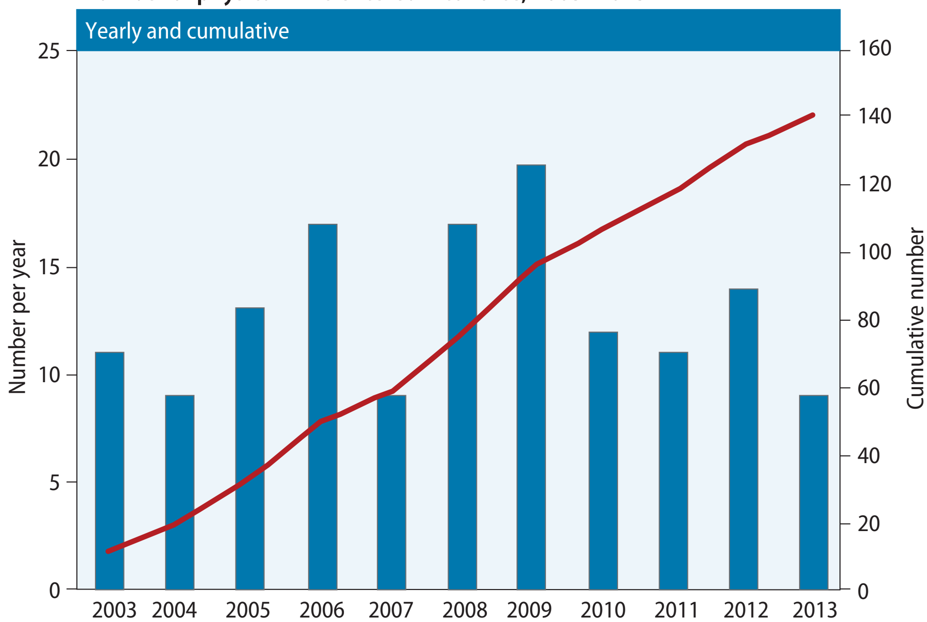
while certain flexibilities in terms of allowed policy tools are still available for developing countries, and in particular for least developed countries (LDCs), some of those currently enjoyed by developed economies (agricultural subsidies being the most notorious example) are off-limits, which introduces an important element of inequity in the system.

Preferential trade agreements and bilateral investment agreements

The increased popularity of GVCs as the preferred business model to organize production and distribution has contributed to the mushrooming of regional and bilateral preferential trade agreements (RTAs). The RTA proliferation contributes to undermining the principle of most favoured nation (MFN), one of the pillars of the multilateral trading system. As of November 2013, there are 250 RTAs in force, of which over 140 came into force after 2003 (figure 6). RTAs often go beyond what is agreed at the multilateral level. These practices raise concerns when RTAs are contracted by partners of asymmetric economic and political power. In fact, a greater number of WTO-plus and WTO-minus provisions, as well as provisions on areas beyond the current scope of WTO, are found in RTAs among partners of different levels of development than in those contracted between partners of similar levels of development (World Trade Organization, 2011). Some RTAs extend disciplines to capital flows that effectively reduce the capacity to minimize financial instability associated with cross-border capital flows. In their quest for greater market shares in developed countries, developing countries are giving up policy space beyond what is envisaged by WTO rules. But it is not clear what they actually gain in return, since RTAs tend to exclude products of export interest to developing countries, such as agricultural and food products and labour-intensive manufactures.

Further policy constraints originate in bilateral investment agreements (BITs), which regulate bilateral investment flows, and go well beyond the obligation of providing prompt, effective and adequate compensation in case of expropriation. A typical model BIT prohibits performance requirements; it defines investment not only as physical investment but also intellectual property, financial assets and, most importantly, legal and contractual rights. The latter implies that changes in the national laws (for social or environmental reasons, for instance) that may impose unanticipated costs or additional obligations on the foreign investors are considered

Figure 6
Number of physical RTAs entered into force, 2003–2013



Source: World Trade Organization (2014), chart 13, p. 54.

as breach of contract and expropriation of the foreign investor's contractual rights (regulatory takings) and require compensation (Cotula, 2007).[1]

RTAs and BITs may undermine systemic consistency and increase coordination costs in view of varying and divergent requirements such as rules of origin, phytosanitary measures and other technical requirements (labelling, etc.). They may also create other difficulties for developing countries if some of the flexibilities they enjoy in WTO expire or become no longer permissible under the WTO regime, but are considered an integral part of the regulatory environment negotiated with the foreign investor. For instance, flexibilities under the WTO Agreement on Subsidies and Countervailing Measures, many of which are relevant for export processing zones, are to be phased out by December 2015 and/or when a country graduates from Annex VII status (Waters, 2013).[2] Thus, under the

1 It is interesting to note that no two developed countries have stand-alone BITs (i.e., one which is not an integral part of an RTA) with one another (excluding with the former economies in transition that joined the EU).

2 Annex VII countries are LDCs and countries whose per capita income is lower than $1,000 measured in 1990 U.S. dollars.

regulatory taking provision, a developing country may end up having to compensate foreign investors because it had to reform its subsidy system to comply with WTO disciplines.

In any case, it seems contradictory that developing countries may resist the imposition of limits to their policy space at multilateral forums to relinquish that space at the bilateral or regional levels. A possible explanation is that by resisting constraints at the multilateral level (as a group) but granting concessions at the bilateral level, a country may boost its attractiveness for FDI vis-à-vis other competing destinations.

WTO decision-making: power asymmetries?

The proliferation of RTAs also coincides with the difficulties in advancing the multilateral trade negotiations. The Doha Round has been pronounced dead several times in the past, and despite the recent Bali agreement, it has a visibly declining vigour. The Bali deliverables (trade facilitation, some items in agriculture, and development issues) are a far cry from the initial ambitious agenda and are surrounded by controversies. Overall, there is a great deal of discontent with the lack of a true development orientation in the Round. Developing countries' concerns have not been properly addressed, while tighter disciplines are being considered. These outcomes may reflect the marked asymmetry in economic and political power among members, despite the formal equality (i.e., one country, one vote) in terms of decision-making rights. Yet, decisions are not taken by vote, but by consensus, which would imply, in principle, the right by any country to block any decision. However, there are problems on how consensus is forged in some instances and there is a relative lack of transparency in some key aspects of WTO operations. In this regard, applying the principles of inclusiveness and transparency discussed above, the consensus system should be used in a manner that fully respects the views of developing-country members and procedures should be established for smaller, issue-based meetings, with authorization coming from all members and the meetings being governed by transparent rules.

Asymmetries in power and capacities are also reflected in the use of the dispute settlement mechanism (DSM), certainly not with respect to the transparency of the process and the independence of its rulings, but rather due to issues of access and actual use of remedies (retaliatory measures) against faulty parties that are unable or unwilling to act on a given ruling. Few small- and low-income countries have initiated disputes; Bangladesh is the only LDC that requested consultations. The costs of using the system are high and require a great deal of awareness and knowledge of WTO disciplines, which is lacking in many developing countries, LDCs in particular (Girvan and Cortez, 2013). In fact, the system seems to be dominated by developed countries: a total of 40 per cent of cases were between developed countries, while another 22.2 per cent of cases involved developed countries requesting the investigation of middle-income countries (Lee, Shin and Shin, 2014).

Special and differential treatment: the right approach to development?

To a large extent, trade agreements in multilateral, regional and bilateral spheres have evolved in a manner that: (i) largely reflects the needs and interests of the production sectors and big business in the dominant economies; (ii) covers new areas; and (iii) provides deeper disciplines as business models have changed, new practices have emerged and the organization of production have become increasingly complex and internationally fragmented. Development concerns in GATT/WTO legal texts are addressed through special and differential treatment measures (SDTs). There are a total of 139 SDT provisions in the agreements adopted at the conclusion of the Uruguay Round (World Trade Organization, 2013). Many more followed. But in general there is a great deal of dissatisfaction with the SDTs, and the measures have failed to deliver as anticipated. The value of preferential market access has been compromised—not only by progressive liberalization, but also by a wide range of complex rules-of-origin requirements—and greatly offset, if not reversed, when preferential treatment accorded to competitors under RTAs are also taken into account. Meanwhile, conditionalities associated with adjustment programmes by the international financial institutions have constrained the use of some SDTs by developing countries, while most of the provisions are just indicative of best endeavour, or policy guidelines, and are not subject to enforcement through dispute settlement.

Recent trends seem to indicate that the system seems to be moving away from differential treatment for developing countries as a group to preferential treatment based on specific, individual needs. While this may be a practical solution in view of greater diversity among developing countries, and in tandem with the principle of common but differentiated responsibilities, the new approach has not yet been tested. A number of problems will likely emerge, including difficulties related to country classification based on needs, the selection of needs eligible for assistance, and monitoring the extent and modalities of additional resources committed (Cortez and Arda, 2014). Moreover, there is a risk that while new disciplines will be binding, the provision of the technical assistance they require will not. This can already be seen in the recently negotiated Agreement on Trade Facilitation.

Another source of concern is the enhanced reciprocity that the new trend entails, particularly if rules are not flexible enough to accommodate different country needs. It would also imply a breach of the principle of common but differentiated responsibilities and of the very principles of WTO, as the legal texts state that developing countries should only undertake commitments that are compatible with their level of development. In fact, these trends seem to suggest that the principle of less than full reciprocity, which has been another important pillar of the multilateral trade regime, has been eroded.

Moving forward

Trade rules, at a minimum, should not perpetuate or intensify current asymmetries. Accordingly, the overall transparency and fairness of the DSM could be further improved if the trade policy reviews—which provide an assessment of the state of trade policies—of member countries with the largest shares of world trade could be geared towards the identification of WTO-incompatible practices that are harmful to the export interests of developing countries, in particular of the smaller countries and/or of those countries without established WTO legal competence. In this regard, WTO could evolve from being a members-driven organization to taking on a greater role in overseeing and enforcing the disciplines contained in its various agreements to the greater benefit of developing countries' members and in accordance with the principle of common but differentiated responsibilities.

Strengthening multilateralism offers the best option for developing countries in addressing the issue of reduced policy space and exercising their collective bargaining power to their benefit. With respect to fragmentation brought about by RTAs, two complementary initiatives are suggested: one is "bottom up", the other is "top down".

The bottom-up initiative would imply a multilateralization of RTA disciplines that would bring some order to the pattern of deeper disciplines (Bhagwati and others, 2011). Yet, not all disciplines may be best placed under global governance, and one-size-fits-all rules are not ideal in all circumstances, as discussed above. In the case of the EU, for instance, the principles of subsidiarity and proportionality have guided what has been brought under EU governance while it imposes disciplines to control for negative spillover effects from individual country actions, including beggar-thy-neighbour policies among members (the supranational level is involved to the least extent necessary) (Baldwin, 2014).

The top-down initiative would imply the negotiation of a code of conduct to anchor policy action in the negotiations of RTAs and BITs. One possibility could be a revision of GATT article XXIV, beyond what is being envisaged by the Doha Round, so as to reflect the evolving nature of RTAs (going beyond tariff liberalization). Similar observations apply to GATT article V on economic integration in the area of trade in services. This option would also entail giving WTO a stronger overseeing responsibility. In fact, reforming article XXIV has already been suggested to ensure the supremacy of WTO rules vis-à-vis RTA rules so as to improve coherence and consistency in the world trade regime (e.g., Picker, 2005; Davey, 2011) and to protect policy space in developing countries (Lang, 2006). Another option to be considered is a stand-alone agreement on basic investment rules or a code of conduct for foreign investors and host countries. The UNCTAD Investment Policy Framework for Sustainable Development, with its set of core principles for investment policy, is one step on this direction. Either way, these options may offer a much needed policy anchor to limit "unilateral investment incentives and bilateral concessions over behind-the-border policies" (Blanchard, 2013, p. 17), increase coherence and compatibility with WTO rules and offset negative consequences of existing power asymmetries in negotiating such agreements. Existing agreements would then need to be modified or adjusted to be compatible with the rules or code of conduct agreed multilaterally.

With respect to the multilateral disciplines, as WTO continues to move the liberalization frontier from "at the border" to "behind the border", further exemptions may be needed in view of the varying development levels and needs of WTO membership. If deviations are needed, then some of the rules may not necessarily be in line with developing countries' interests. Increasing participation by developing countries and LDCs in the multilateral trading system may then strengthen the system itself, but not necessarily promote the development of these countries, or, at a minimum, be developmentally neutral. Of greater concern, this tendency may give further weight to the relevance of the question whether the policy package implicit in WTO agreements is in fact appropriate for economies at an early stage of development.

Thus, the way forward is not necessarily to make the SDTs more effective and operational. SDTs are in fact the second best solution to the quest for development. What matters is not so much to have SDTs, which are deviations to the rules, but to negotiate trade rules that are sufficiently flexible and supportive of development so that no deviation is needed (Cortez and Arda, 2014). Currently, just a few developing countries are actively engaged in negotiating rules (Brazil and India being the obvious examples, among others). Many developing countries seem to concentrate their energies in negotiating SDTs, which in the current WTO context mean little more than additional implementation periods and (non-binding) provisions for technical assistance. Developing countries would be better off negotiating rules that are suitable to their development trajectory. This is one of the greatest advantages of belonging to WTO: the possibility to influence rule making. Thus, efforts need to be scaled up to improve the negotiating capacity of developing countries, particularly of the LDCs, and the more advanced or "trade-savvy" developing countries could play an active role in that direction. Moreover, treating trade as a means to development implies that developing countries should be negotiating trade disciplines with the objective of maximizing development, which would also improve the coherence of the global governance for development.

As Rodrik (2001) eloquently argued, increasing trade flows and expanding market access do not necessarily imply moving up the development ladder, particularly if greater access is obtained at the expense of policy space beyond what is necessary for the efficient management of interdependence. The development objective thus gives further weight to the idea of approaching the WTO as the institution that manages diversity and not as one that imposes uniformity.

International tax matters: enhancing cooperation in a world of high capital mobility

While the increase in trade in goods is the bedrock of globalization, the most rapid expansion has been in the area of finance. Over the span of the three decades between 1980 and 2012, capital flows grew five times faster than exports. Most capital flows have been directed towards the service sector, including banking. At the same time, while there have been substantial efforts to establish global frameworks for the regulation of trade in goods, much less has been done to coordinate trade in financial services and associated flows. The increased mobility of capital and the ease of shifting profits and savings across territories as corporations and individuals take advantage of disparities in institutional and regulatory environments, as well as the lack of transparency in international transactions, place a serious burden on national tax systems. Those systems must strike a balance in meeting the dual objective of mobilizing government revenue on the one hand, and facilitating trade and retaining and attracting investment capital and savings on the other. The proliferation of tax havens, safe havens (secrecy jurisdictions) and offshore financial centres has made matters even more complicated. It is in this context that developments in globalization become highly relevant for tax cooperation.[3] There are four issues that are relevant to this discussion.

First, there is increasing evidence that average taxation on capital income has declined over time in developed as well as emerging countries (Devereux, Lockwood and Redoano, 2008). This raises the question of whether the decline in tax on capital is the result of deliberate attempts by countries to unilaterally use their tax policy to attract foreign capital and savings—a harmful type of competition by which countries would be undercutting each other with a race-to-the-bottom approach.

Second, the increasing mobility of capital and the ease of incorporation of enterprises in foreign territories raise a concern not only about multinational corporations engaging in profit shifting, taking advantages of loopholes in tax policy and other regulatory frameworks, but also regarding the lack of coordination of taxation and regulation across countries. This has important implications for efficiency and equity. The problem is

3 The expressions "tax haven" and "safe haven" are related but have different meanings. "Tax haven" refers to low or no taxation, while "safe haven" encompasses broader aspects of secrecy and regulatory arbitrage provided to investors.

exacerbated by the lack of transparency in the global financial services, and especially in safe havens (Shaxson, 2011). Profit shifting results in substantial losses in government revenue in developing countries, which undermines their efforts to mobilize domestic revenue for development financing. Moreover, safe havens facilitate illicit flows from developing countries, which constitute a major drain on domestic saving and undermine domestic investment. More effective international cooperation on taxation and increased transparency in the global financial system can help alleviate these problems and advance the development financing agenda.

The third issue is that there is no level playing field in the globalization process, and developing countries—particularly LDCs—are at substantial disadvantage in the allocation of capital and savings. In particular, several developing countries suffer large losses owing to profit-shifting practices of multinational corporations operating in the natural resources, manufacturing and service sectors, while at the same time they face severe hemorrhaging through capital flight and other forms of illicit financial flows (African Development Bank and Global Financial Integrity, 2013; Ndikumana and Boyce, 2011; Shaxson, 2011).

Lastly, from a global perspective, taxation policy can play an important role in advancing global initiatives. In particular, taxation can generate valuable resources to finance global public goods such as mitigation and adaptation to climate change and the fight against major endemic diseases. Moreover, targeted taxation can help discipline the production of global public bads. Achieving these goals requires a high level of coordination and political commitment by national Governments.

The existing national, regional and global initiatives geared towards fighting tax evasion through improved tax cooperation and increased transparency have produced limited and uneven results. For multilateral frameworks, the implementation is especially hampered by the lack of coordination among countries, lack of mechanisms of accountability to penalize failure to cooperate, and inadequate technical capacity in the case of developing countries. In this context the work of the United Nations Committee of Experts on International Cooperation in Tax Matters (a subsidiary body of the Economic and Social Council) offers a useful framework for addressing these challenges. In particular, the Committee can play an important role in guiding the design of interventions aimed at enhancing technical capacity in developing countries with regard to complex matters in taxation, such as the handling of transfer pricing by international institutions, as provided for in the United Nations Practical Manual on Transfer Pricing for Developing Countries (United Nations, 2013b).

In addition to multilateral frameworks to advance cooperation in taxation matters, countries continue to establish bilateral agreements to promote common interests in the area of taxation. However, bilateral agreements also have their limitations. One important challenge is that operators in tax havens are able to take advantage of the complex layers of secrecy and intricate legal machinery to make detection of criminal financial activity difficult and prosecution even harder. Moreover, tax evaders are able to stay one step ahead of the regulator and the investigator. They are able to shift shell companies, bank accounts and other transactions to territories that are not yet covered by treaties. As a result, tax information exchange agreements (TIEAs) have not yet produced a significant decline in tax evasion or meaningful repatriation of funds. Their initial impact seems to be a relocation of funds or redirection of new illicit financial flows towards jurisdictions that are not party to TIEAs (Johannesen and Zucman, 2012).

Moving forward

Coordination of efforts to fight tax havens is challenging because not all tax havens are created equally. The set includes both large and small offshore financial centres, including some in poor nations (Rawlings, 2005). Determining how to sequence global action is difficult. Yet, the effectiveness of efforts to fight tax evasion is bound to be limited in the absence of a concerted global approach to take on safe havens at once through a "big-bang" style multilateral intervention (Elsayyad and Konrad, 2012). But the question remains as to how to organize such big-bang combat against all safe and tax havens, especially given the difficulties in forging a consensus among all stakeholders on a comprehensive, ranked list of safe and tax havens.

Notwithstanding the above, the limited success in combating tax evasion is largely due to lack of effective implementation and enforcement of existing frameworks; accountability needs to be improved and this is where efforts should be concentrated going forward. In this context, a few areas are worth highlighting. The first is in the area of exchange of information, which is critical to dismantling the tradition of secrecy. In this respect, in addition to efforts to establish and enforce TIEAs, countries should push for institutionalizing automatic exchanges of information on taxation (AEITs). In the same vein, countries and international institutions must swiftly endorse and enforce mechanisms to increase accountability and transparency in the corporate sector, especially with regard to large multinational corporations. Thus, the global community must rally behind efforts to institutionalize rules on country-by-country reporting, as well as unitary taxation of multinational corporations, to enable all countries to collect taxes on all taxable activities taking place in their territory by every taxpayer, regardless of geographical location. In addition to the establishment of effective monitoring mechanisms, including clear and measurable goals and targets to track progress in the area of international cooperation in taxation, action is required on two other related fronts: (i) strengthening of the role and operational capacity of the Committee of Experts on International Cooperation in Tax Matters, including its conversion into an intergovernmental subsidiary; and, (ii) the promotion of an international convention against tax avoidance and evasion.

While there are large potential gains from taxation aimed at financing global public goods and controlling global public bads, the implementation of such tools faces substantial challenges at both technical and political levels. The biggest challenge is building a global consensus and mobilizing support from individual Governments and institutions around these innovative taxation instruments. This challenge arises partly from the fact that it is difficult to quantify and apportion the benefits accruing to each member country. Individual countries may therefore avoid the first-mover disadvantage associated with the free-rider problem. Moreover, global initiatives to mobilize additional tax revenue and to use taxation as a disciplining instrument against global public bads are constrained by the lack of a global institution entrusted with coordination and execution of such initiatives. So far, proposals for the creation of an international authority in charge of global taxation have not made any headway. Here, the principle of subsidiarity can offer some guidance, as a more feasible avenue would be to work with existing institutions and capitalize on experiences at the regional level in policy coordination. In this context, the EU can offer fertile ground for implementation. Indeed, there is already a substantial degree of coordination on valued-added tax administration among EU members that could offer some lessons for the way forward. Such experiences could be emulated in other regions and eventually scaled up at the global level.

International cooperation on taxation has important implications for official development assistance (ODA) as a means of helping developing countries reach and sustain high growth rates and accelerate progress towards their social development goals. Coherence would be considerably improved if the debate on assistance to developing countries moved beyond increasing budgetary allocations to foreign aid, and considered ways to help developing countries mobilize domestic resources. In fact, international tax cooperation can help countries graduate from ODA. In particular, it can help developing countries increase their tax revenue by curbing tax evasion by multinational corporations, negotiating a fairer share in natural resource rents, stemming illicit financial flows, and collecting tax on private assets held abroad by their residents.

The donor community can help through two main interventions. The first—as with international tax cooperation in general—is to adopt and effectively implement measures aimed at preventing tax evasion and related illicit practices by multinational corporations operating in developing countries. The second action is to provide technical assistance to developing countries in the design and implementation of tax reforms, as well as the monitoring and prosecution of financial crimes, including by establishing and strengthening specialized institutions, such as national financial intelligence units. By scaling up global efforts to fight against tax evasion and other forms of financial crimes, and by supporting domestic institutional reforms in developing countries, the donor community can better help these countries reap the benefits of globalization, or at least minimize its negative effects.

Managing labour mobility: a missing pillar of global governance

One of the most visible signs of the process of globalization is the increase in international migratory flows. In 2013, there were about 232 million migrants in the world, which represents over 3.2 per cent of the world population. The percentage does not seem exceptionally high, especially when compared to the proportion of other cross-border economic transactions. However, the social and political relevance of migration goes beyond numbers: migration involves not only production factors, but people—social agents that have rights, motivations and goals.

The international mobility of people is taking place in a regulatory context that is limited and fragmented and that gives ample room for recipient countries to impose their national choices and policies; meanwhile, the room to manoeuvre is very limited for sending countries. In most cases, those policies are too restrictive when it comes to labour immigration, especially with regard to unskilled workers. This restrictive tone contrasts, first, with the increasing liberalization of other economic flows, which illustrates the unbalanced nature of the globalization process currently under way. Since globalization benefits mainly those factors that are mobile (capital over labour and skilled over unskilled workers), restrictive policies on migration tend to accentuate the asymmetries of the international order. Second, the restrictive tone of migratory policies is contrary to the need for labour in developed countries, given the countries' stagnant demographics and ageing populations; it also conflicts with the pressure on young people in developing countries to seek employment and personal growth.

Migration can potentially improve the efficiency and well-being of the overall international economic system, as both theoretical and empirical studies have confirmed (Walmsley and Winters, 2005; World Bank, 2006, among others). History shows, moreover, that migration can, in certain circumstances, be an important force in correcting international inequalities and reducing international wage differences between host and home countries (Hatton and Williamson, 1998 and 2005). In terms of a potential increase in global well-being, the effects of a more liberal regime are, even in their most modest estimates, comparable or superior to those that would result from liberalization of trade in goods (Anderson and Martin, 2005; World Bank, 2006). Additionally, migration is an effective although notably selective means of increasing the possibilities for individuals to better themselves, improving individual income, health, education and living conditions. It is, therefore, an important development factor, especially if we believe that people (not just countries) matter (Clemens, 2010). Of course, migration can also entail costs, not only for the countries of origin (breaking of family structures and loss of human capital, for example) and for the recipient countries (reducing social coherence and increasing congestion in the provision of social services), but also for the migrants themselves. All these costs need to be considered and, to the extent possible, minimized through adequate policies in both countries of origin and host countries.

The recent economic crisis has only worsened the vulnerable situation of many groups of migrants. The economic downturn has led to increased unemployment among migrants (above and beyond that of the native population), stricter conditions for new residents in countries hit by the crisis, and a containment—albeit a limited one—in remittances that migrants send to their families (Alonso, 2013). In addition, and this is the most worrying effect, the crisis has stirred up unease about immigration, causing discriminatory and xenophobic reactions even in countries with well-established democracies. All these factors confirm that international migration should be part of any development agenda and regulated by adequate global mechanisms.

A fragmented and disorderly international order

The importance of migration and the aggravation of the conditions in which it is produced suggest the need to regulate the phenomenon in a coherent way. Initiatives undertaken to date have had very limited success. As a result, what exists are a fragmented set of poorly supported rules and a group of international institutions with partial competencies, overlapping one another with informal mechanisms for dialogue and multiple and varied agreements at a bilateral and regional level (Betts, ed., 2011; Ghosh, ed., 2000).

In the specific case of labour mobility, some international conventions were promoted, but all of them harvested limited support (box 2). A few universal legal instruments also have a bearing on migration. The most important are the fundamental treaties on human rights, listed in box 2, which contain clauses against the many kinds of discrimination. These treaties oblige countries to respect, protect and fulfil human rights of all people, including migrants, regardless of their citizenship status.

In addition to these binding treaties, the status of migrants was tackled by various world summits and their programmes of action promoted by the United Nations. Among them, the Cairo Programme of Action of the International Conference on Population and Development (1994) was the one that most comprehensively considered migration; but migration was also addressed by the Vienna Declaration and Programme of Action on Human Rights (1993), the Beijing Platform of Action of the Fourth World Conference on Women (1995), and, more recently, the Durban Declaration and Programme of Action, approved by the World Conference on Racism, Racial Discrimination, Xenophobia and Related Intolerance (2001).

Box 2

Conventions and agreements relevant for labour mobility

Several international conventions have been negotiated to regulate migration, with limited success. That is the case of the International Labour Organization Convention 97 (1949), ratified by 49 countries, whose central purpose was to tackle labour discrimination against migrants; the ILO Convention 143 (1975), ratified by 23 countries, whose goal was to tackle illegal migration and the clandestine movement of people; and the United Nations International Convention on the Protection of the Rights of all Migrant Workers and Members of their Families (2003), that was endorsed by 47 countries and tries to harmonize some basic principles concerning labour migration.

Additionally, two other conventions should be mentioned, even if they are not strictly related to labour migration: first, the Convention Relating to the Status of Refugee (1954) and its Protocol (1967), which aim to regulate the forced movement of people and conditions for granting asylum; and, second, the Convention against Transnational Organized Crime (2003), with the Protocol to Prevent, Suppress and Punish Trafficking in Persons (2003); and the Protocol against Smuggling of Migrants (2004).

Human rights treaties and conventions also have implications for regulating the status and protection of migrants. The most general of all are doubtlessly the United Nations Charter of 1945 and the Universal Declaration of Human Rights of 1948. However, there are six other regulatory frameworks that are relevant to migration: the International Convention on the Elimination of All Forms of Racial Discrimination (1965, signed by 170 countries); the International Covenant on Civil and Political Rights (1966, signed by 154 countries); the International Covenant on Economic, Social and Cultural Rights (1966, signed by 151 countries); the Convention on the Elimination of All Forms of Discrimination against Women (1981, signed by 180 countries); the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment (1987, signed by 139 countries); and the Convention on the Rights of the Child (1990, signed by 192 countries).

The United Nations Secretary-General has promoted diverse initiatives in relation to migration. In 2003, he created the Global Commission on International Migration, which elaborated a comprehensive report that was launched in 2005. In 2006, and in response to the request by the General Assembly (resolutions 59/241 and 60/227), the Secretary-General prepared a report on international migration and development that was presented at the first High-level Dialogue on Migration and Development, organized by the General Assembly with the aim of discussing the effects of international migration and its regulation among Governments, international organizations, civil society and the private sector. In 2013, a second high-level dialogue took place.

Finally, as a result of the first high-level dialogue, and as an attempt to overcome the inertia of the United Nations framework and the unwillingness of Member States to create a formal intergovernmental organ for regular debates on this issue, the Global Forum on Migration and Development was promoted as a platform for informal and non-binding dialogue. The Forum aims to exchange experiences and discuss relevant policies and practical challenges. Between 2007 and 2013, as many as six meetings were organized on themes related to migration.

There have also been several other initiatives to promote regional dialogue on migration, some of them focused on specific aspects of human mobility. Rather than oriented to "norm-dissemination", these regional consultative processes (RCPs) have been primarily engaged in "practice dissemination", attempting to define common standards of good practices relating to regional migration.

The institutional landscape on migration is equally complex and disorderly, with several institutions having partial and overlapping mandates on migration. For example, the International Labour Organization is specialized in the rights of migrant workers; the United Nations High Commissioner for Refugees focuses on the conditions of the refugee and asylum-seeking population; the Office of the United Nations High Commissioner for Human Rights is tasked, among other things, with defending the rights of migrants who have been the victims of traffickers; and the United Nations Educational, Scientific and Cultural Organization, the United Nations Population Fund and the Office of the United Nations Against Drugs and Crime all have mandates involving some specific areas related to migration. Although without normative powers, the Department of Economic and Social Affairs, the United Nations Development Programme and the World Bank are also partly involved in migration. Lastly, the International Organization for Migration (IOM) is specialized in this field, although its mandate is limited and does not belong to the United Nations system. All of these institutions are part of the Global Migration Group (formerly the Geneva Migration Group), which was created with the purpose of facilitating coordination at the international level.

Moving forward

The disorderly and fragmented nature of governance of migration has efficiency costs, since it is more difficult to contemplate the externalities that the national policies generate for other countries. Migration is a global phenomenon, and it requires global responses.

The difficulties of building a global regime in this field rest on two main asymmetries. The first relates to the asymmetries of power between sending and recipient countries, the latter being in a better position for regulating migration. The second is the asymmetric way in which the benefits and the costs of the migratory process are distributed. While benefits are mainly private (captured to a large extent by migrants), the costs are social, affecting both home countries (loss of human capital) and host countries (challenging social cohesion and the access to social services). While beneficiaries in host countries are mainly foreigners, those who may lose out are citizens and voters; this explains why recipient countries are so reluctant to give up their autonomy to regulate in this area. Without question, there are benefits to citizens in host countries that are not always recognized, including contributing human capital, filling jobs that citizens are no longer willing to take, helping to smooth out the effects of population ageing, and making social security and tax contributions. Nevertheless, there is a consensus that more adequate international rules and governance of migratory processes could increase the positive effects (and reduce the negative ones) of migration, sharing its benefits more fairly and guaranteeing the rights of those involved more effectively (Martin, Abella and Kuptsch, 2006; Alonso, 2013).

In order to overcome resistance to building a global regime, a two-track process might be put in place, combining the definition of a framework of minimum standards at the global level with a dynamic of more comprehensive bilateral and regional agreements. The framework should be based on the principles that previous conventions on labour migration have established. It should provide a balanced framework that: (i) recognizes the right that countries have to define the rules of access of non-nationals to their territories, while preserving the greatest possible freedom for people to choose where they want to live and work; (ii) guarantees the rights of people who emigrate, regardless of their administrative status, and allows those in a regular situation to achieve a dignified life in the host country without any discrimination; (iii) accepts that all people have the right to stay in their home country, holding Governments responsible for the consequences of governance that may provoke mass emigration of their citizens; (iv) maximizes the benefits resulting from emigration both for the migrants themselves as well as for the countries involved; and, (v) establishes mechanisms to compensate those that are damaged by the migratory process.

Taking into account these general principles, countries should reduce unnecessary obstacles to migration. However, given that countries face different conditions, that process should be carried out gradually and flexibly, moving towards a progressive liberalization of migratory policies while allowing regulation to be adapted to the circumstances of individual countries. A way to define this process of dialogue and negotiation is by using a system based on a request-offer type of negotiation, similar to that used to liberalize services through the General Agreement on Trade in Services, with countries negotiating on the basis of positive lists of liberalized services, adapted to the conditions in each country (Trachtman, 2009).

At the same time, regional agreements on migration should be encouraged, in some cases taking advantage of the existing regional integration mechanisms. The fact that there is a greater similarity between economies in regional frameworks means that deals on migration would be more feasible. This could facilitate the path to global governance, even if through denser and more diffuse structures and with a set of agreements that would not necessarily be uniform.

Mechanisms of informal dialogue, both globally and regionally, should continue to be supported. RCPs may create a dynamic of coordinated solutions, based on constant exchange of information, addressing issues, dissemination of good practices and formulation of non-binding codes of conduct. These networks might facilitate the environment for more formal supranational agreements.

Finally, regarding the institutional structure to govern labour migration at the global level, the most viable alternative is to start with the IOM, changing its mandate and statute to transform it into a multilateral body integrated within the United Nations system. Since in the last few years the IOM has been increasingly active in the work processes of the

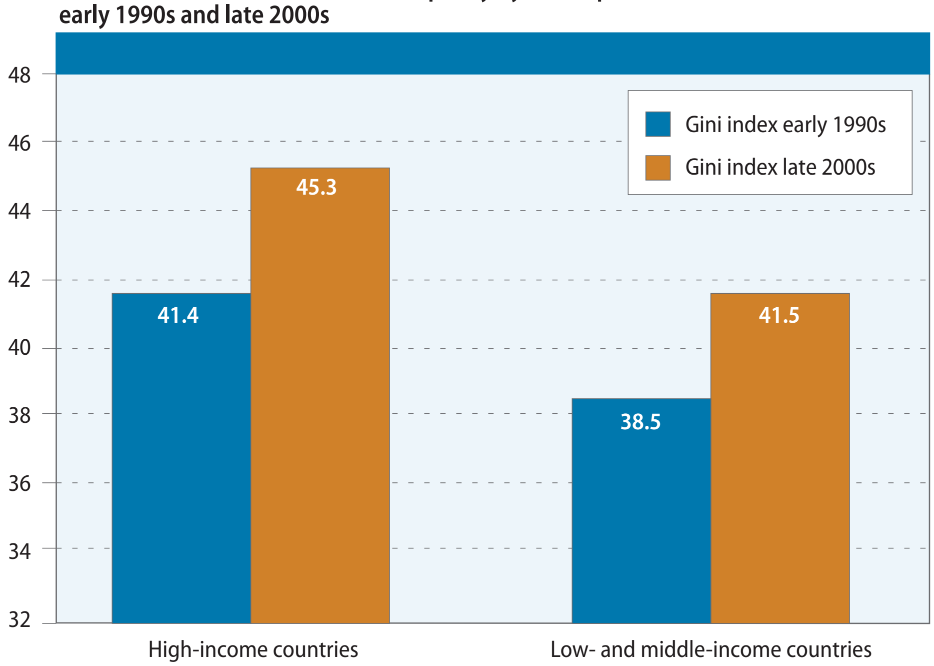
United Nations, much of the work here has already been started. In any case, the IOM should add a standard-setting and monitoring mandate to its current operational mission.

Addressing inequality: why good global governance matters

The subsections above have addressed issues of global governance and inequality between countries. Here we address the links between global governance and inequality within countries.

Experience in recent decades has shown that economic growth has been accompanied by rising inequalities within countries, in both developing and developed countries (figure 7), including not only inequalities among households in terms of income but also in terms of wealth, and multiple economic and social inequalities in relation to gender, ethnicity,

Figure 7
Gini index of household income inequality by development status, early 1990s and late 2000s



Source: UNDP, 2013, Figure 3.1.

age and location (United Nations, 2013a; United Nations Development Programme, 2013a; Piketty, 2014).

For instance, despite the fact that Africa's economic growth has been consistently above 5 percent on average since 2002, the Africa Progress Panel (a group of 10 eminent world leaders led by Kofi Annan) indicated in its 2012 Africa Progress Report that class, gender, regional and rural-urban inequalities are on the rise in many African countries. Among the social groups adversely affected are: households living in poverty in rural and urban areas and in inhospitable agro-climatic zones; food crop farmers, particularly those operating on a small scale or assisting with family farm enterprises; workers in the informal sector, the unemployed (particularly youth who have dropped out of school). Adversely affected groups constitute the majority of the population in Africa.

Growth and rising inequalities are also present in several Asian countries. Inequality increased in countries that account for more than 80 per cent of Asia's population. For developing Asia as a whole, the Gini coefficient rose from 0.39 to 0.46 between the 1990s and the 2000s (Wan, 2013). The pattern of growth has favoured urban areas over rural, certain regions over others (such as coastal areas versus inland areas in China), and capital over labour. Growth has also favoured the more skilled over the less skilled and the more educated over the less educated. In rural areas, access to non-farm sources of income has been a factor in differential incomes.

A few countries, including 18 in Latin America and 4 in South-east Asia, have managed to reduce domestic inequality in the period 2000-2010. Latin American countries have expanded social sector spending substantially since the early 1990s, and the more successful countries also adopted more vigorous education, health and social protection policies (Cornia, 2013). However, while these measures have reversed the growth in inequality in the region and led to a substantial reduction in some countries, inequality remains high and its reduction has recently tended to stagnate in several countries.

The barriers that current levels of inequality pose for achievement of the Millennium Development Goals and for sustainable development in the post-2015 world are by now well-recognized. Such inequality was the subject of one of the eleven global consultations instituted by the United Nations in preparation for the post-2015 development agenda. The significance of growing inequality between people has also been recognized by the corporations that contribute to the World Economic Forum's global risk assessment (World Economic Forum, 2014), which in 2014 found income disparity to be the risk most likely to have an impact on a global scale in the next decade. Inequalities between people reduce the sustainability of economic growth, diminish the productive potential of those who suffer from them and deprive their societies of their full contribution. Moreover, inequalities threaten national cohesion and create insecurity. "Equitable societies promote social capital, social cohesion and stability, trust and tolerance and thereby innovation, economic growth and sustainable development", notes the Chairpersons' summary statement at the Addressing Inequalities in the Post-2015 Development Agenda: Public Dialogue and Leadership Meeting, held in Copenhagen in 2013, hosted by the Governments of Denmark and Ghana (Chairpersons' summary statement, 2013).

Domestic inequality is influenced by national actors and systems of national governance as well as international actors and global governance. To reduce inequalities in income, wealth, capabilities and voice requires better policies at the national level. But improvements in global governance are also required, so as to prevent the establishment of global rules and institutions that generate and/or perpetuate inequality, and to allow Governments the policy space for financial, trade and fiscal policies that support reduction in inequality.

Poor global governance makes it difficult to reduce inequality within countries and can worsen existing inequalities by creating systemic risks that are then downloaded to countries and people with the least capacity to absorb them. Thus, lack of effective global governance in the use of environmental resources means that a large part of the damage created by countries and people who generate high levels of per capita emissions of greenhouse gases are shifted to lower-income countries and people with low levels of emissions per capita, who lack resources to mitigate the damage.

The financial crisis that erupted in 2008 also amply illustrates this creation and transfer of risk. It was a North Atlantic crisis, linked to poor regulation of international banks and financial companies in developed countries, but it spilled over, via international financial markets, into many developing countries, whose policies had played no part in the genesis of the crisis. Some highly paid employees in the financial sector in London and New York lost their jobs, but so did many millions of other people. Between the onset of the crisis and 2012, an estimated 28 million people became unemployed, bringing the global total of unemployed to 200 million. Over half of the increase was in high-income industrialized countries, but developing countries have been increasingly affected, accounting for 75 per cent of the newly unemployed in 2012 (International Labour Organization, 2013). The youth unemployment rate is particularly high, globally standing at 12.6 per cent in 2013, compared to an adult unemployment rate of 4.6 per cent (Ibid., 2013). A study for selected developed countries found that the growth in youth unemployment during the economic crisis raised the Gini coefficient considerably (Morsy, 2012).

Pressure to maintain the confidence of private investors in international financial markets and to comply with conditions attached to loans from the IMF and other international financial institutions has led many Governments to introduce cuts to public expenditure, often falling on basic public services and social protection, not only in Europe, but also in developing countries (United Nations Entity for Gender Equality and the Empowerment of Women, 2014). Basic public services and social security transfers are, of course, vital tools for the reduction of inequality. The capacity of Governments to use them for this purpose has been undermined. As a consequence, new obstacles to progress made in gender equality have emerged, tending to intensify the amount of unpaid work that women have to do to care for families and communities, and making it more difficult for women to cushion their children against the impact of the crisis in many developed and developing countries (Ibid., 2014).

Even in times of no financial crisis, the asymmetric governance of international markets in goods, finance and labour is conducive to inequality among people and undermines the capacity of Governments to reduce inequality through fiscal and regulatory measures. Trade agreements undermine the fiscal capacity of Governments through loss of tariff revenues, which are difficult to replace with revenue from taxation on large corporations because of international capital mobility and lack of effective international tax cooperation. The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) makes it harder for Governments to provide access to essential medicines. Trade and investment agreements operate "behind the border" to restrict the policy space available to Governments to foster structural change, including movement to more inclusive patterns of growth, based on economy-wide increases in labour productivity.

The current structures of asymmetric global governance that make the international movement of capital much easier than the international movement of labour have a number of other adverse impacts on equality. The prospect of capital flight puts pressure on Governments to adopt an over-restrictive fiscal stance, starving basic services of the money they need to ensure everyone has access to good quality services (Stiglitz, 2000). Moreover, capital flight can lead to sharp devaluation of the currency, pushing up prices with particularly adverse impacts on low-income households. In addition, competition to attract FDI is reported to lead to downward pressure on minimum wages and labour standards (United Nations Development Programme, 2013).

Moving forward

Reforms of global governance to support enlargement of the policy space for all Governments to secure sustainable reductions in inequality should therefore:

(i) *Strengthen fiscal capacity*. Higher tax-to-GDP ratios and greater progressivity in taxation and expenditure have been associated with reductions in inequality. Fiscal policy has powerful redistributive potential. Global initiatives need to be taken to: (a) reduce tax avoidance and evasion, including a United Nations Convention to combat both practices; (b) introduce new globally agreed measures, like the financial transactions (Tobin) tax; and (c) change the norms against which tax policies are evaluated, so as to encourage Governments to design progressive fiscal policies. Enhanced and more efficient international tax cooperation is necessary to guarantee positive outcomes in this direction.

(ii) *Facilitate better regulation of finance and capital flows*. Reductions of inequality in the period 2000-2010 were associated with stronger controls on banks and non-bank financial institutions, and controls on international mobility of capital were instrumental in allowing some countries to avoid large swings in economic activity and employment. The recent financial crisis made it clear that global financial reforms are essential. Though some reforms have been adopted, more are required.

(iii) *Enable better cooperation in macroeconomic policy so that the fiscal space to promote greater equality within countries is not undermined by recessionary bias in the international monetary system*. The current prevalence of recessionary bias undermines progress to reduce inequality.

(iv) *Support implementation of internationally agreed social and labour standards, thus also securing greater coherence between global economic governance and the global system of human rights obligations.* In fact, reductions in inequality in some Latin American countries has been associated with policies that did more to comply with these standards, such as increased health and education expenditures, increases in the minimum wage, strengthening of wage bargaining institutions, and improved social protection. The International Labour Organization conventions and human rights treaties set out rights that apply to everyone—citizens and non-citizens alike—and progressively implementing these conventions and treaties is an obligation of all United Nations Member States. Following the principle of responsible sovereignty, countries should also have the obligation to ensure that the policies of any one Government do not damage the capacities of other Governments to realize these rights. Rules and disciplines deriving from international trade and investment agreements have some provisions that make it harder for Governments to meet international social and human rights standards (an example is TRIPS). More must also be done to secure the adherence of non-State actors, such as corporations, to internationally agreed social and labour standards. Implementation of these standards is particularly important for international migrants, who frequently live in countries of which they are not citizens. Moreover, in the context of pluri-ethnic and multicultural societies, a strategy for sustainable development needs to recognize the rights of indigenous communities to land, natural resources, ethnic identity and cultural heritage, as well as their right to participate in relevant decision-making processes.

IV. Global governance for development

Global governance has become a domain with many different players (Alexandroff, 2010; Weiss, 2009) including: multilateral organizations that have a universal character, such as the United Nations General Assembly; elite multilateral groupings such as the Group of Eight (G8) and the Group of Twenty (G20) (Ocampo, 2011); different coalitions relevant to specific policy subjects (such as climate change); informal multilateralism (as exemplified in financial standard-setting bodies) and regional formations (for example, those relating to trade and investment agreements). Also included are activities of the private sector (e.g., the Global Compact) non-governmental organizations (NGOs) and large philanthropic foundations (e.g., Bill and Melinda Gates Foundation, Turner Foundation) and associated global funds to address particular issues) (Anheier, 2000). Participation of several actors is noticeable, for instance, in public heath with the emergence of global health partnerships (United Nations, 2009b).

In this increasingly complex system of global governance, questions arise on how effective these institutions have been in identifying and handling global issues, especially from a development perspective and how these institutions fulfil desirable criteria such as effectiveness, representativeness, participation and transparency, and coherence. This is of particular importance for addressing ongoing and emerging challenges for meeting the Millennium Development Goals (MDGs) in 2015, for securing the reforms for global governance identified above, and for sustainable development in the post-2015 era. In this respect, promoting a global economic governance system with the right balance between legitimacy and effectiveness, built around the principles laid out in Section II of this report, is an essential element in achieving these goals.

Currently, the system of global governance does not meet these criteria. The representativeness, opportunities for participation, and transparency of many of the main actors are open to question. Decision-making processes at the International Monetary Fund and World Bank, for instance, do not give major developing countries a share of voting power corresponding to their increasing relevance in the world economy, while other developing countries seem to have very little or no weight at all. The G20 is a self-appointed group where the participation of Governments of emerging market economies is on their own account, and not on the behalf of other developing countries. NGOs, while providing key impetus and innovative approaches to tackle development issues (Bradford, Jr., 2005), often have governance structures that are not subject to open and democratic accountability. The lack of representativeness, accountability and transparency of corporations (George, 2014) is even more important as corporations have more power and are currently promoting multi-stakeholder governance with a leading role for the private sector (Pingeot, 2014).

Against this background, "the United Nations emerges as an actor with distinct advantages, including the equal representation of its 192 Member States [now 193] under the United Nations Charter" (Deiss, 2010), as an institutional framework for monitoring the implementation of the internationally agreed development goals, including the MDGs, and the post-2015 development goals for achieving sustainable, equitable and inclusive growth. Nevertheless, the key question remains whether the United Nations will function as the main political forum for dealing with socioeconomic issues at the global level, playing a key and effective role in managing global challenges, or whether Member States will leave this role to other forums, including selective, elite multilateral groupings, and multi-stakeholder processes.

Currently, it seems that the United Nations has not been able to provide direction in the solution of global governance problems—perhaps lacking appropriate resources or authority, or both. United Nations bodies, with the exception of the Security Council, cannot make binding decisions. Further, the United Nations system is very fragmented, with scarce resources thinly distributed between competing agencies, each having its own agenda and governance processes. As a result, most global issues do not move forward as expeditiously as needed: there is little progress on climate change or the broader sustainability agenda, and most development goals are only voluntary commitments, with few enforcement mechanisms.

The role of the United Nations

For the United Nations to utilize its distinct advantages, it must strengthen its position in global governance. Its intellectual history suggests that the Organization is the source of many ideas that have led to human progress and to agreed global development goals, particularly through a series of United Nations conferences convened since 1970, and more recently through summits, starting with the 1990 World Summit for Children (Ocampo, 2013). For example, "the concept of human rights, and ideas about social and economic development and environmental sustainability have guided the UN's work in different countries" (Dutt, 2012). If this has been the strength of the United Nations, the weakness has been its accountability mechanisms and even a deficient monitoring of international commitments (Ocampo, 2013).

There have been several proposals on how to enhance the Organization's central role in global governance, as an essential element to achieving a broad development agenda including all dimensions of sustainable development. The key issue here is finding the right balance between representativeness and participation on the one hand, and effectiveness on the other. However, the very condition that generates the greatest legitimacy of the United Nations among all international institutions—the principle of one country, one vote—also makes it quite difficult to get things done. The divergent interests, conflicting incentives and differing values and norms of Member States can seriously impede the ability to move from broad consensus to agreement on operational policymaking and coordinated delivery of measures on the ground.

As a possible way forward towards more effective global governance, the United Nations Commission of Experts on Reform of the International Financial and Monetary System (United Nations, 2009a) recommended to the General Assembly the creation of a new universal, constituency-based economic governance body within the United Nations—a Global Economic Coordination Council at a level equivalent to the General Assembly and the Security Council. This Council would be a democratically representative alternative to the G20, and would aim to "promote development, secure consistency and coherence in the policy goals of the major international organizations and support consensus building among Governments on efficient and effective solutions for issues of global economic governance" and "help set the agenda for global economic and financial reforms" (Ibid.). The new Council would thus secure a more coherent and effective response of the United Nations on issues related to global economic governance. The Commission also put forward an alternative proposal of a body similar to the Intergovernmental Panel on Climate Change, but dealing with economic and social issues. These proposals deserve greater attention. However, there has been no action in this regard; instead the focus has been on reforming the United Nations Economic and Social Council (ECOSOC), the existing mechanism within the United Nations for economic policy coordination.

When ECOSOC was created as one of the main United Nations organs, it was expected to take over the function of coordinating economic and social policymaking across the world and within the United Nations system. However, it has not been able to fulfil this function very effectively, owing in part to the ambiguous relationship between the General Assembly and ECOSOC. Its responsibility for international and social cooperation was to be discharged under the authority of the General Assembly, giving ECOSOC few of the powers the Charter of the United Nations grants to the Security Council (Steven, 2012), which operates independently of the General Assembly. In practice, ECOSOC responsibility has been reduced to the coordination and monitoring of social, economic and environmental issues and related activities of the United Nations system.

ECOSOC has played no role in coordinating and providing guidance for the post-2015 development agenda so far. Instead, the post-2015 process has been largely coordinated directly by the Secretary-General, who sought inputs from within the United Nations system (coordinated by United Nations Department of Economic and Social Affairs), the High-level Panel on Eminent Persons on the Post-2015 Development Agenda, a global conversation with a broader set of actors (coordinated by the United Nations Development Programme), and the Sustainability Development Solutions Network, in which corporations play a leading role (Pingeot, 2014). In turn, at the intergovernmental level, the General Assembly has merged this discussion with the agenda on sustainable development agreed at the 2012 United Nations Conference on Sustainable Development (Rio+20), through the Open Working Group on Sustainable Development Goals. This Open Working Group has emphasized, at its sixth session, “that the United Nations remains the forum for a broad, development-focused discussion of the international financial and economic system, notably in the context of a reinvigorated ECOSOC”. To what extent ECOSOC will provide more than a discussion forum remains to be seen.

Moving forward

There have been periodic initiatives to strengthen ECOSOC, including at the 2005 World Summit, which led to General Assembly resolution 61/16 creating the Annual Ministerial Review and the biennial Development Cooperation Forum. The most recent strengthening of ECOSOC by the General Assembly was the adoption of resolution 68/1 of September 2013, based on the follow-up to resolution 61/16, and given special impetus by the outcome of Rio+20. At Rio+20, Heads of State and Government recognized the key role of ECOSOC in achieving a balanced integration of the three dimensions of sustainable development, elevating the Council’s function as a platform for sustainable development. The annual ministerial meetings of the High-level Political Forum will take place under the auspices of ECOSOC, while the Forum’s meetings at the level of Heads of State will be convened every four years under the General Assembly. This framework raises the visibility of the follow-up to the Sustainable Development Goals (SDGs) and the future post-2015 development agenda (which will hopefully be one and the same) by including high-level government representatives in its deliberations. It also creates a novel mechanism of coordination between the General Assembly and ECOSOC.

ECOSOC, as a principal body for the follow-up on the implementation of the United Nations development agenda, should take on the responsibility for advancement of the reform agenda set out in Section III. It should provide guidance to the work of the entire United Nations system in addressing deficiencies in the current governance in areas requiring improved international cooperation, such as the environment, international monetary and financial architecture, capital and labour flows, trade rules, and inequality. This includes reviewing and improving upon the coherence of existing structures as well as filling the gaps in global governance. These issues should be part of the Council's annual programme of work under the main overarching themes of promoting the balanced integration of the economic social and environmental dimensions of sustainable development, as well as the post-2015 development agenda.

However, if the Council is to be the principal body for the follow-up on the implementation of the United Nations development agenda, its ability to coordinate and guide should be strengthened by appropriate follow-up and monitoring mechanisms for bridging the gap between commitments and the implementation of these commitments. For this, a United Nations led monitoring and accountability mechanism with quantifiable targets and indicators needs to be established for both countries as well as United Nations agencies working on this agenda (United Nations, 2014).

This accountability mechanism would focus on the three dimensions of sustainable development (economic, social and environmental), while taking into account principles that support the development efforts of developing countries and environmental sustainability as presented in this report. It would systematically assess and monitor the effectiveness, representativeness, participation and transparency and coherence of global governance in achieving internationally agreed goals (currently the MDGs, and, in the future, the SDGs and the post-2015 development goals). Such a monitoring and accountability mechanism would provide an important basis for regular discussion of the evaluation at a high political level on how to further improve the outcome of the post-2015 development agenda, both in countries and within the United Nations system. The layout of such a system will require special attention in relation to the quantification of targets (means vs. ends/outcomes), data collection (the availability of data and/or the need for new data sources), and definitions and indicators measuring representativeness, inclusiveness, transparency and coherence of global governance.

Implementation of the post-2015 development agenda ultimately depends on the political will of Member States to carry it through. Therefore, success will depend on whether all countries contribute to the reform of global governance and use their policy space to implement policies that promote the three dimensions of sustainable development in an integrated manner. However, national States have tended to commit themselves to those solutions that are in their narrow national interest or do not interfere with what they perceive as their national sovereignty, and/or those from which they are expecting to maximize their national interest at the expense of others, either by domination or by free-riding (Kaul, 2013). While global challenges continue to be viewed from this narrow perspective, the probability of failing to address them will remain high. The need for responsible sovereignty, one of the five principles presented in Section II above, is more than relevant in this context. In this regard, ECOSOC should take an initiative on how to operationalize this principle. Responsible sovereignty is, no doubt, a necessary condition for States to cooperate in creating the conditions for the realization of internationally recognized rights and freedoms and to act according to the other key principles of global governance put forward in this report: common but differentiated responsibilities, inclusiveness, transparency, accountability and coherence. Likewise, the relevance of the United Nations in global economic governance largely depends on how much Member States are willing to strengthen the Organization, so that it may become a more effective factor in global economic governance for implementing a post-2015 development agenda for the benefit of all.

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Carta *das*

N*ações* U*nidas*

Nações Unidas

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NOTA INTRODUTÓRIA

A Carta das Nações Unidas foi assinada em São Francisco, a 26 de junho de 1945, após o término da Conferência das Nações Unidas sobre Organização Internacional, entrando em vigor a 24 de outubro daquele mesmo ano. O Estatuto da Corte Internacional de Justiça é parte integrante da Carta (*o texto do Estatuto do CIJ pode ser consultado em www.nacoesunidas.org/carta/cij*).

A 17 de dezembro de 1963, a Assembleia Geral aprovou as emendas aos artigos 23, 27 e 61 da Carta, as quais entraram em vigor a 31 de agosto de 1965. Uma posterior emenda ao artigo 61 foi aprovada pela Assembleia Geral a 20 de dezembro de 1971 e entrou em vigor a 24 de setembro de 1973. A emenda do artigo 109, aprovada pela Assembleia Geral a 20 de dezembro de 1965, entrou em vigor a 12 de junho de 1968.

A emenda ao artigo 23 eleva o número de membros do Conselho de Segurança de onze para quinze. O artigo 27 emendado estipula que as decisões do Conselho de Segurança sobre questões de procedimento sejam efetuadas pelo voto afirmativo de nove membros (anteriormente sete) e, sobre todas as demais questões, pelo voto afirmativo de nove membros (anteriormente sete), incluindo-se entre eles os votos dos cinco membros permanentes do Conselho de Segurança.

A emenda ao artigo 61, que entrou em vigor a 31 de agosto de 1965, eleva o número de membros do Conselho Econômico e Social de dezoito para vinte e sete. A emenda subsequente a este artigo, que entrou em vigor a 24 de setembro de 1973, elevou posteriormente o número de membros do Conselho para cinquenta e quatro.

A emenda ao artigo 109, relacionada com o primeiro parágrafo do referido artigo, estipula que uma Conferência Geral de Estados-membros, convocada com a finalidade de rever a Carta, poderá efetuar-se em lugar e data a serem fixados pelo voto de dois terços dos membros da Assembleia Geral e pelo voto de nove membros quaisquer (anteriormente sete) do Conselho de Segurança.

O parágrafo 3 do artigo 109, sobre uma possível revisão da Carta durante a décima sessão da Assembleia Geral, mantém-se em sua forma original, quando se refere a um "voto de sete membros quaisquer do Conselho de Segurança", havendo o referido parágrafo sido aplicado em 1955 pela Assembleia Geral durante sua décima sessão ordinária e pelo Conselho de Segurança.

CARTA DAS NAÇÕES UNIDAS

Preâmbulo

NÓS, OS POVOS DAS NAÇÕES UNIDAS, RESOLVIDOS

a preservar as gerações vindouras do flagelo da guerra, que por duas vezes, no espaço da nossa vida, trouxe sofrimentos indizíveis à humanidade, e a reafirmar a fé nos direitos fundamentais do homem, na dignidade e no valor do ser humano, na igualdade de direito dos homens e das mulheres, assim como das nações grandes e pequenas, e a estabelecer condições sob as quais a justiça e o respeito às obrigações decorrentes de tratados e de outras fontes do direito internacional possam ser mantidos, e a promover o progresso social e melhores condições de vida dentro de uma liberdade ampla.

E PARA TAIS FINS,

praticar a tolerância e viver em paz, uns com os outros, como bons vizinhos, e unir as nossas forças para manter a paz e a segurança internacionais, e a garantir, pela aceitação de princípios e a instituição dos métodos, que a força armada não será usada a não ser no interesse comum, a empregar um mecanismo internacional para promover o progresso econômico e social de todos os povos.

RESOLVEMOS CONJUGAR NOSSOS ESFORÇOS PARA A CONSECUÇÃO DESSES OBJETIVOS.

Em vista disso, nossos respectivos Governos, por intermédio de representantes reunidos na cidade de São Francisco, depois de exibirem seus plenos poderes, que foram achados em boa e devida forma, concordaram com a presente Carta das Nações Unidas e estabelecem, por meio dela, uma organização internacional que será conhecida pelo nome de Nações Unidas.

CAPÍTULO I

PROPÓSITOS E PRINCÍPIOS

Artigo 1

Os propósitos das Nações unidas são:

1. Manter a paz e a segurança internacionais e, para esse fim: tomar, coletivamente, medidas efetivas para evitar ameaças à paz e reprimir os atos de agressão ou outra qualquer ruptura da paz e chegar, por meios pacíficos e de conformidade com os princípios da justiça e do direito internacional, a um ajuste ou solução das controvérsias ou situações que possam levar a uma perturbação da paz;
2. Desenvolver relações amistosas entre as nações, baseadas no respeito ao princípio de igualdade de direitos e de autodeterminação dos povos, e tomar outras medidas apropriadas ao fortalecimento da paz universal;
3. Conseguir uma cooperação internacional para resolver os problemas internacionais de caráter econômico, social, cultural ou humanitário, e para promover e estimular o respeito aos direitos humanos e às liberdades fundamentais para

todos, sem distinção de raça, sexo, língua ou religião; e

4. Ser um centro destinado a harmonizar a ação das nações para a consecução desses objetivos comuns.

Artigo 2

A Organização e seus membros, para a realização dos propósitos mencionados no artigo 1, agirão de acordo com os seguintes Princípios:

1. A Organização é baseada no princípio da igualdade soberana de todos os seus membros.
2. Todos os membros, a fim de assegurarem para todos em geral os direitos e vantagens resultantes de sua qualidade de membros, deverão cumprir de boa fé as obrigações por eles assumidas de acordo com a presente Carta.
3. Todos os membros deverão resolver suas controvérsias internacionais por meios pacíficos, de modo que não sejam ameaçadas a paz, a segurança e a justiça internacionais.
4. Todos os membros deverão evitar em suas relações internacionais a ameaça ou o uso da força contra a integridade territorial ou a

dependência política de qualquer Estado, ou qualquer outra ação incompatível com os Propósitos das Nações Unidas.

5. Todos os membros darão às Nações toda assistência em qualquer ação a que elas recorrerem de acordo com a presente Carta e se absterão de dar auxílio a qual Estado contra o qual as Nações Unidas agirem de modo preventivo ou coercitivo.
6. A Organização fará com que os Estados que não são membros das Nações Unidas ajam de acordo com esses Princípios em tudo quanto for necessário à manutenção da paz e da segurança internacionais.
7. Nenhum dispositivo da presente Carta autorizará as Nações Unidas a intervirem em assuntos que dependam essencialmente da jurisdição de qualquer Estado ou obrigará os membros a submeterem tais assuntos a uma solução, nos termos da presente Carta; este princípio, porém, não prejudicará a aplicação das medidas coercitivas constantes do Capítulo VII.

CAPÍTULO II

DOS MEMBROS

Artigo 3

Os membros originais das Nações Unidas serão os Estados que, tendo participado da Conferência das Nações Unidas sobre a Organização Internacional, realizada em São Francisco, ou, tendo assinado previamente a Declaração das Nações Unidas, de 1 de janeiro de 1942, assinarem a presente Carta, e a ratificarem, de acordo com o artigo 110.

Artigo 4

1. A admissão como membro das Nações Unidas fica aberta a todos os Estados amantes da paz que aceitarem as obrigações contidas na presente Carta e que, a juízo da Organização, estiverem aptos e dispostos a cumprir tais obrigações.
2. A admissão de qualquer desses Estados como membros das Nações Unidas será efetuada por decisão da Assembleia Geral, mediante recomendação do Conselho de Segurança.

Artigo 5

O membro das Nações Unidas, contra o qual for levada a efeito ação preventiva ou coercitiva por parte do Conselho de Segurança, poderá ser suspenso do exercício dos direitos e privilégios de membro pela Assembleia Geral, mediante recomendação do Conselho de Segurança. O exercício desses direitos e privilégios poderá ser restabelecido pelo Conselho de Segurança.

Artigo 6

O membro das Nações Unidas que houver violado persistentemente os Princípios contidos na presente Carta, poderá ser expulso da Organização pela Assembleia Geral mediante recomendação do Conselho de Segurança.

CAPÍTULO III

ÓRGÃOS

Artigo 7

1. Ficam estabelecidos como órgãos principais das Nações Unidas: uma Assembleia Geral, um Conselho de Segurança, um Conselho Econômico e Social, um Conselho de Tutela, uma Corte Internacional de Justiça e um Secretariado.
2. Serão estabelecidos, de acordo com a presente Carta, os órgãos subsidiários considerados de necessidade.

Artigo 8

As Nações Unidas não farão restrições quanto à elegibilidade de homens e mulheres destinados a participar em qualquer caráter e em condições de igualdade em seus órgãos principais e subsidiários.

CAPÍTULO IV

ASSEMBLEIA GERAL

COMPOSIÇÃO

Artigo 9

1. A Assembleia Geral será constituída por todos os membros das Nações Unidas.
2. Cada membro não deverá ter mais de cinco representantes na Assembleia Geral.

FUNÇÕES E ATRIBUIÇÕES

Artigo 10

A Assembleia Geral poderá discutir quaisquer questões ou assuntos que estiverem dentro das finalidades da presente Carta ou que se relacionarem com as atribuições e funções de qualquer dos órgãos nela previstos e, com exceção do estipulado no artigo 12, poderá fazer recomendações aos membros das Nações Unidas ou ao Conselho de Segurança ou a este e àqueles, conjuntamente, com referência a qualquer daquelas questões ou assuntos.

Artigo 11

1. A Assembleia Geral poderá considerar os princípios gerais de cooperação na manutenção da paz e da segurança internacionais, inclusive os princípios que disponham sobre o desarmamento e a regulamentação dos armamentos, e poderá fazer recomendações relativas a tais princípios aos membros ou ao Conselho de Segurança, ou a este e àqueles conjuntamente.
2. A Assembleia Geral poderá discutir quaisquer questões relativas à manutenção da paz e da segurança internacionais, que a ela forem submetidas por qualquer membro das Nações Unidas, ou pelo Conselho de Segurança, ou por um Estado que não seja membro das Nações unidas, de acordo com o artigo 35, parágrafo 2, e, com exceção do que fica estipulado no artigo 12, poderá fazer recomendações relativas a quaisquer destas questões ao Estado ou Estados interessados, ou ao Conselho de Segurança ou a ambos. Qualquer destas questões, para cuja solução for necessária uma ação, será submetida ao Conselho de Segurança pela Assembleia Geral, antes ou depois da discussão.

3. A Assembleia Geral poderá solicitar a atenção do Conselho de Segurança para situações que possam constituir ameaça à paz e à segurança internacionais.
4. As atribuições da Assembleia Geral enumeradas neste artigo não limitarão a finalidade geral do artigo 10.

Artigo 12

1. Enquanto o Conselho de Segurança estiver exercendo, em relação a qualquer controvérsia ou situação, as funções que lhe são atribuídas na presente Carta, a Assembleia Geral não fará nenhuma recomendação a respeito dessa controvérsia ou situação, a menos que o Conselho de Segurança a solicite.
2. O secretário-geral, com o consentimento do Conselho de Segurança, comunicará à Assembleia Geral, em cada sessão, quaisquer assuntos relativos à manutenção da paz e da segurança internacionais que estiverem sendo tratados pelo Conselho de Segurança, e da mesma maneira dará conhecimento de tais assuntos à Assembleia Geral, ou aos membros das Nações Unidas se a Assembleia Geral não estiver em sessão, logo que o Conselho de

Segurança terminar o exame dos referidos assuntos.

Artigo 13

1. A Assembleia Geral iniciará estudos e fará recomendações, destinados a: a) promover cooperação internacional no terreno político e incentivar o desenvolvimento progressivo do direito internacional e a sua codificação; b) promover cooperação internacional nos terrenos econômico, social, cultural, educacional e sanitário e favorecer o pleno gozo dos direitos humanos e das liberdades fundamentais, por parte de todos os povos, sem distinção de raça, sexo, língua ou religião.
2. As demais responsabilidades, funções e atribuições da Assembleia Geral, em relação aos assuntos mencionados no parágrafo 1 (b) acima, estão enumeradas nos Capítulos IX e X.

Artigo 14

A Assembleia Geral sujeita aos dispositivos do artigo 12, poderá recomendar medidas para a solução pacífica de qualquer situação, qualquer que seja sua origem, que lhe pareça prejudicial ao bem-estar geral ou às relações amistosas entre as nações, inclusive em situações que resultem da violação dos dispositivos da presente Carta que estabelecem os Propósitos e Princípios das Nações Unidas.

Artigo 15

1. A Assembleia Geral receberá e examinará os relatórios anuais e especiais do Conselho de Segurança. Esses relatórios incluirão uma relação das medidas que o Conselho de Segurança tenha adotado ou aplicado a fim de manter a paz e a segurança internacionais.
2. A Assembleia Geral receberá e examinará os relatórios dos outros órgãos das Nações Unidas.

Artigo 16

A Assembleia Geral desempenhará, com relação ao sistema internacional de tutela, as funções a ela atribuídas nos Capítulos XII e XIII, inclusive a aprovação de acordos de tutela referentes às zonas não designadas como estratégicas.

Artigo 17

1. A Assembleia Geral considerará e aprovará o orçamento da Organização.
2. As despesas da Organização serão custeadas pelos membros, segundo cotas fixadas pela Assembleia Geral.
3. A Assembleia Geral considerará e aprovará quaisquer ajustes financeiros e orçamentários com as agências especializadas, a que se refere o artigo 57, e examinará os orçamentos administrativos de tais instituições especializadas com o fim de lhes fazer recomendações.

VOTAÇÃO

Artigo 18

1. Cada membro da Assembleia Geral terá um voto.
2. As decisões da Assembleia Geral, em questões importantes, serão tomadas por maioria de dois terços dos membros presentes e votantes. Essas questões compreenderão: recomendações relativas à manutenção da paz e da segurança internacionais; à eleição dos membros não

permanentes do Conselho de Segurança; à eleição dos membros do Conselho Econômico e Social; à eleição dos membros dos Conselho de Tutela, de acordo como parágrafo 1 (c) do artigo 86; à admissão de novos membros das Nações Unidas; à suspensão dos direitos e privilégios de membros; à expulsão dos membros; questões referentes o funcionamento do sistema de tutela e questões orçamentárias.

3. As decisões sobre outras questões, inclusive a determinação de categoria adicionais de assuntos a serem debatidos por uma maioria dos membros presentes e que votem.

Artigo 19

O membro das Nações Unidas que estiver em atraso no pagamento de sua contribuição financeira à Organização não terá voto na Assembleia Geral, se o total de suas contribuições atrasadas igualarem ou excederem a soma das contribuições correspondentes aos dois anos anteriores completos. A Assembleia Geral poderá, entretanto, permitir que o referido membro vote, se ficar provado que a falta de pagamento é devida a condições independentes de sua vontade.

PROCEDIMENTO

Artigo 20

A Assembleia Geral reunir-se-á em sessões anuais regulares e em sessões especiais exigidas pelas circunstâncias. As sessões especiais serão convocadas pelo secretário-geral, a pedido do Conselho de Segurança ou da maioria dos membros das Nações Unidas.

Artigo 21

A Assembleia Geral adotará suas regras de processo e elegerá seu presidente para cada sessão.

Artigo 22

A Assembleia Geral poderá estabelecer os órgãos subsidiários que julgar necessários ao desempenho de suas funções.

CAPÍTULO V

CONSELHO DE SEGURANÇA

COMPOSIÇÃO

Artigo 23

1. O Conselho de Segurança será composto de quinze membros das Nações Unidas. A República da China, a França, a União das Repúblicas Socialistas Soviéticas, o Reino Unido da Grã-Bretanha e Irlanda do Norte, e os Estados Unidos da América serão membros permanentes do Conselho de Segurança. A Assembleia Geral elegerá dez outros membros das Nações Unidas para membros não permanentes do Conselho de Segurança, tendo especialmente em vista, em primeiro lugar, a contribuição dos membros das Nações Unidas para a manutenção da paz e da segurança internacionais e para os outros propósitos da Organização e também a distribuição geográfica equitativa.
2. Os membros não permanentes do Conselho de Segurança serão eleitos por um período de dois anos. Na primeira eleição dos membros não

permanentes do Conselho de Segurança, que se celebre depois do aumento do número de membros do Conselho de Segurança de onze para quinze, dois dos quatro membros novos serão eleitos por um período de um ano. Nenhum membro que termine seu mandato poderá ser reeleito para o período imediato.

3. Cada membro do Conselho de Segurança terá um representante.

FUNÇÕES E ATRIBUIÇÕES

Artigo 24

1. A fim de assegurar pronta e eficaz ação por parte das Nações Unidas, seus membros conferem ao Conselho de Segurança a principal responsabilidade na manutenção da paz e da segurança internacionais e concordam em que no cumprimento dos deveres impostos por essa responsabilidade o Conselho de Segurança aja em nome deles.
2. No cumprimento desses deveres, o Conselho de Segurança agirá de acordo com os Propósitos e Princípios das Nações Unidas. As atribuições específicas do Conselho de Segurança para o

cumprimento desses deveres estão enumeradas nos Capítulos VI, VII, VIII e XII.

3. O Conselho de Segurança submeterá relatórios anuais e, quando necessário, especiais à Assembleia Geral para sua consideração.

Artigos 25

Os membros das Nações Unidas concordam em aceitar e executar as decisões do Conselho de Segurança, de acordo com a presente Carta.

Artigos 26

A fim de promover o estabelecimento e a manutenção da paz e da segurança internacionais, desviando para armamentos o menos possível dos recursos humanos e econômicos do mundo, o Conselho de Segurança terá o encargo de formular, com a assistência da Comissão de Estado-Maior, a que se refere o artigo 47, os planos a serem submetidos aos membros das Nações Unidas, para o estabelecimento de um sistema de regulamentação dos armamentos.

VOTAÇÃO

Artigos 27

1. Cada membro do Conselho de Segurança terá um voto.
2. As decisões do Conselho de Segurança, em questões processuais, serão tomadas pelo voto afirmativo de nove membros.
3. As decisões do Conselho de Segurança, em todos os outros assuntos, serão tomadas pelo voto afirmativo de nove membros, inclusive os votos afirmativos de todos os membros permanentes, ficando estabelecido que, nas decisões previstas no Capítulo VI e no parágrafo 3 do artigo 52, aquele que for parte em uma controvérsia se absterá de votar.

PROCEDIMENTO

Artigo 28

1. O Conselho de Segurança será organizado de maneira que possa funcionar continuamente. Cada membro do Conselho de Segurança será, para tal fim, em todos os momentos, representado na sede da Organização.

2. O Conselho de Segurança terá reuniões periódicas, nas quais cada um de seus membros poderá, se assim o desejar, ser representado por um membro do governo ou por outro representante especialmente designado.
3. O Conselho de Segurança poderá reunir-se em outros lugares, fora da sede da Organização, e que, a seu juízo, possam facilitar o seu trabalho.

Artigo 29

O Conselho de Segurança poderá estabelecer órgãos subsidiários que julgar necessários para o desempenho de suas funções.

Artigo 30

O Conselho de Segurança adotará seu próprio regulamento interno, que incluirá o método de escolha de seu Presidente.

Artigo 31

Qualquer membro das Nações Unidas, que não for membro do Conselho de Segurança, poderá participar, sem direito a voto, na discussão de qualquer questão submetida ao Conselho de Segurança, sempre que este considere que os interesses do referido membro estão especialmente em jogo.

Artigo 32

Qualquer membro das Nações Unidas que não for membro do Conselho de Segurança, ou qualquer Estado que não for membro das Nações Unidas, será convidado, desde que seja parte em uma controvérsia submetida ao Conselho de Segurança, a participar, sem voto, na discussão dessa controvérsia. O Conselho de Segurança determinará as condições que lhe parecerem justas para a participação de um Estado que não for membro das Nações Unidas.

CAPÍTULO VI

SOLUÇÃO PACÍFICA DE CONTROVÉRSIAS

Artigo 33

1. As partes em uma controvérsia, que possa vir a constituir uma ameaça à paz e à segurança internacionais, procurarão, antes de tudo, chegar a uma solução por negociação, inquérito, mediação, conciliação, arbitragem, solução judicial, recurso a organismos ou acordos regionais, ou a qualquer outro meio pacífico à sua escolha.
2. O Conselho de Segurança convidará, quando julgar necessário, as referidas partes a resolver, por tais meios, suas controvérsias.

Artigo 34

O Conselho de Segurança poderá investigar sobre qualquer controvérsia ou situação suscetível de provocar atritos entre as Nações ou dar origem a uma controvérsia, a fim de determinar se a continuação de tal controvérsia ou situação pode constituir ameaça à manutenção da paz e da segurança internacionais.

Artigo 35

1. Qualquer membro das Nações Unidas poderá solicitar a atenção do Conselho de Segurança ou da Assembleia Geral para qualquer controvérsia, ou qualquer situação, da natureza das que se acham previstas no artigo 34.
2. Um Estado que não for membro das Nações Unidas poderá solicitar a atenção do Conselho de Segurança ou da Assembleia Geral para qualquer controvérsia em que seja parte, uma vez que aceite, previamente, em relação a essa controvérsia, as obrigações de solução pacífica previstas na presente Carta.
3. Os atos da Assembleia Geral, a respeito dos assuntos submetidos à sua atenção, de acordo com este artigo, serão sujeitos aos dispositivos dos artigos 11 e 12.

Artigo 36

1. O Conselho de Segurança poderá, em qualquer fase de uma controvérsia da natureza a que se refere o artigo 33, ou de uma situação de natureza semelhante, recomendar procedimentos ou métodos de solução apropriados.

2. O Conselho de Segurança deverá tomar em consideração quaisquer procedimentos para a solução de uma controvérsia que já tenham sido adotados pelas partes.
3. Ao fazer recomendações, de acordo com este artigo, o Conselho de Segurança deverá tomar em consideração que as controvérsias de caráter jurídico devem, em regra geral, ser submetidas pelas partes à Corte Internacional de Justiça, de acordo com os dispositivos do Estatuto da Corte.

Artigo 37

1. No caso em que as partes em controvérsia da natureza a que se refere o artigo 33 não conseguirem resolvê-la pelos meios indicados no mesmo artigo, deverão submetê-la ao Conselho de Segurança.
2. O Conselho de Segurança, caso julgue que a continuação dessa controvérsia poderá realmente constituir uma ameaça à manutenção da paz e da segurança internacionais, decidirá sobre a conveniência de agir de acordo com o artigo 36 ou recomendar as condições que lhe parecerem apropriadas à sua solução.

Artigo 38

Sem prejuízo dos dispositivos dos artigos 33 a 37, o Conselho de Segurança poderá, se todas as partes em uma controvérsia assim o solicitarem, fazer recomendações às partes, tendo em vista uma solução pacífica da controvérsia.

CAPÍTULO VII

AÇÃO RELATIVA A AMEAÇAS À PAZ, RUPTURA DA PAZ E ATOS DE AGRESSÃO

Artigo 39

O Conselho de Segurança determinará a existência de qualquer ameaça à paz, ruptura da paz ou ato de agressão, e fará recomendações ou decidirá que medidas deverão ser tomadas de acordo com os artigos 41 e 42, a fim de manter ou restabelecer a paz e a segurança internacionais.

Artigo 40

A fim de evitar que a situação se agrave, o Conselho de Segurança poderá, antes de fazer as recomendações ou decidir a respeito das medidas previstas no artigo 39, convidar as partes interessadas a aceitarem as medidas provisórias que lhe pareçam necessárias ou aconselháveis. Tais medidas provisórias não prejudicarão os direitos ou pretensões, nem a situação das partes interessadas. O Conselho de Segurança tomará devida nota do não cumprimento dessas medidas.

Artigo 41

O Conselho de Segurança decidirá sobre as medidas que, sem envolver o emprego de forças armadas, deverão ser tomadas para tornar efetivas suas decisões e poderá convidar os membros das Nações Unidas a aplicarem tais medidas. Estas poderão incluir a interrupção completa ou parcial das relações econômicas, dos meios de comunicação ferroviários, marítimos, aéreos, postais, telegráficos, radiofônicos, ou de outra qualquer espécie e o rompimento das relações diplomáticas.

Artigo 42

No caso de o Conselho de Segurança considerar que as medidas previstas no artigo 41 seriam ou demonstraram que são inadequadas, poderá levar e efeito, por meio de forças aéreas, navais ou terrestres, a ação que julgar necessária para manter ou restabelecer a paz e a segurança internacionais. Tal ação poderá compreender demonstrações, bloqueios e outras operações, por parte das forças aéreas, navais ou terrestres dos membros das Nações Unidas.

Artigo 43

1. Todos os membros das Nações Unidas, a fim de contribuir para a manutenção da paz e da segurança internacionais, se comprometem a proporcionar ao Conselho de Segurança, a seu pedido e de conformidade com o acordo ou acordos especiais, forças armadas, assistência e facilidades, inclusive direitos de passagem, necessários à manutenção da paz e da segurança internacionais.
2. Tal acordo ou tais acordos determinarão o número e tipo das forças, seu grau de preparação e sua localização geral, bem como a natureza das facilidades e da assistência a serem proporcionadas.
3. O acordo ou acordos serão negociados o mais cedo possível, por iniciativa do Conselho de Segurança. Serão concluídos entre o Conselho de Segurança e membros da Organização ou entre o Conselho de Segurança e grupos de membros e submetidos à ratificação, pelos Estados signatários, de conformidade com seus respectivos processos constitucionais.

Artigo 44

Quando o Conselho de Segurança decidir o emprego de força, deverá, antes de solicitar a um membro nele não representado o fornecimento de forças armadas em cumprimento das obrigações assumidas em virtude do artigo 43, convidar o referido membro, se este assim o desejar, a participar das decisões do Conselho de Segurança relativas ao emprego de contingentes das forças armadas do dito membro.

Artigo 45

A fim de habilitar as Nações Unidas a tomarem medidas militares urgentes, os membros das Nações Unidas deverão manter imediatamente utilizáveis, contingentes das forças aéreas nacionais para a execução combinada de uma ação coercitiva internacional. A potência e o grau de preparação desses contingentes, como os planos de ação combinada, serão determinados pelo Conselho de Segurança com a assistência da Comissão de Estado-Maior, dentro dos limites estabelecidos no acordo ou acordos especiais a que se refere o artigo 43.

Artigo 46

O Conselho de Segurança, com a assistência da Comissão de Estado-maior, fará planos para a aplicação das forças armadas.

Artigo 47

1. Será estabelecida uma Comissão de Estado-Maior destinada a orientar e assistir o Conselho de Segurança, em todas as questões relativas às exigências militares do mesmo Conselho, para manutenção da paz e da segurança internacionais, utilização e comando das forças colocadas à sua disposição, regulamentação de armamentos e possível desarmamento.
2. A Comissão de Estado-Maior será composta dos Chefes de Estado-Maior dos membros Permanentes do Conselho de Segurança ou de seus representantes. Todo membro das Nações Unidas que não estiver permanentemente representado na Comissão será por esta convidado a tomar parte nos seus trabalhos, sempre que a sua participação for necessária ao eficiente cumprimento das responsabilidades da Comissão.

3. A Comissão de Estado-Maior será responsável, sob a autoridade do Conselho de Segurança, pela direção estratégica de todas as forças armadas postas à disposição do dito Conselho. As questões relativas ao comando dessas forças serão resolvidas ulteriormente.
4. A Comissão de Estado-Maior, com autorização do Conselho de Segurança e depois de consultar os organismos adequados, poderá estabelecer subcomissões regionais.

Artigo 48

1. A ação necessária ao cumprimento das decisões do Conselho de Segurança para manutenção da paz e da segurança internacionais será levada a efeito por todos os membros das Nações Unidas ou por alguns deles, conforme seja determinado pelo Conselho de Segurança.
2. Essas decisões serão executas pelos membros das Nações Unidas diretamente e, por seu intermédio, nos organismos internacionais apropriados de que façam parte.

Artigo 49

Os membros das Nações Unidas prestar-se-ão assistência mútua para a execução das medidas determinadas pelo Conselho de Segurança.

Artigo 50

No caso de serem tomadas medidas preventivas ou coercitivas contra um Estado pelo Conselho de Segurança, qualquer outro Estado, membro ou não das Nações Unidas, que se sinta em presença de problemas especiais de natureza econômica, resultantes da execução daquelas medidas, terá o direito de consultar o Conselho de Segurança a respeito da solução de tais problemas.

Artigo 51

Nada na presente Carta prejudicará o direito inerente de legítima defesa individual ou coletiva no caso de ocorrer um ataque armado contra um membro das Nações Unidas, até que o Conselho de Segurança tenha tomado as medidas necessárias para a manutenção da paz e da segurança internacionais. As medidas tomadas pelos membros no exercício desse direito de legítima defesa serão comunicadas imediatamente ao Conselho de

Segurança e não deverão, de modo algum, atingir a autoridade e a responsabilidade que a presente Carta atribui ao Conselho para levar a efeito, em qualquer tempo, a ação que julgar necessária à manutenção ou ao restabelecimento da paz e da segurança internacionais.

CAPÍTULO VIII

ACORDOS REGIONAIS

Artigo 52

1. Nada na presente Carta impede a existência de acordos ou de organismos regionais, destinadas a tratar dos assuntos relativos à manutenção da paz e da segurança internacionais que forem suscetíveis de uma ação regional, desde que tais acordos ou entidades regionais e suas atividades sejam compatíveis com os Propósitos e Princípios das Nações Unidas.
2. Os membros das Nações Unidas, que forem parte em tais acordos ou que constituírem tais entidades, empregarão todos os esforços para chegar a uma solução pacífica das controvérsias locais por meio desses acordos e entidades

regionais, antes de submetê-las ao Conselho de Segurança.

3. O Conselho de Segurança estimulará o desenvolvimento da solução pacífica de controvérsias locais mediante os referidos acordos ou entidades regionais, por iniciativa dos Estados interessados ou a instância do próprio Conselho de Segurança.
4. Este artigo não prejudica, de modo algum, a aplicação dos artigos 34 e 35.

Artigo 53

1. O Conselho de Segurança utilizará, quando for o caso, tais acordos e entidades regionais para uma ação coercitiva sob a sua própria autoridade. Nenhuma ação coercitiva será, no entanto, levada a efeito de conformidade com acordos ou entidades regionais sem autorização do Conselho de Segurança, com exceção das medidas contra um Estado inimigo como está definido no parágrafo 2 deste artigo, que forem determinadas em consequência do artigo 107 ou em acordos regionais destinados a impedir a renovação de uma política agressiva por parte de qualquer desses Estados, até o momento em que a Organização possa, a pedido dos

Governos interessados, ser incumbida de impedir toda nova agressão por parte de tal Estado.

2. O termo Estado inimigo, usado no parágrafo 1 deste artigo, aplica-se a qualquer Estado que, durante a Segunda Guerra Mundial, foi inimigo de qualquer signatário da presente Carta.

Artigo 54

O Conselho de Segurança será sempre informado de toda ação empreendida ou projetada em conformidade com os acordos ou entidades regionais para manutenção da paz e da segurança internacionais.

CAPÍTULO IX

COOPERAÇÃO INTERNACIONAL ECONÔMICA E SOCIAL

Artigo 55

Com o fim de criar condições de estabilidade e bem-estar, necessárias às relações pacíficas e amistosas entre as Nações, baseadas no respeito ao princípio da igualdade de direitos e da autodeterminação dos povos, as Nações Unidas favorecerão:

a. níveis mais altos de vida, trabalho efetivo e condições de progresso e desenvolvimento econômico e social;
b. a solução dos problemas internacionais econômicos, sociais, sanitários e conexos; a cooperação internacional, de caráter cultural e educacional; e
c. o respeito universal e efetivo raça, sexo, língua ou religião.

Artigo 56

Para a realização dos propósitos enumerados no artigo 55, todos os membros da Organização se comprometem a agir em cooperação com esta, em conjunto ou separadamente.

Artigo 57

1. As várias agências especializadas, criadas por acordos intergovernamentais e com amplas responsabilidades internacionais, definidas em seus instrumentos básicos, nos campos

econômico, social, cultural, educacional, sanitário e conexos, serão vinculadas às Nações Unidas, em conformidade com as disposições do artigo 63.

2. Tais agências assim vinculadas às Nações Unidas serão designadas, daqui por diante, como agências especializadas.

Artigo 58

A Organização fará recomendação para coordenação dos programas e atividades das agências especializadas.

Artigo 59

A Organização, quando julgar conveniente, iniciará negociações entre os Estados interessados para a criação de novas agências especializadas que forem necessárias ao cumprimento dos propósitos enumerados no artigo 55.

Artigo 60

A Assembleia Geral e, sob sua autoridade, o Conselho Econômico e Social, que dispõe, para esse efeito, da competência que lhe é atribuída no Capítulo X, são incumbidos de exercer as funções da Organização estipuladas no presente Capítulo.

CAPÍTULO X

CONSELHO ECONÔMICO E SOCIAL

COMPOSIÇÃO

Artigo 61

1. O Conselho Econômico e Social será composto de cinquenta e quatro membros das Nações Unidas eleitos pela Assembleia Geral.
2. De acordo com os dispositivos do parágrafo 3, dezoito membros do Conselho Econômico e Social serão eleitos cada ano para um período de três anos, podendo, ao terminar esse prazo, ser reeleitos para o período seguinte.
3. Na primeira eleição a realizar-se depois de elevado de vinte e sete para cinquenta e quatro o número de membros do Conselho Econômico e Social, além dos membros que forem eleitos para substituir os nove membros, cujo mandato expira no fim desse ano, serão eleitos outros

vinte e sete membros. O mandato de nove destes vinte e sete membros suplementares assim eleitos expirará no fim de um ano e o de nove outros no fim de dois anos, de acordo com o que for determinado pela Assembleia Geral.

4. Cada membro do Conselho Econômico e social terá nele um representante.

FUNÇÕES E ATRIBUIÇÕES

Artigo 62

1. O Conselho Econômico e Social fará ou iniciará estudos e relatórios a respeito de assuntos internacionais de caráter econômico, social, cultural, educacional, sanitário e conexos e poderá fazer recomendações a respeito de tais assuntos à Assembleia Geral, aos membros das Nações Unidas e às agências especializadas interessadas.
2. Poderá, igualmente, fazer recomendações destinadas a promover o respeito e a observância dos direitos humanos e das liberdades fundamentais para todos.
3. Poderá preparar projetos de convenções a serem submetidos à Assembleia Geral, sobre assuntos de sua competência.

4. Poderá convocar, de acordo com as regras estipuladas pelas Nações Unidas, conferências internacionais sobre assuntos de sua competência.

Artigo 63

1. O Conselho Econômico e Social poderá estabelecer acordos com qualquer das agências a que se refere o artigo 57, a fim de determinar as condições em que a entidade interessada será vinculada às Nações Unidas. Tais acordos serão submetidos à aprovação da Assembleia Geral. 2
2. Poderá coordenar as atividades das agências especializadas, por meio de consultas e recomendações às mesmas e de recomendações à Assembleia Geral e aos membros das Nações Unidas.

Artigo 64

1. O Conselho Econômico e Social poderá tomar as medidas adequadas a fim de obter relatórios regulares das agências especializadas. Poderá entrar em entendimentos com os membros das Nações Unidas e com as agências especializadas, a fim de obter relatórios sobre

as medidas tomadas para cumprimento de suas próprias recomendações e das que forem feitas pelas Assembleia Geral sobre assuntos da competência do Conselho.

2. Poderá comunicar à Assembleia Geral suas observações a respeito desses relatórios.

Artigo 65

O Conselho Econômico e Social poderá fornecer informações ao Conselho de Segurança e, a pedido deste, prestar-lhe assistência.

Artigo 66

1. O Conselho Econômico e Social desempenhará as funções que forem de sua competência em relação ao cumprimento das recomendações da Assembleia Geral.
2. Poderá mediante aprovação da Assembleia Geral, prestar os serviços que lhe forem solicitados pelos membros das Nações Unidas e pelas agências especializadas.
3. Desempenhará as demais funções específicas em outras partes da presente Carta ou as que forem atribuídas pela Assembleia Geral.

VOTAÇÕES

Artigo 67

1. Cada membro do Conselho Econômico e Social terá um voto.
2. As decisões do Conselho Econômico e Social serão tomadas por maioria dos membros presentes e votantes.

PROCEDIMENTO

Artigo 68

O Conselho Econômico e Social criará comissões para os assuntos econômicos e sociais e a proteção dos direitos humanos, assim como outras comissões que forem necessárias para o desempenho de suas funções.

Artigo 69

O Conselho Econômico e Social poderá convidar qualquer membro das Nações Unidas a tomar parte, sem voto, em suas deliberações sobre qualquer assunto que interesse particularmente a esse membro.

Artigo 70

O Conselho Econômico e Social poderá entrar em entendimentos para que representantes das agências especializadas tomem parte, sem voto, em suas deliberações e nas das comissões por ele criadas, e para que os seus próprios representantes tomem parte nas deliberações das agências especializadas.

Artigo 71

O Conselho Econômico e Social poderá entrar nos entendimentos convenientes para a consulta com organizações não governamentais, encarregadas de questões que estiverem dentro da sua própria competência. Tais entendimentos poderão ser feitos com organizações internacionais e, quando for o caso, com organizações nacionais, depois de efetuadas consultas com o membro das Nações Unidas no caso.

Artigo 72

1. O Conselho Econômico e Social adotará seu próprio regulamento, que incluirá o método de escolha de seu Presidente.
2. O Conselho Econômico e Social reunir-se-á quando for necessário, de acordo com o seu

regulamento, o qual deverá incluir disposições referentes à convocação de reuniões a pedido da maioria dos membros.

CAPÍTULO XI

DECLARAÇÃO RELATIVA A TERRITÓRIOS SEM GOVERNO PRÓPRIO

Artigo 73

Os membros das Nações Unidas, que assumiram ou assumam responsabilidades pela administração de territórios cujos povos não tenham atingido a plena capacidade de se governarem a si mesmos, reconhecem o princípio de que os interesses dos habitantes desses territórios são da mais alta importância, e aceitam, como missão sagrada, a obrigação de promover no mais alto grau, dentro do sistema de paz e segurança internacionais estabelecido na presente Carta, o bem-estar dos habitantes desses territórios e, para tal fim, se obrigam a:

a. assegurar, com o devido respeito à cultura dos povos interessados, o seu progresso político, econômico, social e educacional, o seu tratamento equitativo e a sua proteção contra todo abuso;

b. desenvolver sua capacidade de governo próprio, tomar devida nota das aspirações políticas dos povos e auxiliá-los no desenvolvimento progressivo de suas instituições políticas livres, de acordo com as circunstâncias peculiares a cada território e seus habitantes e os diferentes graus de seu adiantamento;

c. consolidar a paz e a segurança internacionais;

d. promover medidas construtivas de desenvolvimento, estimular pesquisas, cooperar uns com os outros e, quando for o caso, com organismos internacionais especializadas, com vistas à realização prática dos propósitos de ordem social, econômica ou científica enumerados neste artigo; e;

e. transmitir regularmente ao secretário-geral, para fins de informação, sujeitas às reservas impostas por considerações de segurança e de ordem constitucional, informações estatísticas ou de outro caráter técnico, relativas às condições econômicas, sociais e educacionais dos territórios pelos quais são respectivamente responsáveis e que não estejam compreendidos entre aqueles a que se referem os Capítulos XII e XIII da Carta.

Artigo 74

Os membros das Nações Unidas concordam também em que a sua política com relação aos territórios a que se aplica o presente Capítulo deve ser baseada, do mesmo modo que a política seguida nos respectivos territórios metropolitanos, no princípio geral de boa vizinhança, tendo na devida conta os interesses e o bem-estar do resto do mundo no que se refere às questões sociais, econômicas e comerciais.

CAPÍTULO XII

SISTEMA INTERNACIONAL DE TUTELA

Artigo 75

As Nações Unidas estabelecerão sob sua autoridade um sistema internacional de tutela para a administração e fiscalização dos territórios que possam ser colocados sob tal sistema em consequência de futuros acordos individuais. Esses territórios serão, daqui em diante, mencionados como territórios tutelados.

Artigo 76

Os objetivos básicos do sistema de tutela, de acordo com os Propósitos das Nações Unidas enumerados no artigo 1 da presente Carta serão:

a. favorecer a paz e a segurança internacionais;
b. fomentar o progresso político, econômico, social e educacional dos habitantes dos territórios tutelados e o seu desenvolvimento progressivo para alcançar governo próprio ou independência, como mais convenha

às circunstâncias particulares de cada território e de seus habitantes e aos desejos livremente expressos dos povos interessados e como for previsto nos termos de cada acordo de tutela;

c. estimular o respeito aos direitos humanos e às liberdades fundamentais para todos, sem distinção de raça, sexo língua ou religião e favorecer o reconhecimento da interdependência de todos os povos; e

d. assegurar igualdade de tratamento nos domínios social, econômico e comercial para todos os membros das Nações Unidas e seus nacionais e, para estes últimos, igual tratamento na administração da justiça, sem prejuízo dos objetivos acima expostos e sob reserva das disposições do artigo 80.

Artigo 77

1. O sistema de tutela será aplicado aos territórios das categorias seguintes, que venham a ser colocados sob tal sistema por meio de acordos de tutela:

    a. territórios atualmente sob mandato;

b. territórios que possam ser separados de Estados inimigos em consequência da Segunda Guerra Mundial; e
c. territórios voluntariamente colocados sob tal sistema por Estados responsáveis pela sua administração.

2. Será objeto de acordo ulterior a determinação dos territórios das categorias acima mencionadas a serem colocados sob o sistema de tutela e das condições em que o serão.

Artigo 78

O sistema de tutela não será aplicado a territórios que se tenham tornado membros das Nações Unidas, cujas relações mútuas deverão basear-se no respeito ao princípio da igualdade soberana.

Artigo 79

As condições de tutela em que cada território será colocado sob este sistema, bem como qualquer alteração ou emenda, serão determinadas por acordo entre os Estados diretamente interessados, inclusive a potência mandatária no caso de território sob mandato de um membro das Nações Unidas e serão aprovadas de conformidade com as disposições dos artigos 83 e 85.

Artigo 80

1. Salvo o que for estabelecido em acordos individuais de tutela, feitos de conformidade com os artigos 77, 79 e 81, pelos quais se coloque cada território sob este sistema e até que tais acordos tenham sido concluídos, nada neste Capítulo será interpretado como alteração de qualquer espécie nos direitos de qualquer Estado ou povo ou dos termos dos atos internacionais vigentes em que os membros das Nações Unidas forem partes.
2. O parágrafo 1 deste artigo não será interpretado como motivo para demora ou adiamento da negociação e conclusão de acordos destinados a colocar territórios dentro do sistema de tutela, conforme as disposições do artigo 77.

Artigo 81

O acordo de tutela deverá, em cada caso, incluir as condições sob as quais o território tutelado será administrado e designar a autoridade que exercerá essa administração. Tal autoridade, daqui por diante chamada a autoridade administradora, poderá ser um ou mais Estados ou a própria Organização.

Artigo 82

Poderão designar-se, em qualquer acordo de tutela, uma ou várias zonas estratégicas, que compreendam parte ou a totalidade do território tutelado a que o mesmo se aplique, sem prejuízo de qualquer acordo ou acordos especiais feitos de conformidade com o artigo 43.

Artigo 83

1. Todas as funções atribuídas às Nações Unidas relativamente às zonas estratégicas, inclusive a aprovação das condições dos acordos de tutela, assim como de sua alteração ou emendas, serão exercidas pelo Conselho de Segurança.
2. Os objetivos básicos enumerados no artigo 76 serão aplicáveis aos habitantes de cada zona estratégica.
3. O Conselho de Segurança, ressalvadas as disposições dos acordos de tutela e sem prejuízo das exigências de segurança, poderá valer-se da assistência do Conselho de Tutela para desempenhar as funções que cabem às Nações Unidas pelo sistema de tutela, relativamente a matérias políticas, econômicas, sociais ou educacionais dentro das zonas estratégicas.

Artigo 84

A autoridade administradora terá o dever de assegurar que o território tutelado preste sua colaboração à manutenção da paz e da segurança internacionais. Para tal fim, a autoridade administradora poderá fazer uso de forças voluntárias, de facilidades e da ajuda do território tutelado para o desempenho das obrigações por ele assumidas a este respeito perante o Conselho de Segurança, assim como para a defesa local e para a manutenção da lei e da ordem dentro do território tutelado.

Artigo 85

1. As funções das Nações Unidas relativas a acordos de tutela para todas as zonas não designadas como estratégias, inclusive a aprovação das condições dos acordos de tutela e de sua alteração ou emenda, serão exercidas pela Assembleia Geral.
2. O Conselho de Tutela, que funcionará sob a autoridade da Assembleia Geral, auxiliará esta no desempenho dessas atribuições.

CAPÍTULO XIII

CONSELHO DE TUTELA

COMPOSIÇÃO

Artigo 86

1. O Conselho de Tutela será composto dos seguintes membros das Nações Unidas:
    a. os membros que administrem territórios tutelados;
    b. aqueles dentre os membros mencionados nominalmente no artigo 23, que não estiverem administrando territórios tutelados; e
    c. quantos outros membros eleitos por um período de três anos, pela Assembleia Geral, sejam necessários para assegurar que o número total de membros do Conselho de Tutela fique igualmente dividido entre os membros das Nações Unidas que administrem territórios tutelados e aqueles que o não fazem.

2. Cada membro do Conselho de Tutela designará uma pessoa especialmente qualificada para representá-lo perante o Conselho.

FUNÇÕES E ATRIBUIÇÕES

Artigo 87

A Assembleia Geral e, sob a sua autoridade, o Conselho de Tutela, no desempenho de suas funções, poderão:

a. examinar os relatórios que lhes tenham sido submetidos pela autoridade administradora;
b. Aceitar petições e examiná-las, em consulta com a autoridade administradora;
c. providenciar visitas periódicas aos territórios tutelados em épocas ficadas de acordo com a autoridade administradora; e
d. tomar estas e outras medidas de conformidade com os termos dos acordos de tutela.

Artigo 88

O Conselho de Tutela formulará um questionário sobre o adiantamento político, econômico, social e educacional dos habitantes de cada território tutelado e a autoridade administradora de cada um destes territórios, dentro da competência da Assembleia Geral, fará um relatório anual à Assembleia, baseado no referido questionário.

VOTAÇÃO

Artigo 89

1. Cada membro do Conselho de Tutela terá um voto.
2. As decisões do Conselho de Tutela serão tomadas por uma maioria dos membros presentes e votantes.

PROCEDIMENTO

Artigo 90

1. O Conselho de Tutela adotará seu próprio regulamento que incluirá o método de escolha de seu Presidente.

2. O Conselho de Tutela reunir-se-á quando for necessário, de acordo com o seu regulamento, que incluirá uma disposição referente à convocação de reuniões a pedido da maioria dos seus membros.

Artigo 91

O Conselho de Tutela valer-se-á, quando for necessário, da colaboração do Conselho Econômico e Social e das agências especializadas, a respeito das matérias em que estas e aquele sejam respectivamente interessados.

CAPÍTULO XIV

CORTE INTERNACIONAL DE JUSTIÇA

Artigo 92

A Corte Internacional de Justiça será o principal órgão judiciário das Nações Unidas. Funcionará de acordo com o Estatuto anexo, que é baseado no Estatuto da Corte Permanente de Justiça Internacional e faz parte integrante da presente Carta.

Artigo 93

1. Todos os membros das Nações Unidas são *ipso facto* partes do Estatuto da Corte Internacional de Justiça.
2. Um Estado que não for membro das Nações Unidas poderá tornar-se parte no Estatuto da Corte Internacional de Justiça, em condições que serão determinadas, em cada caso, pela Assembleia Geral, mediante recomendação do Conselho de Segurança.

Artigo 94

1. Cada membro das Nações Unidas se compromete a conformar-se com a decisão da Corte Internacional de Justiça em qualquer caso em que for parte.
2. Se uma das partes num caso deixar de cumprir as obrigações que lhe incumbem em virtude de sentença proferida pela Corte, a outra terá direito de recorrer ao Conselho de Segurança que poderá, se julgar necessário, fazer recomendações ou decidir sobre medidas a serem tomadas para o cumprimento da sentença.

Artigo 95

Nada na presente Carta impedirá os membros das Nações Unidas de confiarem a solução de suas divergências a outros tribunais, em virtude de acordos já vigentes ou que possam ser concluídos no futuro.

Artigo 96

1. A Assembleia Geral ou o Conselho de Segurança poderá solicitar parecer consultivo da Corte Internacional de Justiça, sobre qualquer questão de ordem jurídica.
2. Outros órgãos das Nações Unidas e agências especializadas, que forem em qualquer época devidamente autorizados pela Assembleia Geral, poderão também solicitar pareceres consultivos da Corte sobre questões jurídicas surgidas dentro da esfera de suas atividades.

CAPÍTULO XV

O SECRETARIADO

Artigo 97

O Secretariado será composto de um secretário-geral e do pessoal exigido pela Organização. O secretário-geral será indicado pela Assembleia Geral mediante a recomendação do Conselho de Segurança. Será o principal funcionário administrativo da Organização.

Artigo 98

O secretário-geral atuará neste caráter em todas as reuniões da Assembleia Geral, do Conselho de Segurança, do Conselho Econômico e Social e do Conselho de Tutela e desempenhará outras funções que lhe forem atribuídas por estes órgãos. O secretário-geral fará um relatório anual à Assembleia Geral sobre os trabalhos da Organização.

Artigo 99

O secretário-geral poderá chamar a atenção do Conselho de Segurança para qualquer assunto que em sua opinião possa ameaçar a manutenção da paz e da segurança internacionais.

Artigo 100

1. No desempenho de seus deveres, o secretário-geral e o pessoal do Secretariado não solicitarão nem receberão instruções de qualquer governo ou de qualquer autoridade estranha à organização. Abster-se-ão de qualquer ação que seja incompatível com a sua posição de funcionários internacionais responsáveis somente perante a Organização.
2. Cada membro das Nações Unidas se compromete a respeitar o caráter exclusivamente internacional das atribuições do secretário-geral e do pessoal do Secretariado e não procurará exercer qualquer influência sobre eles, no desempenho de suas funções.

Artigo 101

1. O pessoal do Secretariado será nomeado pelo secretário-geral, de acordo com regras estabelecidas pela Assembleia Geral.
2. Será também nomeado, em caráter permanente, o pessoal adequado para o Conselho

Econômico e Social, o Conselho de Tutela e, quando for necessário, para outros órgãos das Nações Unidas. Esses funcionários farão parte do Secretariado.

3. A consideração principal que prevalecerá na escolha do pessoal e na determinação das condições de serviço será a da necessidade de assegurar o mais alto grau de eficiência, competência e integridade. Deverá ser levada na devida conta a importância de ser a escolha do pessoal feita dentro do mais amplo critério geográfico possível.

CAPÍTULO XVI

DISPOSIÇÕES DIVERSAS

Artigo 102

1. Todo tratado e todo acordo internacional, concluídos por qualquer membro das Nações Unidas depois da entrada em vigor da presente Carta, deverão, dentro do mais breve prazo possível, ser registrados e publicados pelo Secretariado.

2. Nenhuma parte em qualquer tratado ou acordo internacional que não tenha sido registrado de conformidade com as disposições do parágrafo 1º deste artigo poderá invocar tal tratado ou acordo perante qualquer órgão das Nações Unidas.

Artigo 103

No caso de conflito entre as obrigações dos membros das Nações Unidas, em virtude da presente Carta e as obrigações resultantes de qualquer outro acordo internacional, prevalecerão as obrigações assumidas em virtude da presente Carta.

Artigo 104

A Organização desfrutará, no território de cada um de seus membros, da capacidade jurídica necessária ao exercício de suas funções e à realização de seus propósitos.

Artigo 105

1. A Organização desfrutará, no território de cada um de seus membros, dos privilégios e

imunidades necessários à realização de seus propósitos.

2. Os representantes dos membros das Nações Unidas e os funcionários da Organização desfrutará, igualmente, dos privilégios e imunidades necessários ao exercício independente de sus funções relacionadas com a Organização.
3. A Assembleia Geral poderá fazer recomendações com o fim de determinar os pormenores da aplicação dos parágrafos 1 e 2 deste artigo ou poderá propor aos membros das Nações Unidas convenções nesse sentido.

CAPÍTULO XVII

DISPOSIÇÕES TRANSITÓRIAS SOBRE SEGURANÇA

Artigo 106

Antes da entrada em vigor dos acordos especiais a que se refere o artigo 43, que, a juízo do Conselho de Segurança, o habilitem ao exercício de suas funções previstas no artigo 42, as partes na Declaração das Quatro Nações, assinada em Moscou, a 30 de outubro de

1943, e a França, deverão, de acordo com as disposições do parágrafo 5 daquela Declaração, consultar-se entre si e, sempre que a ocasião o exija, com outros membros das Nações Unidas a fim de ser levada a efeito, em nome da Organização, qualquer ação conjunta que se torne necessária à manutenção da paz e da segurança internacionais.

Artigo 107

Nada na presente Carta invalidará ou impedirá qualquer ação que, em relação a um Estado inimigo de qualquer dos signatários da presente Carta durante a Segunda Guerra Mundial, for levada a efeito ou autorizada em consequência da dita guerra, pelos governos responsáveis por tal ação.

CAPÍTULO XVIII

EMENDAS

Artigo 108

As emendas à presente Carta entrarão em vigor para todos os membros das Nações Unidas, quando forem adotadas pelos votos de dois terços dos membros da

Assembleia Geral e ratificada de acordo com os seus respectivos métodos constitucionais por dois terços dos membros das Nações Unidas, inclusive todos os membros permanentes do Conselho de Segurança.

Artigo 109

1. Uma Conferência Geral dos membros das Nações Unidas, destinada a rever a presente Carta, poderá reunir-se em data e lugar a serem fixados pelo voto de dois terços dos membros da Assembleia Geral e de nove membros quaisquer do Conselho de Segurança. Cada membro das Nações Unidas terá voto nessa Conferência.
2. Qualquer modificação à presente Carta, que for recomendada por dois terços dos votos da Conferência, terá efeito depois de ratificada, de acordo com os respectivos métodos constitucionais, por dois terços dos membros das Nações Unidas, inclusive todos os membros permanentes do Conselho de Segurança.
3. Se essa Conferência não for celebrada antes da décima sessão anual da Assembleia Geral que se seguir à entrada em vigor da presente Carta, a proposta de sua convocação deverá figurar na

agenda da referida sessão da Assembleia Geral, e a Conferência será realizada, se assim for decidido por maioria de votos dos membros da Assembleia Geral, e pelo voto de sete membros quaisquer do Conselho de Segurança.

CAPÍTULO XIX

RATIFICAÇÃO E ASSINATURA

Artigo 110

1. A presente Carta deverá ser ratificada pelos Estados signatários, de acordo com os respectivos métodos constitucionais.
2. As ratificações serão depositadas junto ao Governo dos Estados Unidos da América, que notificará de cada depósito todos os Estados signatários, assim como o secretário-geral da Organização depois que este for escolhido.
3. A presente Carta entrará em vigor depois do depósito de ratificações pela República da China, França, União das Repúblicas Socialistas Soviéticas, Reino Unido da Grã-Bretanha e Irlanda do Norte, e Estados Unidos da América e pela maioria dos outros Estados

signatários. O Governo dos Estados Unidos da América organizará, em seguida, um protocolo das ratificações depositadas, o qual será comunicado, por meio de cópias, aos Estados signatários.

4. Os Estados signatários da presente Carta, que a ratificarem depois de sua entrada em vigor tornar-se-ão membros fundadores das Nações Unidas, na data do depósito de suas respectivas ratificações.

Artigo 111

A presente Carta, cujos textos em chinês, francês, russo, inglês, e espanhol são igualmente autênticos, ficará depositada nos arquivos do Governo dos Estados Unidos da América. Cópias da mesma, devidamente autenticadas, serão transmitidas por este último Governo aos dos outros Estados signatários.

EM FÉ DO QUE os representantes dos governos das Nações Unidas assinaram a presente Carta.

FEITA na cidade de São Francisco aos vinte e seis dias do mês de junho de mil novecentos e quarenta e cinco.

Declaração Universal dos Direitos Humanos

UNIC/Rio/005, Janeiro 2009. (DPI/876)

Estes são os direitos de:

Atribuídos em:

Enunciados pela Organização das Naões Unidas na Declaração Universal dos Direitos Humanos

No dia 10 de dezembro de 1948, a Assembléia Geral das Nações Unidas adotou e proclamou a Declaração Universal dos Direitos Humanos cujo texto, na íntegra, pode ser lido a seguir. Logo após, a Assembléia Geral solicitou a todos os Países - Membros que publicassem o texto da Declaração"para que ele fosse divulgado, mostrado, lido e explicado, principalmente nas escolas e em outras instituições educacionais, sem distinção nehuma baseada na situação política ou econômica dos Países ou Estados."

DECLARAÇÃO UNIVERSAL DOS
DIREITOS HUMANOS

Preâmbulo

Considerando que o reconhecimento da dignidade inerente a todos os membros da família humana e de seus direitos iguais e inalienáveis é o fundamento da liberdade, da justiça e da paz no mundo,

Considerando que o desprezo e o desrespeito pelos direitos humanos resultaram em atos bárbaros que ultrajaram a consciência da Humanidade e que o advento de um mundo em que os todos gozem de liberdade de palavra, de crença e da liberdade de viverem a salvo do temor e da necessidade foi proclamado como a mais alta aspiração do ser humano comum,

Considerando ser essencial que os direitos humanos sejam protegidos pelo império da lei, para que o ser humano não seja compelido, como último recurso, à rebelião contra a tirania e a opressão,

Considerando ser essencial promover o desenvolvimento de relações amistosas entre as nações,

Considerando que os povos das Nações Unidas reafirmaram, na Carta da ONU, sua fé nos direitos humanos fundamentais, na dignidade e no valor do ser humano e na igualdade de direitos entre homens e mulheres, e que decidiram promover o progresso social e melhores condições de vida em uma liberdade mais ampla,

Considerando que os Estados-Membros se comprometeram a promover, em cooperação com as Nações Unidas, o respeito universal aos direitos e liberdades humanas fundamentais e a observância desses direitos e liberdades,

Considerando que uma compreensão comum desses direitos e liberdades é da mais alta importância para o pleno cumprimento desse compromisso, Agora portanto

A ASSEMBLÉIA GERAL

proclama

A PRESENTE DECLARAÇÃO UNIVERSAL DOS DIREITOS HUMANOS

como o ideal comum a ser atingido por todos os povos e todas as nações, com o objetivo de que cada indivíduo e cada órgão da sociedade, tendo sempre em mente esta Declaração, se esforce, através do ensino e da educação, por promover o respeito a esses direitos e liberdades, e, pela adoção de medidas progressivas de caráter nacional e internacional, por assegurar o seu reconhecimento e a sua observância universal e efetiva, tanto entre os povos dos próprios Estados-Membros, quanto entre os povos dos territórios sob sua jurisdição.

Artigo I

Todos os seres humanos nascem livres e iguais em dignidade e direitos. São dotados de razão e consciência e devem agir em relação uns aos outros com espírito de fraternidade.

Artigo II

1 - Todo ser humano tem capacidade para gozar os direitos e as liberdades estabelecidos nesta Declaração, sem distinção de qualquer espécie, seja de raça, cor, sexo, idioma, religião, opinião política ou de outra natureza, origem nacional ou social, riqueza, nascimento, ou qualquer outra condição.

2 - Não será também feita nenhuma distinção fundada na condição política, jurídica ou internacional do país ou território a que pertença uma pessoa, quer se trate de um território independente, sob tutela, sem governo próprio, quer sujeito a qualquer outra limitação de soberania.

Artigo III

Todo ser humano tem direito à vida, à liberdade e à segurança pessoal.

Artigo IV

Ninguém será mantido em escravidão ou servidão; a escravidão e o tráfico de escravos serão proibidos em todas as suas formas.

Artigo V

Ninguém será submetido à tortura nem a tratamento ou castigo cruel, desumano ou degradante.

Artigo VI

Todo ser humano tem o direito de ser, em todos os lugares, reconhecido como pessoa perante a lei.

Artigo VII

Todos são iguais perante a lei e têm direito, sem qualquer distinção, a igual proteção da lei. Todos têm direito a igual proteção contra qualquer discriminação que viole a presente Declaração e contra qualquer incitamento a tal discriminação.

Artigo VIII

Todo ser humano tem direito a receber dos tribunais nacionais competentes remédio efetivo para os atos que violem os direitos fundamentais que lhe sejam reconhecidos pela constituição ou pela lei.

Artigo IX

Ninguém será arbitrariamente preso, detido ou exilado.

Artigo X

Todo ser humano tem direito, em plena igualdade, a uma justa e pública audiência por parte de um tribunal independente e imparcial, para decidir sobre seus direitos e deveres ou do fundamento de qualquer acusação criminal contra ele.

Artigo XI

1. Todo ser humano acusado de um ato delituoso tem o direito de ser presumido inocente até que a sua culpabilidade tenha sido provada de acordo com a lei, em julgamento público no qual lhe tenham sido asseguradas todas as garantias necessárias à sua defesa.

2. Ninguém poderá ser culpado por qualquer ação ou omissão que, no momento, não constituíam delito perante o direito nacional ou internacional. Também não será imposta

pena mais forte do que aquela que, no momento da prática, era aplicável ao ato delituoso.

Artigo XII

Ninguém será sujeito à interferência em sua vida privada, em sua família, em seu lar ou em sua correspondência, nem a ataque à sua honra e reputação. Todo ser humano tem direito à proteção da lei contra tais interferências ou ataques.

Artigo XIII

1. Todo ser humano tem direito à liberdade de locomoção e residência dentro das fronteiras de cada Estado.

2. Todo ser humano tem o direito de deixar qualquer país, inclusive o próprio, e a este regressar.

Artigo XIV

1. Todo ser humano, vítima de perseguição, tem o direito de procurar e de gozar asilo em outros países.

2. Este direito não pode ser invocado em caso de perseguição legitimamente motivada por crimes de direito comum ou por atos contrários aos objetivos e princípios das Nações Unidas.

Artigo XV

1. Todo homem tem direito a uma nacionalidade.

2. Ninguém será arbitrariamente privado de sua nacionalidade, nem do direito de mudar de nacionalidade.

Artigo XVI

1. Os homens e mulheres de maior idade, sem qualquer restrição de raça, nacionalidade ou religião, têm o direito de contrair matrimônio e fundar uma família. Gozam de iguais direitos em relação ao casamento, sua duração e sua dissolução.

2. O casamento não será válido senão com o livre e pleno consentimento dos nubentes.

3. A família é o núcleo natural e fundamental da sociedade e tem direito à proteção da sociedade e do Estado.

Artigo XVII

1. Todo ser humano tem direito à propriedade, só ou em sociedade com outros.

2. Ninguém será arbitrariamente privado de sua propriedade.

Artigo XVIII

Todo ser humano tem direito à liberdade de pensamento, consciência e religião; este direito inclui a liberdade de mudar de religião ou crença e a liberdade de manifestar essa religião ou crença, pelo ensino, pela prática, pelo culto e pela observância, em público ou em particular.

Artigo XIX

Todo ser humano tem direito à liberdade de opinião e expressão; este direito inclui a liberdade de, sem interferência, ter opiniões e de procurar, receber e transmitir informações e idéias por quaisquer meios e

independentemente de fronteiras.

Artigo XX

1. Todo ser humano tem direito à liberdade de reunião e associação pacífica.

2. Ninguém pode ser obrigado a fazer parte de uma associação.

Artigo XXI

1. Todo ser humano tem o direito de fazer parte no governo de seu país diretamente ou por intermédio de representantes livremente escolhidos.

2. Todo ser humano tem igual direito de acesso ao serviço público do seu país.

3. A vontade do povo será a base da autoridade do governo; esta vontade será expressa em eleições periódicas e legítimas, por sufrágio universal, por voto secreto ou processo equivalente que assegure a liberdade de voto.

Artigo XXII

Todo ser humano, como membro da sociedade, tem direito à segurança social, à realização pelo esforço nacional, pela cooperação internacional e de acordo com a organização e recursos de cada Estado, dos direitos econômicos, sociais e culturais indispensáveis à sua dignidade e ao livre desenvolvimento da sua personalidade.

Artigo XXIII

1. Todo ser humano tem direito ao trabalho, à livre escolha de emprego, a condições justas e favoráveis de trabalho e à proteção contra o desemprego.

2. Todo ser humano, sem qualquer distinção, tem direito a igual remuneração por igual trabalho.

3. Todo ser humano que trabalha tem direito a uma remuneração justa e satisfatória, que lhe assegure, assim como à sua família, uma existência compatível com a dignidade humana e a que se acrescentarão, se necessário, outros meios de proteção social.

4. Todo ser humano tem direito a organizar sindicatos e a neles ingressar para proteção de seus interesses.

Artigo XXIV

Todo ser humano tem direito a repouso e lazer, inclusive a limitação razoável das horas de trabalho e a férias remuneradas periódicas.

Artigo XXV

1. Todo ser humano tem direito a um padrão de vida capaz de assegurar-lhe, e a sua família, saúde e bem-estar, inclusive alimentação, vestuário, habitação, cuidados médicos e os serviços sociais indispensáveis, e direito à segurança em caso de desemprego, doença, invalidez, viuvez, velhice ou outros casos de perda dos meios de subsistência em circunstâncias fora de seu controle.

2. A maternidade e a infância têm direito a cuidados e assistência especiais. Todas as crianças, nascidas dentro ou fora do matrimônio gozarão da mesma proteção social.

Artigo XXVI

1. Todo ser humano tem direito à instrução. A instrução será gratuita, pelo menos nos graus elementares e fundamentais. A instrução elementar será obrigatória. A instrução técnico-profissional será acessível a todos, bem como a instrução superior, esta baseada no mérito.

2. A instrução será orientada no sentido do pleno desenvolvimento da personalidade humana e do fortalecimento do respeito pelos direitos humanos e pelas liberdades fundamentais. A instrução promoverá a compreensão, a tolerância e a amizade entre todas as nações e grupos raciais ou religiosos, e coadjuvará as atividades das Nações Unidas em prol da manutenção da paz.

3. Os pais têm prioridade de direito na escolha do gênero de instrução que será minis trada a seus filhos.

Artigo XXVII

1. Todo ser humano tem o direito de participar

livremente da vida cultural da comunidade, de fruir das artes e de participar do progresso científico e de seus benefícios.

2. Todo ser humano tem direito à proteção dos interesses morais e materiais decorrentes de qualquer produção científica literária ou artística da qual seja autor.

Artigo XXVIII

Todo ser humano tem direito a uma ordem social e internacional em que os direitos e liberdades estabelecidos na presente Declaração possam ser plenamente realizados.

Artigo XXIX

1. Todo ser humano tem deveres para com a comunidade, na qual o livre e pleno desenvolvimento de sua personalidade é possível.

2. No exercício de seus direitos e liberdades, todo ser humano estará sujeito apenas às limitações determinadas pela lei, exclusivamente com o fim de assegurar

o devido reconhecimento e respeito dos direitos e liberdades de outrem e de satisfazer as justas exigências da moral, da ordem pública e do bem-estar de uma sociedade democrática.

3. Esses direitos e liberdades não podem, em hipótese alguma, ser exercidos contrariamente aos objetivos e princípios das Nações Unidas.

Artigo XXX

Nenhuma disposição da presente Declaração pode ser interpretada como o reconhecimento a qualquer Estado, grupo ou pessoa, do direito de exercer qualquer atividade ou praticar qualquer ato destinado à destruição de quaisquer dos direitos e liberdades aqui estabelecidos.

UNIC / Rio / 005 - Agosto 2009

General Assembly

Distr.: General
18 September 2000

Fifty-fifth session
Agenda item 60 *(b)*

Resolution adopted by the General Assembly

[*without reference to a Main Committee (A/55/L.2)*]

55/2. United Nations Millennium Declaration

The General Assembly

Adopts the following Declaration:

United Nations Millennium Declaration

I. Values and principles

1. We, heads of State and Government, have gathered at United Nations Headquarters in New York from 6 to 8 September 2000, at the dawn of a new millennium, to reaffirm our faith in the Organization and its Charter as indispensable foundations of a more peaceful, prosperous and just world.

2. We recognize that, in addition to our separate responsibilities to our individual societies, we have a collective responsibility to uphold the principles of human dignity, equality and equity at the global level. As leaders we have a duty therefore to all the world’s people, especially the most vulnerable and, in particular, the children of the world, to whom the future belongs.

3. We reaffirm our commitment to the purposes and principles of the Charter of the United Nations, which have proved timeless and universal. Indeed, their relevance and capacity to inspire have increased, as nations and peoples have become increasingly interconnected and interdependent.

4. We are determined to establish a just and lasting peace all over the world in accordance with the purposes and principles of the Charter. We rededicate ourselves to support all efforts to uphold the sovereign equality of all States, respect for their territorial integrity and political independence, resolution of disputes by peaceful means and in conformity with the principles of justice and international law, the right to self-determination of peoples which remain under colonial domination and foreign occupation, non-interference in the internal affairs of States, respect for human rights and fundamental freedoms, respect for the equal rights of all without distinction as to race, sex, language or religion and international cooperation in solving international problems of an economic, social, cultural or humanitarian character.

5. We believe that the central challenge we face today is to ensure that globalization becomes a positive force for all the world's people. For while globalization offers great opportunities, at present its benefits are very unevenly shared, while its costs are unevenly distributed. We recognize that developing countries and countries with economies in transition face special difficulties in responding to this central challenge. Thus, only through broad and sustained efforts to create a shared future, based upon our common humanity in all its diversity, can globalization be made fully inclusive and equitable. These efforts must include policies and measures, at the global level, which correspond to the needs of developing countries and economies in transition and are formulated and implemented with their effective participation.

6. We consider certain fundamental values to be essential to international relations in the twenty-first century. These include:

- **Freedom.** Men and women have the right to live their lives and raise their children in dignity, free from hunger and from the fear of violence, oppression or injustice. Democratic and participatory governance based on the will of the people best assures these rights.
- **Equality.** No individual and no nation must be denied the opportunity to benefit from development. The equal rights and opportunities of women and men must be assured.
- **Solidarity.** Global challenges must be managed in a way that distributes the costs and burdens fairly in accordance with basic principles of equity and social justice. Those who suffer or who benefit least deserve help from those who benefit most.
- **Tolerance.** Human beings must respect one other, in all their diversity of belief, culture and language. Differences within and between societies should be neither feared nor repressed, but cherished as a precious asset of humanity. A culture of peace and dialogue among all civilizations should be actively promoted.
- **Respect for nature.** Prudence must be shown in the management of all living species and natural resources, in accordance with the precepts of sustainable development. Only in this way can the immeasurable riches provided to us by nature be preserved and passed on to our descendants. The current unsustainable patterns of production and consumption must be changed in the interest of our future welfare and that of our descendants.
- **Shared responsibility.** Responsibility for managing worldwide economic and social development, as well as threats to international peace and security, must be shared among the nations of the world and should be exercised multilaterally. As the most universal and most representative organization in the world, the United Nations must play the central role.

7. In order to translate these shared values into actions, we have identified key objectives to which we assign special significance.

II. Peace, security and disarmament

8. We will spare no effort to free our peoples from the scourge of war, whether within or between States, which has claimed more than 5 million lives in the

past decade. We will also seek to eliminate the dangers posed by weapons of mass destruction.

9. We resolve therefore:

- To strengthen respect for the rule of law in international as in national affairs and, in particular, to ensure compliance by Member States with the decisions of the International Court of Justice, in compliance with the Charter of the United Nations, in cases to which they are parties.
- To make the United Nations more effective in maintaining peace and security by giving it the resources and tools it needs for conflict prevention, peaceful resolution of disputes, peacekeeping, post-conflict peace-building and reconstruction. In this context, we take note of the report of the Panel on United Nations Peace Operations[1] and request the General Assembly to consider its recommendations expeditiously.
- To strengthen cooperation between the United Nations and regional organizations, in accordance with the provisions of Chapter VIII of the Charter.
- To ensure the implementation, by States Parties, of treaties in areas such as arms control and disarmament and of international humanitarian law and human rights law, and call upon all States to consider signing and ratifying the Rome Statute of the International Criminal Court.[2]
- To take concerted action against international terrorism, and to accede as soon as possible to all the relevant international conventions.
- To redouble our efforts to implement our commitment to counter the world drug problem.
- To intensify our efforts to fight transnational crime in all its dimensions, including trafficking as well as smuggling in human beings and money laundering.
- To minimize the adverse effects of United Nations economic sanctions on innocent populations, to subject such sanctions regimes to regular reviews and to eliminate the adverse effects of sanctions on third parties.
- To strive for the elimination of weapons of mass destruction, particularly nuclear weapons, and to keep all options open for achieving this aim, including the possibility of convening an international conference to identify ways of eliminating nuclear dangers.
- To take concerted action to end illicit traffic in small arms and light weapons, especially by making arms transfers more transparent and supporting regional disarmament measures, taking account of all the recommendations of the forthcoming United Nations Conference on Illicit Trade in Small Arms and Light Weapons.
- To call on all States to consider acceding to the Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-personnel Mines and

[1] A/55/305-S/2000/809; see *Official Records of the Security Council, Fifty-fifth Year, Supplement for July, August and September 2000*, document S/2000/809.

[2] A/CONF.183/9.

on Their Destruction,[3] as well as the amended mines protocol to the Convention on conventional weapons.[4]

10. We urge Member States to observe the Olympic Truce, individually and collectively, now and in the future, and to support the International Olympic Committee in its efforts to promote peace and human understanding through sport and the Olympic Ideal.

III. Development and poverty eradication

11. We will spare no effort to free our fellow men, women and children from the abject and dehumanizing conditions of extreme poverty, to which more than a billion of them are currently subjected. We are committed to making the right to development a reality for everyone and to freeing the entire human race from want.

12. We resolve therefore to create an environment – at the national and global levels alike – which is conducive to development and to the elimination of poverty.

13. Success in meeting these objectives depends, *inter alia*, on good governance within each country. It also depends on good governance at the international level and on transparency in the financial, monetary and trading systems. We are committed to an open, equitable, rule-based, predictable and non-discriminatory multilateral trading and financial system.

14. We are concerned about the obstacles developing countries face in mobilizing the resources needed to finance their sustained development. We will therefore make every effort to ensure the success of the High-level International and Intergovernmental Event on Financing for Development, to be held in 2001.

15. We also undertake to address the special needs of the least developed countries. In this context, we welcome the Third United Nations Conference on the Least Developed Countries to be held in May 2001 and will endeavour to ensure its success. We call on the industrialized countries:

- To adopt, preferably by the time of that Conference, a policy of duty- and quota-free access for essentially all exports from the least developed countries;
- To implement the enhanced programme of debt relief for the heavily indebted poor countries without further delay and to agree to cancel all official bilateral debts of those countries in return for their making demonstrable commitments to poverty reduction; and
- To grant more generous development assistance, especially to countries that are genuinely making an effort to apply their resources to poverty reduction.

16. We are also determined to deal comprehensively and effectively with the debt problems of low- and middle-income developing countries, through various national and international measures designed to make their debt sustainable in the long term.

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[3] See CD/1478.

[4] Amended protocol on prohibitions or restrictions on the use of mines, booby-traps and other devices (CCW/CONF.I/16 (Part I), annex B).

17. We also resolve to address the special needs of small island developing States, by implementing the Barbados Programme of Action[5] and the outcome of the twenty-second special session of the General Assembly rapidly and in full. We urge the international community to ensure that, in the development of a vulnerability index, the special needs of small island developing States are taken into account.

18. We recognize the special needs and problems of the landlocked developing countries, and urge both bilateral and multilateral donors to increase financial and technical assistance to this group of countries to meet their special development needs and to help them overcome the impediments of geography by improving their transit transport systems.

19. We resolve further:

- To halve, by the year 2015, the proportion of the world's people whose income is less than one dollar a day and the proportion of people who suffer from hunger and, by the same date, to halve the proportion of people who are unable to reach or to afford safe drinking water.
- To ensure that, by the same date, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling and that girls and boys will have equal access to all levels of education.
- By the same date, to have reduced maternal mortality by three quarters, and under-five child mortality by two thirds, of their current rates.
- To have, by then, halted, and begun to reverse, the spread of HIV/AIDS, the scourge of malaria and other major diseases that afflict humanity.
- To provide special assistance to children orphaned by HIV/AIDS.
- By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers as proposed in the "Cities Without Slums" initiative.

20. We also resolve:

- To promote gender equality and the empowerment of women as effective ways to combat poverty, hunger and disease and to stimulate development that is truly sustainable.
- To develop and implement strategies that give young people everywhere a real chance to find decent and productive work.
- To encourage the pharmaceutical industry to make essential drugs more widely available and affordable by all who need them in developing countries.
- To develop strong partnerships with the private sector and with civil society organizations in pursuit of development and poverty eradication.

[5] Programme of Action for the Sustainable Development of Small Island Developing States (*Report of the Global Conference on the Sustainable Development of Small Island Developing States, Bridgetown, Barbados, 25 April-6May 1994* (United Nations publication, Sales No. E.94.I.18 and corrigenda), chap. I, resolution 1, annex II).

- To ensure that the benefits of new technologies, especially information and communication technologies, in conformity with recommendations contained in the ECOSOC 2000 Ministerial Declaration,[6] are available to all.

IV. Protecting our common environment

21. We must spare no effort to free all of humanity, and above all our children and grandchildren, from the threat of living on a planet irredeemably spoilt by human activities, and whose resources would no longer be sufficient for their needs.

22. We reaffirm our support for the principles of sustainable development, including those set out in Agenda 21,[7] agreed upon at the United Nations Conference on Environment and Development.

23. We resolve therefore to adopt in all our environmental actions a new ethic of conservation and stewardship and, as first steps, we resolve:

- To make every effort to ensure the entry into force of the Kyoto Protocol, preferably by the tenth anniversary of the United Nations Conference on Environment and Development in 2002, and to embark on the required reduction in emissions of greenhouse gases.
- To intensify our collective efforts for the management, conservation and sustainable development of all types of forests.
- To press for the full implementation of the Convention on Biological Diversity[8] and the Convention to Combat Desertification in those Countries Experiencing Serious Drought and/or Desertification, particularly in Africa.[9]
- To stop the unsustainable exploitation of water resources by developing water management strategies at the regional, national and local levels, which promote both equitable access and adequate supplies.
- To intensify cooperation to reduce the number and effects of natural and man-made disasters.
- To ensure free access to information on the human genome sequence.

V. Human rights, democracy and good governance

24. We will spare no effort to promote democracy and strengthen the rule of law, as well as respect for all internationally recognized human rights and fundamental freedoms, including the right to development.

25. We resolve therefore:

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[6] E/2000/L.9.

[7] *Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992* (United Nations publication, Sales No. E.93.I.8 and corrigenda), vol. I: *Resolutions adopted by the Conference*, resolution 1, annex II.

[8] See United Nations Environment Programme, *Convention on Biological Diversity* (Environmental Law and Institution Programme Activity Centre), June 1992.

[9] A/49/84/Add.2, annex, appendix II.

- To respect fully and uphold the Universal Declaration of Human Rights.[10]
- To strive for the full protection and promotion in all our countries of civil, political, economic, social and cultural rights for all.
- To strengthen the capacity of all our countries to implement the principles and practices of democracy and respect for human rights, including minority rights.
- To combat all forms of violence against women and to implement the Convention on the Elimination of All Forms of Discrimination against Women.[11]
- To take measures to ensure respect for and protection of the human rights of migrants, migrant workers and their families, to eliminate the increasing acts of racism and xenophobia in many societies and to promote greater harmony and tolerance in all societies.
- To work collectively for more inclusive political processes, allowing genuine participation by all citizens in all our countries.
- To ensure the freedom of the media to perform their essential role and the right of the public to have access to information.

VI. Protecting the vulnerable

26. We will spare no effort to ensure that children and all civilian populations that suffer disproportionately the consequences of natural disasters, genocide, armed conflicts and other humanitarian emergencies are given every assistance and protection so that they can resume normal life as soon as possible.

We resolve therefore:

- To expand and strengthen the protection of civilians in complex emergencies, in conformity with international humanitarian law.
- To strengthen international cooperation, including burden sharing in, and the coordination of humanitarian assistance to, countries hosting refugees and to help all refugees and displaced persons to return voluntarily to their homes, in safety and dignity and to be smoothly reintegrated into their societies.
- To encourage the ratification and full implementation of the Convention on the Rights of the Child[12] and its optional protocols on the involvement of children in armed conflict and on the sale of children, child prostitution and child pornography.[13]

VII. Meeting the special needs of Africa

27. We will support the consolidation of democracy in Africa and assist Africans in their struggle for lasting peace, poverty eradication and sustainable development, thereby bringing Africa into the mainstream of the world economy.

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[10] Resolution 217 A (III).

[11] Resolution 34/180, annex.

[12] Resolution 44/25, annex.

[13] Resolution 54/263, annexes I and II.

28. We resolve therefore:

- To give full support to the political and institutional structures of emerging democracies in Africa.
- To encourage and sustain regional and subregional mechanisms for preventing conflict and promoting political stability, and to ensure a reliable flow of resources for peacekeeping operations on the continent.
- To take special measures to address the challenges of poverty eradication and sustainable development in Africa, including debt cancellation, improved market access, enhanced Official Development Assistance and increased flows of Foreign Direct Investment, as well as transfers of technology.
- To help Africa build up its capacity to tackle the spread of the HIV/AIDS pandemic and other infectious diseases.

VIII. Strengthening the United Nations

29. We will spare no effort to make the United Nations a more effective instrument for pursuing all of these priorities: the fight for development for all the peoples of the world, the fight against poverty, ignorance and disease; the fight against injustice; the fight against violence, terror and crime; and the fight against the degradation and destruction of our common home.

30. We resolve therefore:

- To reaffirm the central position of the General Assembly as the chief deliberative, policy-making and representative organ of the United Nations, and to enable it to play that role effectively.
- To intensify our efforts to achieve a comprehensive reform of the Security Council in all its aspects.
- To strengthen further the Economic and Social Council, building on its recent achievements, to help it fulfil the role ascribed to it in the Charter.
- To strengthen the International Court of Justice, in order to ensure justice and the rule of law in international affairs.
- To encourage regular consultations and coordination among the principal organs of the United Nations in pursuit of their functions.
- To ensure that the Organization is provided on a timely and predictable basis with the resources it needs to carry out its mandates.
- To urge the Secretariat to make the best use of those resources, in accordance with clear rules and procedures agreed by the General Assembly, in the interests of all Member States, by adopting the best management practices and technologies available and by concentrating on those tasks that reflect the agreed priorities of Member States.
- To promote adherence to the Convention on the Safety of United Nations and Associated Personnel.[14]

[14] Resolution 49/59, annex.

- To ensure greater policy coherence and better cooperation between the United Nations, its agencies, the Bretton Woods Institutions and the World Trade Organization, as well as other multilateral bodies, with a view to achieving a fully coordinated approach to the problems of peace and development.
- To strengthen further cooperation between the United Nations and national parliaments through their world organization, the Inter-Parliamentary Union, in various fields, including peace and security, economic and social development, international law and human rights and democracy and gender issues.
- To give greater opportunities to the private sector, non-governmental organizations and civil society, in general, to contribute to the realization of the Organization's goals and programmes.

31. We request the General Assembly to review on a regular basis the progress made in implementing the provisions of this Declaration, and ask the Secretary-General to issue periodic reports for consideration by the General Assembly and as a basis for further action.

32. We solemnly reaffirm, on this historic occasion, that the United Nations is the indispensable common house of the entire human family, through which we will seek to realize our universal aspirations for peace, cooperation and development. We therefore pledge our unstinting support for these common objectives and our determination to achieve them.

8th plenary meeting
8 September 2000

International Conference on

Financing for Development

Monterrey, Mexico
18-22 March 2002

Monterrey Consensus on Financing for Development

United Nations

Financing for Development

Monterrey Consensus of the International Conference on Financing for Development

The final text of agreements and commitments adopted at the International Conference on Financing for Development
Monterrey, Mexico, 18-22 March 2002

United Nations • 2003

FOR MORE INFORMATION, PLEASE CONTACT:

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Monterrey Consensus of the International Conference on Financing for Development*

Contents

*Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002 (A/CONF.198/11, chapter 1, resolution 1, annex)

I. Confronting the challenges of financing for development: a global response

1. We the heads of State and Government, gathered in Monterrey, Mexico, on 21 and 22 March 2002, have resolved to address the challenges of financing for development around the world, particularly in developing countries. Our goal is to eradicate poverty, achieve sustained economic growth and promote sustainable development as we advance to a fully inclusive and equitable global economic system.
2. We note with concern current estimates of dramatic shortfalls in resources required to achieve the internationally agreed development goals, including those contained in the United Nations Millennium Declaration.[1]
3. Mobilizing and increasing the effective use of financial resources and achieving the national and international economic conditions needed to fulfil internationally agreed development goals, including those contained in the Millennium Declaration, to eliminate poverty, improve social conditions and raise living standards, and protect our environment, will be our first step to ensuring that the twenty-first century becomes the century of development for all.
4. Achieving the internationally agreed development goals, including those contained in the Millennium Declaration, demands a new partnership between developed and developing countries. We commit ourselves to sound policies, good governance at all levels and the rule of law. We also commit ourselves to mobilizing domestic resources, attracting international flows, promoting international trade as an engine for development, increasing international financial and technical cooperation for development, sustainable debt financing and external debt relief, and enhancing the coherence and consistency of the international monetary, financial and trading systems.
5. The terrorist attacks on 11 September 2001 exacerbated the global economic slowdown, further reducing growth rates. It has now become all the more urgent to enhance collaboration among all stakeholders to promote sustained economic growth and to address the long-term challenges of financing for development. Our resolve to act together is stronger than ever.
6. Each country has primary responsibility for its own economic and social development, and the role of national policies and development strategies cannot be overemphasized. At the same time, domestic economies

[1] General Assembly resolution 55/2.

are now interwoven with the global economic system and, inter alia, the effective use of trade and investment opportunities can help countries to fight poverty. National development efforts need to be supported by an enabling international economic environment. We encourage and support development frameworks initiated at the regional level, such as the New Partnership for Africa's Development and similar efforts in other regions.

7. Globalization offers opportunities and challenges. The developing countries and countries with economies in transition face special difficulties in responding to those challenges and opportunities. Globalization should be fully inclusive and equitable, and there is a strong need for policies and measures at the national and international levels, formulated and implemented with the full and effective participation of developing countries and countries with economies in transition to help them respond effectively to those challenges and opportunities.

8. In the increasingly globalizing interdependent world economy, a holistic approach to the interconnected national, international and systemic challenges of financing for development - sustainable, gender-sensitive, people-centred development - in all parts of the globe is essential. Such an approach must open up opportunities for all and help to ensure that resources are created and used effectively and that strong, accountable institutions are established at all levels. To that end, collective and coherent action is needed in each interrelated area of our agenda, involving all stakeholders in active partnership.

9. Recognizing that peace and development are mutually reinforcing, we are determined to pursue our shared vision for a better future, through our individual efforts combined with vigorous multilateral action. Upholding the Charter of the United Nations and building upon the values of the Millennium Declaration, we commit ourselves to promoting national and global economic systems based on the principles of justice, equity, democracy, participation, transparency, accountability and inclusion.

II. Leading actions

A. Mobilizing domestic financial resources for development

10. In our common pursuit of growth, poverty eradication and sustainable development, a critical challenge is to ensure the necessary internal conditions for mobilizing domestic savings, both public and private, sustaining adequate levels of productive investment and increasing human capacity. A crucial task is to enhance the efficacy, coherence and consis-

tency of macroeconomic policies. An enabling domestic environment is vital for mobilizing domestic resources, increasing productivity, reducing capital flight, encouraging the private sector, and attracting and making effective use of international investment and assistance. Efforts to create such an environment should be supported by the international community.

11. Good governance is essential for sustainable development. Sound economic policies, solid democratic institutions responsive to the needs of the people and improved infrastructure are the basis for sustained economic growth, poverty eradication and employment creation. Freedom, peace and security, domestic stability, respect for human rights, including the right to development, and the rule of law, gender equality, market-oriented policies, and an overall commitment to just and democratic societies are also essential and mutually reinforcing.

12. We will pursue appropriate policy and regulatory frameworks at our respective national levels and in a manner consistent with national laws to encourage public and private initiatives, including at the local level, and foster a dynamic and well functioning business sector, while improving income growth and distribution, raising productivity, empowering women and protecting labour rights and the environment. We recognize that the appropriate role of government in market-oriented economies will vary from country to country.

13. Fighting corruption at all levels is a priority. Corruption is a serious barrier to effective resource mobilization and allocation, and diverts resources away from activities that are vital for poverty eradication and economic and sustainable development.

14. We recognize the need to pursue sound macroeconomic policies aimed at sustaining high rates of economic growth, full employment, poverty eradication, price stability and sustainable fiscal and external balances to ensure that the benefits of growth reach all people, especially the poor. Governments should attach priority to avoiding inflationary distortions and abrupt economic fluctuations that negatively affect income distribution and resource allocation. Along with prudent fiscal and monetary policies, an appropriate exchange rate regime is required.

15. An effective, efficient, transparent and accountable system for mobilizing public resources and managing their use by Governments is essential. We recognize the need to secure fiscal sustainability, along with equitable and efficient tax systems and administration, as well as improvements in public spending that do not crowd out productive private investment. We also recognize the contribution that medium-term fiscal frameworks can make in that respect.

16. Investments in basic economic and social infrastructure, social services and social protection, including education, health, nutrition, shelter and

social security programmes, which take special care of children and older persons and are gender sensitive and fully inclusive of the rural sector and all disadvantaged communities, are vital for enabling people, especially people living in poverty, to better adapt to and benefit from changing economic conditions and opportunities. Active labour market policies, including worker training, can help to increase employment and improve working conditions. The coverage and scope of social protection needs to be further strengthened. Economic crises also underscore the importance of effective social safety nets.

17. We recognize the need to strengthen and develop the domestic financial sector, by encouraging the orderly development of capital markets through sound banking systems and other institutional arrangements aimed at addressing development financing needs, including the insurance sector and debt and equity markets, that encourage and channel savings and foster productive investments. That requires a sound system of financial intermediation, transparent regulatory frameworks and effective supervisory mechanisms, supported by a solid central bank. Guarantee schemes and business development services should be developed for easing the access of small and medium-sized enterprises to local financing.

18. Microfinance and credit for micro-, small and medium-sized enterprises, including in rural areas, particularly for women, as well as national savings schemes, are important for enhancing the social and economic impact of the financial sector. Development banks, commercial and other financial institutions, whether independently or in cooperation, can be effective instruments for facilitating access to finance, including equity financing, for such enterprises, as well as an adequate supply of medium- and long-term credit. In addition, the promotion of private-sector financial innovations and public-private partnerships can also deepen domestic financial markets and further develop the domestic financial sector. The prime objective of pension schemes is social protection, but when those schemes are funded they can also be a source of savings. Bearing in mind economic and social considerations, efforts should be made to incorporate the informal sector into the formal economy, wherever feasible. It is also important to reduce the transfer costs of migrant workers' remittances and create opportunities for development-oriented investments, including housing.

19. It is critical to reinforce national efforts in capacity-building in developing countries and countries with economies in transition in such areas as institutional infrastructure, human resource development, public finance, mortgage finance, financial regulation and supervision, basic education in particular, public administration, social and gender budget policies, early warning and crisis prevention, and debt management. In that regard, par-

ticular attention is required to address the special needs of Africa, the least developed countries, small island developing States and landlocked developing countries. We reaffirm our commitment to the Programme of Action for the Least Developed Countries for the Decade 2001-2010,[2] adopted by the Third United Nations Conference on the Least Developed Countries, held in Brussels from 14 to 20 May 2001, and the Global Programme of Action for the Sustainable Development of Small Island Developing States.[3] International support for those efforts, including technical assistance and through United Nations operational activities for development, is indispensable. We encourage South-South cooperation, including through triangular cooperation, to facilitate exchange of views on successful strategies, practices and experience and replication of projects.

B. Mobilizing international resources for development: foreign direct investment and other private flows

20. Private international capital flows, particularly foreign direct investment, along with international financial stability, are vital complements to national and international development efforts. Foreign direct investment contributes toward financing sustained economic growth over the long term. It is especially important for its potential to transfer knowledge and technology, create jobs, boost overall productivity, enhance competitiveness and entrepreneurship, and ultimately eradicate poverty through economic growth and development. A central challenge, therefore, is to create the necessary domestic and international conditions to facilitate direct investment flows, conducive to achieving national development priorities, to developing countries, particularly Africa, least developed countries, small island developing States, and landlocked developing countries, and also to countries with economies in transition.
21. To attract and enhance inflows of productive capital, countries need to continue their efforts to achieve a transparent, stable and predictable investment climate, with proper contract enforcement and respect for property rights, embedded in sound macroeconomic policies and institutions that allow businesses, both domestic and international, to operate efficiently and profitably and with maximum development impact. Special efforts are required in such priority areas as economic policy and regula-

[2] A/CONF.191/11.
[3] *Report of the Global Conference on the Sustainable Development of Small Island Developing States, Bridgetown, Barbados, 25 April-6 May 1994* (United Nations publication, Sales No. E.94.I.18 and corrigenda), chap. I, resolution 1, annex II.

tory frameworks for promoting and protecting investments, including the areas of human resource development, avoidance of double taxation, corporate governance, accounting standards, and the promotion of a competitive environment. Other mechanisms, such as public/private partnerships and investment agreements, can be important. We emphasize the need for strengthened, adequately resourced technical assistance and productive capacity-building programmes, as requested by recipients.

22. To complement national efforts, there is the need for the relevant international and regional institutions as well as appropriate institutions in source countries to increase their support for private foreign investment in infrastructure development and other priority areas, including projects to bridge the digital divide, in developing countries and countries with economies in transition. To this end, it is important to provide export credits, co-financing, venture capital and other lending instruments, risk guarantees, leveraging aid resources, information on investment opportunities, business development services, forums to facilitate business contacts and cooperation between enterprises of developed and developing countries, as well as funding for feasibility studies. Inter-enterprise partnership is a powerful means for transfer and dissemination of technology. In this regard, strengthening of the multilateral and regional financial and development institutions is desirable. Additional source country measures should also be devised to encourage and facilitate investment flows to developing countries.

23. While Governments provide the framework for their operation, businesses, for their part, are expected to engage as reliable and consistent partners in the development process. We urge businesses to take into account not only the economic and financial but also the developmental, social, gender and environmental implications of their undertakings. In that spirit, we invite banks and other financial institutions, in developing countries as well as developed countries, to foster innovative developmental financing approaches. We welcome all efforts to encourage good corporate citizenship and note the initiative undertaken in the United Nations to promote global partnerships.

24. We will support new public/private sector financing mechanisms, both debt and equity, for developing countries and countries with economies in transition, to benefit in particular small entrepreneurs and small and medium-size enterprises and infrastructure. Those public/private initiatives could include the development of consultation mechanisms between international and regional financial organizations and national Governments with the private sector in both source and recipient countries as a means of creating business-enabling environments.

25. We underscore the need to sustain sufficient and stable private financial flows to developing countries and countries with economies in transition. It is important to promote measures in source and destination countries

to improve transparency and the information about financial flows. Measures that mitigate the impact of excessive volatility of short-term capital flows are important and must be considered. Given each country's varying degree of national capacity, managing national external debt profiles, paying careful attention to currency and liquidity risk, strengthening prudential regulations and supervision of all financial institutions, including highly leveraged institutions, liberalizing capital flows in an orderly and well sequenced process consistent with development objectives, and implementation, on a progressive and voluntary basis, of codes and standards agreed internationally, are also important. We encourage public/private initiatives that enhance the ease of access, accuracy, timeliness and coverage of information on countries and financial markets, which strengthen capacities for risk assessment. Multilateral financial institutions could provide further assistance for all those purposes.

C. International trade as an engine for development

26. A universal, rule-based, open, non-discriminatory and equitable multilateral trading system, as well as meaningful trade liberalization, can substantially stimulate development worldwide, benefiting countries at all stages of development. In that regard, we reaffirm our commitment to trade liberalization and to ensure that trade plays its full part in promoting economic growth, employment and development for all. We thus welcome the decisions of the World Trade Organization to place the needs and interests of developing countries at the heart of its work programme, and commit ourselves to their implementation.
27. To benefit fully from trade, which in many cases is the single most important external source of development financing, the establishment or enhancement of appropriate institutions and policies in developing countries, as well as in countries with economies in transition, is needed. Meaningful trade liberalization is an important element in the sustainable development strategy of a country. Increased trade and foreign direct investment could boost economic growth and could be a significant source of employment.
28. We acknowledge the issues of particular concern to developing countries and countries with economies in transition in international trade to enhance their capacity to finance their development, including trade barriers, trade-distorting subsidies and other trade-distorting measures, particularly in sectors of special export interest to developing countries, including agriculture; the abuse of anti-dumping measures; technical barriers and sanitary and phytosanitary measures; trade liberalization in labour intensive manufactures; trade liberalization in agricultural products; trade in services; tariff peaks, high tariffs and tariff escalation, as well as

non-tariff barriers; the movement of natural persons; the lack of recognition of intellectual property rights for the protection of traditional knowledge and folklore; the transfer of knowledge and technology; the implementation and interpretation of the Agreement on Trade-Related Aspects of Intellectual Property Rights[4] in a manner supportive of public health; and the need for special and differential treatment provisions for developing countries in trade agreements to be made more precise, effective and operational.

29. To ensure that world trade supports development to the benefit of all countries, we encourage the members of the World Trade Organization to implement the outcome of its Fourth Ministerial Conference, held in Doha, Qatar from 9 to 14 November 2001.

30. We also undertake to facilitate the accession of all developing countries, particularly the least developed countries, as well as countries with economies in transition, that apply for membership in the World Trade Organization.

31. We will implement the commitments made in Doha to address the marginalization of the least developed countries in international trade as well as the work programme adopted to examine issues related to the trade of small economies.

32. We also commit ourselves to enhancing the role of regional and subregional agreements and free trade areas, consistent with the multilateral trading system, in the construction of a better world trading system. We urge international financial institutions, including the regional development banks, to continue to support projects that promote subregional and regional integration among developing countries and countries with economies in transition.

33. We recognize the importance of enhanced and predictable access to all markets for the exports of developing countries, including small island developing States, landlocked developing countries, transit developing countries and countries in Africa, as well as countries with economies in transition.

34. We call on developed countries that have not already done so to work towards the objective of duty-free and quota-free access for all least developed countries' exports, as envisaged in the Programme of Action for the Least Developed Countries adopted in Brussels. Consideration of proposals for developing countries to contribute to improved market access for least developed countries would also be helpful.

[4] *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts* (Geneva, GATT secretariat, 1994), annex 1C.

35. We further recognize the importance for developing countries as well as countries with economies in transition of considering reducing trade barriers among themselves.

36. In cooperation with the interested Governments and their financial institutions and to further support national efforts to benefit from trade opportunities and effectively integrate into the multilateral trading system, we invite multilateral and bilateral financial and development institutions to expand and coordinate their efforts, with increased resources, for gradually removing supply-side constraints; improve trade infrastructure; diversify export capacity and support an increase in the technological content of exports; strengthen institutional development and enhance overall productivity and competitiveness. To that end, we further invite bilateral donors and the international and regional financial institutions, together with the relevant United Nations agencies, funds and programmes, to reinforce the support for trade-related training, capacity and institution building and trade-supporting services. Special consideration should be given to least developed countries, landlocked developing countries, small island developing States, African development, transit developing countries and countries with economies in transition, including through the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries and its follow-up, the Joint Integrated Technical Assistance Programme, the World Trade Organization Doha Development Agenda Global Trust Fund, as well as the activities of the International Trade Centre.

37. Multilateral assistance is also needed to mitigate the consequences of depressed export revenues of countries that still depend heavily on commodity exports. Thus, we recognize the recent review of the International Monetary Fund Compensatory Financing Facility and will continue to assess its effectiveness. It is also important to empower developing country commodity producers to insure themselves against risk, including against natural disasters. We further invite bilateral donors and multilateral aid agencies to strengthen their support to export diversification programmes in those countries.

38. In support of the process launched in Doha, immediate attention should go to strengthening and ensuring the meaningful and full participation of developing countries, especially the least developed countries, in multilateral trade negotiations. In particular, developing countries need assistance in order to participate effectively in the World Trade Organization work programme and negotiating process through the enhanced cooperation of all relevant stakeholders, including the United Nations Conference on Trade and Development, the World Trade Organization and the World Bank. To those ends, we underscore the importance of

effective, secure and predictable financing of trade-related technical assistance and capacity-building.

D. Increasing international financial and technical cooperation for development

39. Official development assistance (ODA) plays an essential role as a complement to other sources of financing for development, especially in those countries with the least capacity to attract private direct investment. ODA can help a country to reach adequate levels of domestic resource mobilization over an appropriate time horizon, while human capital, productive and export capacities are enhanced. ODA can be critical for improving the environment for private sector activity and can thus pave the way for robust growth. ODA is also a crucial instrument for supporting education, health, public infrastructure development, agriculture and rural development, and to enhance food security. For many countries in Africa, least developed countries, small island developing States and landlocked developing countries, ODA is still the largest source of external financing and is critical to the achievement of the development goals and targets of the Millennium Declaration and other internationally agreed development targets.

40. Effective partnerships among donors and recipients are based on the recognition of national leadership and ownership of development plans and, within that framework, sound policies and good governance at all levels are necessary to ensure ODA effectiveness. A major priority is to build those development partnerships, particularly in support of the neediest, and to maximize the poverty reduction impact of ODA. The goals, targets and commitments of the Millennium Declaration and other internationally agreed development targets can help countries to set short- and medium-term national priorities as the foundation for building partnerships for external support. In that context, we underline the importance of the United Nations funds, programmes and specialized agencies, and we will strongly support them.

41. We recognize that a substantial increase in ODA and other resources will be required if developing countries are to achieve the internationally agreed development goals and objectives, including those contained in the Millennium Declaration. To build support for ODA, we will cooperate to further improve policies and development strategies, both nationally and internationally, to enhance aid effectiveness.

42. In that context, we urge developed countries that have not done so to make concrete efforts towards the target of 0.7 per cent of gross national product (GNP) as ODA to developing countries and 0.15 to 0.20 per cent of GNP of developed countries to least developed countries, as reconfirmed at the Third United Nations Conference on Least Developed

Countries, and we encourage developing countries to build on progress achieved in ensuring that ODA is used effectively to help achieve development goals and targets. We acknowledge the efforts of all donors, commend those donors whose ODA contributions exceed, reach or are increasing towards the targets, and underline the importance of undertaking to examine the means and time frames for achieving the targets and goals.

43. Recipient and donor countries, as well as international institutions, should strive to make ODA more effective. In particular, there is a need for the multilateral and bilateral financial and development institutions to intensify efforts to:

- Harmonize their operational procedures at the highest standard so as to reduce transaction costs and make ODA disbursement and delivery more flexible, taking into account national development needs and objectives under the ownership of the recipient country;
- Support and enhance recent efforts and initiatives, such as untying aid, including the implementation of the Organisation for Economic Cooperation and Development/Development Assistance Committee recommendation on untying aid to the least developed countries, as agreed by the Organisation for Economic Cooperation and Development in May 2001. Further efforts should be made to address burdensome restrictions;
- Enhance the absorptive capacity and financial management of the recipient countries to utilize aid in order to promote the use of the most suitable aid delivery instruments that are responsive to the needs of developing countries and to the need for resource predictability, including budget support mechanisms, where appropriate, and in a fully consultative manner;
- Use development frameworks that are owned and driven by developing countries and that embody poverty reduction strategies, including poverty reduction strategy papers, as vehicles for aid delivery, upon request;
- Enhance recipient countries' input into and ownership of the design, including procurement, of technical assistance programmes; and increase the effective use of local technical assistance resources;
- Promote the use of ODA to leverage additional financing for development, such as foreign investment, trade and domestic resources;
- Strengthen triangular cooperation, including countries with economies in transition, and South-South cooperation, as delivery tools for assistance;
- Improve ODA targeting to the poor, coordination of aid and measurement of results.

We invite donors to take steps to apply the above measures in support of all developing countries, including immediately in support of the comprehensive strategy that is embodied in the New Partnership for Africa's Development and similar efforts in other regions, as well as in support of least developed countries, small island developing States and landlocked developing countries. We acknowledge and appreciate the discussions taking place in other forums on proposals to increase the concessionality of development financing, including greater use of grants.

44. We recognize the value of exploring innovative sources of finance provided that those sources do not unduly burden developing countries. In that regard, we agree to study, in the appropriate forums, the results of the analysis requested from the Secretary-General on possible innovative sources of finance, noting the proposal to use special drawing rights allocations for development purposes. We consider that any assessment of special drawing rights allocations must respect the International Monetary Fund's Articles of Agreement and the established rules of procedure of the Fund, which requires taking into account the global need for liquidity at the international level.

45. Multilateral and regional development banks continue to play a vital role in serving the development needs of developing countries and countries with economies in transition. They should contribute to providing an adequate supply of finance to countries that are challenged by poverty, follow sound economic policies and may lack adequate access to capital markets. They should also mitigate the impact of excessive volatility of financial markets. Strengthened regional development banks and subregional financial institutions add flexible financial support to national and regional development efforts, enhancing ownership and overall efficiency. They also serve as a vital source of knowledge and expertise on economic growth and development for their developing member countries.

46. We will ensure that the long-term resources at the disposal of the international financial system, including regional and subregional institutions and funds, allow them to adequately support sustained economic and social development, technical assistance for capacity-building, and social and environmental protection schemes. We will also continue to enhance their overall lending effectiveness through increased country ownership, operations that raise productivity and yield measurable results in reducing poverty, and closer coordination with donors and the private sector.

E. External debt

47. Sustainable debt financing is an important element for mobilizing resources for public and private investment. National comprehensive strategies to monitor and manage external liabilities, embedded in the domestic preconditions for debt sustainability, including sound macro-

economic policies and public resource management, are a key element in reducing national vulnerabilities. Debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations. Technical assistance for external debt management and debt tracking can play an important role and should be strengthened.

48. External debt relief can play a key role in liberating resources that can then be directed towards activities consistent with attaining sustainable growth and development, and therefore, debt relief measures should, where appropriate, be pursued vigorously and expeditiously, including within the Paris and London Clubs and other relevant forums. Noting the importance of re-establishing financial viability for those developing countries facing unsustainable debt burdens, we welcome initiatives that have been undertaken to reduce outstanding indebtedness and invite further national and international measures in that regard, including, as appropriate, debt cancellation and other arrangements.

49. The enhanced Heavily Indebted Poor Countries Initiative provides an opportunity to strengthen the economic prospects and poverty reduction efforts of its beneficiary countries. Speedy, effective and full implementation of the enhanced Initiative, which should be fully financed through additional resources, is critical. Heavily indebted poor countries should take the policy measures necessary to become eligible for the Initiative. Future reviews of debt sustainability should also bear in mind the impact of debt relief on progress towards the achievement of the development goals contained in the Millennium Declaration. We stress the importance of continued flexibility with regard to the eligibility criteria. Continued efforts are needed to reduce the debt burden of heavily indebted poor countries to sustainable levels. The computational procedures and assumptions underlying debt sustainability analysis need to be kept under review. Debt sustainability analysis at the completion point needs to take into account any worsening global growth prospects and declining terms of trade. Debt relief arrangements should seek to avoid imposing any unfair burdens on other developing countries.

50. We stress the need for the International Monetary Fund and the World Bank to consider any fundamental changes in countries' debt sustainability caused by natural catastrophes, severe terms of trade shocks or conflict, when making policy recommendations, including for debt relief, as appropriate.

51. While recognizing that a flexible mix of instruments is needed to respond appropriately to countries' different economic circumstances and capacities, we emphasize the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors. We encourage donor countries to take steps to ensure that resources provided for debt relief do not detract from

ODA resources intended to be available for developing countries. We also encourage exploring innovative mechanisms to comprehensively address debt problems of developing countries, including middle-income countries and countries with economies in transition.

F. Addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development

52. In order to complement national development efforts, we recognize the urgent need to enhance coherence, governance, and consistency of the international monetary, financial and trading systems. To contribute to that end, we underline the importance of continuing to improve global economic governance and to strengthen the United Nations leadership role in promoting development. With the same purpose, efforts should be strengthened at the national level to enhance coordination among all relevant ministries and institutions. Similarly, we should encourage policy and programme coordination of international institutions and coherence at the operational and international levels to meet the Millennium Declaration development goals of sustained economic growth, poverty eradication and sustainable development.
53. Important international efforts are under way to reform the international financial architecture. Those efforts need to be sustained with greater transparency and the effective participation of developing countries and countries with economies in transition. One major objective of the reform is to enhance financing for development and poverty eradication. We also underscore our commitment to sound domestic financial sectors, which make a vital contribution to national development efforts, as an important component of an international financial architecture that is supportive of development.
54. Strong coordination of macroeconomic policies among the leading industrial countries is critical to greater global stability and reduced exchange rate volatility, which are essential to economic growth as well as for enhanced and predictable financial flows to developing countries and countries with economies in transition.
55. The multilateral financial institutions, in particular the International Monetary Fund, need to continue to give high priority to the identification and prevention of potential crises and to strengthening the underpinnings of international financial stability. In that regard, we stress the need for the Fund to further strengthen its surveillance activities of all economies, with particular attention to short-term capital flows and their impact. We encourage the International Monetary Fund to facilitate the timely detection of external vulnerability through well designed surveil-

lance and early warning systems and to coordinate closely with relevant regional institutions or organizations, including the regional commissions.

56. We stress the need for multilateral financial institutions, in providing policy advice and financial support, to work on the basis of sound, nationally owned paths of reform that take into account the needs of the poor and efforts to reduce poverty, and to pay due regard to the special needs and implementing capacities of developing countries and countries with economies in transition, aiming at economic growth and sustainable development. The advice should take into account social costs of adjustment programmes, which should be designed to minimize negative impact on the vulnerable segments of society.

57. It is essential to ensure the effective and equitable participation of developing countries in the formulation of financial standards and codes. It is also essential to ensure implementation, on a voluntary and progressive basis, as a contribution to reducing vulnerability to financial crisis and contagion.

58. Sovereign risk assessments made by the private sector should maximize the use of strict, objective and transparent parameters, which can be facilitated by high-quality data and analysis.

59. Noting the impact of financial crisis or risk of contagion in developing countries and countries with economies in transition, regardless of their size, we underline the need to ensure that the international financial institutions, including the International Monetary Fund, have a suitable array of financial facilities and resources to respond in a timely and appropriate way in accordance with their policies. The International Monetary Fund has a range of instruments available and its current financial position is strong. The contingent credit line is an important signal of the strength of countries' policies and a safeguard against contagion in financial markets. The need for special drawing rights allocations should be kept under review. In that regard, we also underline the need to enhance the stabilizing role of regional and subregional reserve funds, swap arrangements and similar mechanisms that complement the efforts of international financial institutions.

60. To promote fair burden-sharing and minimize moral hazard, we would welcome consideration by all relevant stakeholders of an international debt workout mechanism, in the appropriate forums, that will engage debtors and creditors to come together to restructure unsustainable debts in a timely and efficient manner. Adoption of such a mechanism should not preclude emergency financing in times of crisis.

61. Good governance at all levels is also essential for sustained economic growth, poverty eradication and sustainable development worldwide. To better reflect the growth of interdependence and enhance legitimacy, economic governance needs to develop in two areas: broadening the

base for decision-making on issues of development concern and filling organizational gaps. To complement and consolidate advances in those two areas, we must strengthen the United Nations system and other multilateral institutions. We encourage all international organizations to seek to continually improve their operations and interactions.

62. We stress the need to broaden and strengthen the participation of developing countries and countries with economies in transition in international economic decision-making and norm-setting. To those ends, we also welcome further actions to help developing countries and countries with economies in transition to build their capacity to participate effectively in multilateral forums.

63. A first priority is to find pragmatic and innovative ways to further enhance the effective participation of developing countries and countries with economies in transition in international dialogues and decision-making processes. Within the mandates and means of the respective institutions and forums, we encourage the following actions:

- International Monetary Fund and World Bank: to continue to enhance participation of all developing countries and countries with economies in transition in their decision-making, and thereby to strengthen the international dialogue and the work of those institutions as they address the development needs and concerns of these countries;
- World Trade Organization: to ensure that any consultation is representative of its full membership and that participation is based on clear, simple and objective criteria;
- Bank for International Settlements, Basel Committees and Financial Stability Forum: to continue enhancing their outreach and consultation efforts with developing countries and countries with economies in transition at the regional level, and to review their membership, as appropriate, to allow for adequate participation;
- Ad hoc groupings that make policy recommendations with global implications: to continue to improve their outreach to non-member countries, and to enhance collaboration with the multilateral institutions with clearly defined and broad-based intergovernmental mandates.

64. To strengthen the effectiveness of the global economic system's support for development, we encourage the following actions:

- Improve the relationship between the United Nations and the World Trade Organization for development, and strengthen their capacity to provide technical assistance to all countries in need of such assistance;
- Support the International Labour Organization and encourage its ongoing work on the social dimension of globalization;
- Strengthen the coordination of the United Nations system and all other multilateral financial, trade and development institutions to support eco-

nomic growth, poverty eradication and sustainable development worldwide;

- Mainstream the gender perspective into development policies at all levels and in all sectors;
- Strengthen international tax cooperation, through enhanced dialogue among national tax authorities and greater coordination of the work of the concerned multilateral bodies and relevant regional organizations, giving special attention to the needs of developing countries and countries with economies in transition;
- Promote the role of the regional commissions and the regional development banks in supporting policy dialogue among countries at the regional level on macroeconomic, financial, trade and development issues.

65. We commit ourselves to negotiating and finalizing as soon as possible a United Nations convention against corruption in all its aspects, including the question of repatriation of funds illicitly acquired to countries of origin, and also to promoting stronger cooperation to eliminate money-laundering. We encourage States that have not yet done so to consider signature and ratification of the United Nations Convention against Transnational Organized Crime.[5]

66. We urge as a matter of priority all States that have not yet done so to consider becoming parties to the International Convention for the Suppression of the Financing of Terrorism,[6] and call for increased cooperation with the same objective.

67. We attach priority to reinvigorating the United Nations system as fundamental to the promotion of international cooperation for development and to a global economic system that works for all. We reaffirm our commitment to enabling the General Assembly to play effectively its central role as the chief deliberative, policy-making and representative organ of the United Nations, and to further strengthening the Economic and Social Council to enable it to fulfil the role ascribed to it in the Charter of the United Nations.

III. Staying engaged

68. To build a global alliance for development will require an unremitting effort. We thus commit ourselves to keeping fully engaged, nationally, regionally and internationally, to ensuring proper follow-up to the implementation of agreements and commitments reached at the present

[5] General Assembly resolution 55/25.
[6] General Assembly resolution 54/109, annex.

Conference, and to continuing to build bridges between development, finance, and trade organizations and initiatives, within the framework of the holistic agenda of the Conference. Greater cooperation among existing institutions is needed, based on a clear understanding and respect for their respective mandates and governance structures.

69. Building on the successful experience of the Conference and the process leading up to it, we shall strengthen and make fuller use of the General Assembly and the Economic and Social Council, as well as the relevant intergovernmental/governing bodies of other institutional stakeholders, for the purposes of conference follow-up and coordination, by substantively connecting, in ascending series, the following elements:

(a) Interactions between representatives of the Economic and Social Council and the directors of the executive boards of the World Bank and the International Monetary Fund can serve as preliminary exchanges on matters related to follow-up to the Conference and preparations for the annual spring meeting between those institutions. Similar interactions can also be initiated with representatives of the appropriate intergovernmental body of the World Trade Organization;

(b) We encourage the United Nations, the World Bank and the International Monetary Fund, with the World Trade Organization, to address issues of coherence, coordination and cooperation, as a follow-up to the Conference, at the spring meeting between the Economic and Social Council and the Bretton Woods institutions. The meeting should include an intergovernmental segment to address an agenda agreed to by the participating organizations, as well as a dialogue with civil society and the private sector;

(c) The current high-level dialogue on strengthening international cooperation for development through partnership, held every two years in the General Assembly, would consider the financing for development-related reports coming from the Economic and Social Council and other bodies, as well as other financing for development-related issues. It would be reconstituted to enable it to become the intergovernmental focal point for the general follow-up to the Conference and related issues. The high-level dialogue would include a policy dialogue, with the participation of the relevant stakeholders, on the implementation of the results of the Conference, including the theme of coherence and consistency of the international monetary, financial and trading systems in support of development;

(d) Appropriate modalities to enable participation in the reconstituted high-level dialogue by all relevant stakeholders, as necessary, will be considered.

70. To support the above elements at the national, regional and international levels, we resolve:

- To continue to improve our domestic policy coherence through the continued engagement of our ministries of development, finance, trade and foreign affairs, as well as our central banks;
- To harness the active support of the regional commissions and the regional development banks;
- To keep the financing for development process on the agenda of the intergovernmental bodies of all main stakeholders, including all United Nations funds, programmes and agencies, including the United Nations Conference on Trade and Development.

71. We recognize the link between financing of development and attaining internationally agreed development goals and objectives, including those contained in the Millennium Declaration, in measuring development progress and helping to guide development priorities. We welcome in that regard the intention of the United Nations to prepare a report annually. We encourage close cooperation between the United Nations, the World Bank, the International Monetary Fund and the World Trade Organization in the preparation of that report. We shall support the United Nations in the implementation of a global information campaign on the internationally agreed development goals and objectives, including those contained in the Millennium Declaration. In that respect, we would like to encourage the active involvement of all relevant stakeholders, including civil society organizations and the private sector.

72. To underpin those efforts, we request the Secretary-General of the United Nations to provide - with collaboration from the secretariats of the major institutional stakeholders concerned, fully utilizing the United Nations System Chief Executives Board for Coordination mechanism - sustained follow-up within the United Nations system to the agreements and commitments reached at the present Conference and to ensure effective secretariat support. That support will build on the innovative and participatory modalities and related coordination arrangements utilized in the preparations of the Conference. The Secretary-General of the United Nations is further requested to submit an annual report on those follow-up efforts.

73. We call for a follow-up international conference to review the implementation of the Monterrey Consensus. The modalities of that conference shall be decided upon not later than 2005.

Financing *for* Development

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63/303. Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development

The General Assembly,

Noting the Conference on the World Financial and Economic Crisis and Its Impact on Development, held in New York from 24 to 30 June 2009, and the adoption by the Conference of the outcome document,

Decides to endorse the Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development, annexed to the present resolution.

95th plenary meeting
9 July 2009

Annex

Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development

We, Heads of State and Government and High Representatives, met in New York from 24 to 30 June 2009 for the Conference on the World Financial and Economic Crisis and Its Impact on Development.

1. The world is confronted with the worst financial and economic crisis since the Great Depression. The evolving crisis, which began within the world's major financial centres, has spread throughout the global economy, causing severe social, political and economic impacts. We are deeply concerned about its adverse impact on development. This crisis is negatively affecting all countries, particularly developing countries, and threatening the livelihoods, well-being and development opportunities of millions of people. The crisis has not only highlighted long-standing systemic fragilities and imbalances, but has also led to an intensification of efforts to reform and strengthen the international financial system and architecture. Our challenge is to ensure that actions and responses to the crisis are commensurate with its scale, depth and urgency, adequately financed, promptly implemented and appropriately coordinated internationally.

2. We reaffirm the purposes of the United Nations, as set forth in its Charter, including "to achieve international cooperation in solving international problems of an economic, social, cultural, or humanitarian character" and "to be a centre for harmonizing the actions of nations in the attainment of these common ends". The principles of the Charter are

particularly relevant in addressing the current challenges. The United Nations, on the basis of its universal membership and legitimacy, is well positioned to participate in various reform processes aimed at improving and strengthening the effective functioning of the international financial system and architecture. This United Nations Conference is part of our collective effort towards recovery. It builds on and contributes to what already is being undertaken by diverse actors and in various forums, and is intended to support, inform and provide political impetus to future actions. This Conference also highlights the importance of the role of the United Nations in international economic issues.

3. Developing countries, which did not cause the global economic and financial crisis, are nonetheless severely affected by it. The economic and social progress achieved during recent years, in particular on internationally agreed development goals, including the Millennium Development Goals, is now being threatened in developing countries, particularly least developed countries. This progress, partially underpinned by a period of high economic growth in many countries, needs to be secured and enhanced in the face of threats posed by the crisis. Our endeavours must be guided by the need to address the human costs of the crisis: an increase in the already unacceptable number of poor and vulnerable, particularly women and children, who suffer and die of hunger, malnutrition and preventable or curable disease; a rise in unemployment; the reduction in access to education and health services; and the current inadequacy of social protection in many countries. Women also face greater income insecurity and increased burdens of family care. These particular human costs have serious development consequences on the human security of those affected. An equitable global recovery requires the full participation of all countries in shaping appropriate responses to the crisis.

4. Although the financial and economic crisis has affected all countries, it is important to take into account the varying impacts and challenges of the crisis on the different categories of developing countries. The crisis is further endangering the achievement of their national development objectives, as well as the internationally agreed development goals, including the Millennium Development Goals. We are particularly concerned about the impact on countries in special situations, including least developed countries, small island developing States and landlocked developing countries, and on African countries and countries emerging from conflict. We are equally concerned about the specific development challenges of middle-income countries and low-income countries with vulnerable and poor populations. For all these countries, the crisis presents unique challenges to their efforts to achieve their national development goals. Our collective responses to this crisis must be made with sensitivity to the specific needs of these different categories of developing countries, which include trade and market access, access to adequate financing and concessionary financing, capacity-building, strengthened support for sustainable development, financial and technical assistance, debt sustainability, trade facilitation measures, infrastructure development, peace and security, the Millennium Development Goals, and our previous international development commitments.

5. Peace, stability and prosperity are indivisible. In today's globalized economy, all nations are far more closely tied together than ever before. The global reach of the crisis calls for prompt, decisive and coordinated action to address its causes, mitigate its impact and strengthen or establish the necessary mechanisms to help prevent similar crises in the future.

6. This Conference represents a milestone in an ongoing and concerted engagement by all States Members of the United Nations to address the crisis and its impact on development. Today, we have set forth our global consensus on the responses to this crisis, prioritized required actions and defined a clear role for the United Nations. We are doing so in the interest of all nations in order to achieve a more inclusive, equitable, balanced, development-oriented and sustainable economic development to help overcome poverty and inequality.

Present state of the world economy

7. This crisis is connected to multiple, interrelated global crises and challenges, such as increased food insecurity, volatile energy and commodity prices and climate change, as well as the lack of results so far in the multilateral trade negotiations and a loss of confidence in the international economic system. The global economic downturn is deeper than many early estimates, and the recovery is predicted to be gradual and varied. While some countries still experience positive, though much slower growth, the latest estimate of the United Nations indicates that world gross product will fall by 2.6 per cent in 2009, the first such decline since the Second World War. The crisis threatens to have calamitous human and development consequences. Millions of people all over the world are losing their jobs, their income, their savings and their homes. The World Bank estimates that more than 50 million people have already been driven into extreme poverty, particularly women and children. The Food and Agriculture Organization of the United Nations projects that the crisis will contribute to the number of hungry and undernourished people worldwide rising to a historic high of over one billion.

Impacts of the crisis

8. The crisis has produced or exacerbated serious, wide-ranging yet differentiated impacts across the globe. Since the crisis began, many States have reported negative impacts, which vary by country, region, level of development and severity, including the following:

- Rapid increases in unemployment, poverty and hunger
- Deceleration of growth, economic contraction
- Negative effects on trade balances and balance of payments
- Dwindling levels of foreign direct investment
- Large and volatile movements in exchange rates
- Growing budget deficits, falling tax revenues and reduction of fiscal space
- Contraction of world trade
- Increased volatility and falling prices for primary commodities
- Declining remittances to developing countries
- Sharply reduced revenues from tourism
- Massive reversal of private capital inflows
- Reduced access to credit and trade financing
- Reduced public confidence in financial institutions
- Reduced ability to maintain social safety nets and provide other social services, such as health and education
- Increased infant and maternal mortality
- Collapse of housing markets.

Causes of the crisis

9. The drivers of the financial and economic crisis are complex and multifaceted. We recognize that many of the main causes of the crisis are linked to systemic fragilities and imbalances that contributed to the inadequate functioning of the global economy. Major

underlying factors in the current situation included inconsistent and insufficiently coordinated macroeconomic policies and inadequate structural reforms, which led to unsustainable global macroeconomic outcomes. These factors were made acute by major failures in financial regulation, supervision and monitoring of the financial sector, and inadequate surveillance and early warning. These regulatory failures, compounded by over-reliance on market self-regulation, overall lack of transparency, financial integrity and irresponsible behaviour, have led to excessive risk-taking, unsustainably high asset prices, irresponsible leveraging and high levels of consumption fuelled by easy credit and inflated asset prices. Financial regulators, policymakers and institutions failed to appreciate the full measure of risks in the financial system or address the extent of the growing economic vulnerabilities and their cross-border linkages. Insufficient emphasis on equitable human development has contributed to significant inequalities among countries and peoples. Other weaknesses of a systemic nature also contributed to the unfolding crisis, which has demonstrated the need for more effective government involvement to ensure an appropriate balance between the market and public interest.

Response to the crisis

10. We are all in this crisis together. While each country has primary responsibility for its own economic and social development, we will continue to work in solidarity on a vigorous, coordinated and comprehensive global response to the crisis in accordance with our respective abilities and responsibilities. Developed countries and emerging markets have taken the lead in restoring global growth. An immediate priority has been to stabilize the financial markets and restore confidence in them and counter falling demand and the recession. Major actions have already been taken to maintain macroeconomic stability and strengthen the international financial system. At the same time, strong and urgent actions are needed to counter the impact of the crisis on the most vulnerable populations and help to restore strong growth and recover lost ground in their progress towards our internationally agreed development goals, including the Millennium Development Goals. Therefore, an adequate share of any additional resources – both short-term liquidity and long-term development financing – will need to be made available to developing countries, especially the least developed countries. Although this crisis continues to have a significant impact on the peoples of the world, we believe that it represents an important opportunity for meaningful change. Going forward, our response must focus on creating jobs, increasing prosperity, strengthening access to health and education, correcting imbalances, designing and implementing environmentally and socially sustainable development paths and having a strong gender perspective. It must also strengthen the foundation for a fair, inclusive and sustainable globalization supported by renewed multilateralism. We are confident that we will emerge from this crisis stronger and more vigorous and more united.

The need for prompt and decisive action

11. We commit to working in solidarity on a coordinated and comprehensive global response to the crisis and to undertaking actions aimed at, inter alia:

- Restoring confidence and economic growth, and creating full and productive employment and decent work for all
- Safeguarding economic, development and social gains
- Providing adequate support for developing countries to address the human and social impacts of the crisis, in order to safeguard and build upon hard-won economic and development gains to date, including the progress being achieved towards the implementation of the Millennium Development Goals
- Ensuring long-term debt sustainability of developing countries

- Seeking to provide sufficient development resources to developing countries without unwarranted conditionalities
- Rebuilding trust in the financial sector and restoring lending
- Promoting and revitalizing open trade and investment and rejecting protectionism
- Fostering an inclusive, green and sustainable recovery, and providing continued support for sustainable development efforts by developing countries
- Strengthening the role of the United Nations development system in responding to the economic crisis and its impact on development
- Reforming and strengthening the international financial and economic system and architecture, as appropriate, to adapt to current challenges
- Fostering good governance at all levels, including in the international financial institutions and financial markets
- Addressing the human and social impacts of the crisis.

Lines of action

Make the stimulus work for all

12. In attempting to combat the immediate impacts of the crisis, there have already been a number of responses at the national, regional and international levels. While acknowledging those efforts, we encourage greater cooperation and coordination among countries' fiscal and economic actions. Support for development is an essential and integral part of the solution to the global crisis, inter alia, through actions aimed at enhancing sustained economic growth, poverty eradication and sustainable development. We encourage countries, while implementing national stimulus measures, to avoid protectionism in any form and possible adverse impacts on third countries, particularly developing countries.

13. We encourage countries in a position to do so to utilize the room for fiscal stimulus that they possess, while also ensuring long-term fiscal sustainability. We also encourage individual countries to tailor their responses to their specific circumstances and use the available scope for domestic resource mobilization.

14. While a number of developed and emerging market economies have implemented stimulus packages, the majority of the world's developing countries lack fiscal space to implement countercyclical measures to combat the effects of the crisis and spur recovery. Many also face foreign-exchange shortages. In order to adequately respond to the crisis, developing countries will need a larger share of any additional resources – both short-term liquidity and long-term development financing. We call for an examination of mechanisms to ensure that adequate resources are provided to developing countries, especially the least developed countries. We underscore that developing countries should not be unduly financially burdened by the crisis and its impacts.

15. Developing countries facing an acute and severe shortage of foreign reserves because of the fallout of the crisis, which is negatively affecting their balance-of-payment situation, should not be denied the right to use legitimate trade defence measures in accordance with relevant provisions of the World Trade Organization (WTO), and, as a last resort, impose temporary capital restrictions and seek to negotiate agreements on temporary debt standstills between debtors and creditors, in order to help mitigate the adverse impacts of the crisis and stabilize macroeconomic developments.

16. We acknowledge the G20 summit held in London on 2 April 2009, and recognize its commitment to make available an additional $1.1 trillion programme aimed at revitalizing the world economy. A major part of these funds will be available for use by emerging markets and developing countries. A limited share ($50 billion) of these resources was targeted specifically to low-income countries. We call upon the G20 to further consider addressing the financial needs of developing countries, especially low-income countries. We also call upon all G20 countries to follow through with their commitments and to monitor the implementation of them. While recognizing the decisions taken by the G20, we are resolved to strengthen the role of the United Nations and its Member States in economic and financial affairs, including its coordinating role.

17. Countries must have the necessary flexibility to implement countercyclical measures and to pursue tailored and targeted responses to the crisis. We call for a streamlining of conditionalities to ensure that they are timely, tailored and targeted and support developing countries in the face of financial, economic and development challenges. In this context we note the recent improvement of the lending framework of the International Monetary Fund (IMF), through inter alia, modernizing conditionality, and the creation of more flexible instruments, such as a flexible credit line, as a welcome step. New and ongoing programmes should not contain unwarranted procyclical conditionalities. We call upon the multilateral development banks to move forward on flexible, concessional, fast-disbursing and front-loaded assistance designed to substantially and quickly assist developing countries facing financing gaps. While doing so, multilateral development banks need to assure the application of agreed safeguards to ensure their financial stability.

18. The increasing interdependence of national economies in a globalizing world and the emergence of rules-based regimes for international economic relations have meant that the space for national economic policy, that is, the scope for domestic policies, especially in the areas of trade, investment and international development, is now often framed by international disciplines and commitments and global market considerations. We recognize that these regimes, disciplines, commitments and considerations have presented challenges to many developing countries seeking to fashion a national response to the financial and economic crisis. We also recognize that many developing countries have called for opportunities to exercise greater policy flexibility within the scope of these constraints as a necessary component of recovery from the crisis and to address specific national concerns, which include, inter alia, the human and social impacts of the crisis, safeguarding progress achieved towards implementation of the Millennium Development Goals, effective use of credit and liquidity facilities, regulation of local financial markets, institutions, instruments and capital flows, and limited trade defence measures. It is for each Government to evaluate the trade-off between the benefits of accepting international rules and commitments and the constraints posed by the loss of policy space.

19. We recognize the continued importance of good governance along with national ownership of policies and strategies. We commit ourselves to the promotion of effective and efficient economic and financial institutions at all levels – key determinants of long-term economic growth and development. We also commit ourselves to accelerating our collective recovery from the crisis through improved transparency, eradication of corruption and strengthened governance. In this regard, we urge all States that have not done so to consider ratifying or acceding to the United Nations Convention against Corruption[1] and call upon all States parties to vigorously implement the Convention.

[1] United Nations, *Treaty Series*, vol. 2349, No. 42146.

20. The crisis has disparate impacts across regions, subregions and countries. These heterogeneous impacts have added complexity to our common goal of eradicating poverty, reducing inequality and promoting human development. Given the sensitivity of regional and subregional institutions to the specific needs of their constituencies, we note the value of regional and subregional cooperation efforts in meeting the challenges of the global economic crisis and we encourage enhanced regional and subregional cooperation, for example, through regional and subregional development banks, commercial and reserve currency arrangements, and other regional initiatives, as contributions to the multilateral response to the current crisis and to improved resilience to potential future crises.

Contain the effects of the crisis and improve future global resilience

21. This crisis does not affect only the economic and financial sectors. We recognize the human and social impacts of the crisis and the inherent challenges involved in addressing them. Short-term mitigation measures should take into account long-term goals, especially those related to poverty eradication; sustainable development, including environmental protection and clean and renewable energy; food security; gender equality; health; education; and sustained economic growth, including full and productive employment and decent work for all. Strengthening existing social safety nets, establishing new ones where needed and protecting social expenditures are important for the advancement of people-centred development and addressing the human and social impacts of the crisis. We reaffirm our commitment to the timely achievement of our internationally agreed development goals, including the Millennium Development Goals.

22. Closer cooperation and strong partnership between the United Nations development system, regional development banks and the World Bank and their scaled-up efforts can effectively address the needs of those hardest hit and ensure that their plight is not ignored. We call for the mobilization of additional resources for social protection, food security and human development through all sources of development finance, including voluntary bilateral contributions, to strengthen the foundation for early and sustained economic and social recovery in developing countries, particularly least developed countries. Such additional resources should be channelled through existing institutions such as the United Nations development system, the World Bank-proposed vulnerability fund and framework and multilateral development banks, where appropriate. These funds, including those for the United Nations development system, should be provided on a predictable basis. Furthermore, we stress the importance of the United Nations development system, given its broad field presence, in supporting the activities at the country level to mitigate the impact of the crisis in developing countries.

23. We commit ourselves to strengthening the ability of the United Nations to fulfil its development mandate. United Nations funds and programmes and United Nations agencies, in accordance with their respective mandates, have an important role to play in advancing development and in protecting development gains, in accordance with national strategies and priorities, including progress towards achieving the internationally agreed development goals, including the Millennium Development Goals, threatened by the current economic crisis. The United Nations should use the current economic situation as an opportunity to redouble its efforts to improve the efficiency and effectiveness of its development programmes in support of system-wide coherence. We recognize the unique role of the United Nations as an inclusive forum to promote a better understanding of the social and economic impact of the crisis and to fashion appropriate responses.

24. We acknowledge that the current economic crisis has the potential to increase the need for resources for humanitarian assistance in developing countries. We stress the need to take measures to ensure adequate resources for international cooperation in the provision of humanitarian assistance.

25. The crisis has severely impacted on international trade in most countries, especially developing countries. For many developing countries, these impacts include, among others, falling exports and loss of export revenue, diminishing access to trade finance, reductions in export-oriented and infrastructure investment, lower fiscal revenues and balance-of-payment problems. We undertake to resist all protectionist tendencies and rectify any protectionist measures already taken. At the same time we recognize the right of countries to fully utilize their flexibilities consistent with their WTO commitments and obligations. It is important that we contribute to the efforts of WTO and other relevant bodies to monitor and report on protectionist measures, including on how they affect developing countries.

26. We must also fully harness the potential of trade as an engine of sustained economic growth and development in our efforts to overcome this crisis. In this regard, we reaffirm our commitment to a universal, rules-based, open, non-discriminatory and equitable multilateral trading system. We reaffirm that international trade is an engine for development and sustained economic growth. We therefore reiterate our call for an early, ambitious, successful and balanced conclusion to the Doha Round that increases market access, generates increased trade flows and places the needs of developing countries at its centre. We welcome the commitment to implement duty-free and quota-free access for least developed countries, as agreed in the WTO Hong Kong Ministerial Declaration;[2] to make operationally effective the principle of special and differential treatment for developing countries; to the parallel elimination of all forms of export subsidies; to disciplines on all export measures with equivalent effect; to substantial reductions in trade-distorting domestic support, in accordance with the mandate of the Doha Round and the WTO Hong Kong Ministerial Declaration; and to meet existing aid-for-trade pledges. We also reaffirm the need to make progress on the implementation of the WTO work programme on small economies, mandated in the Doha Ministerial Declaration.[3]

27. Migrant workers are among the most vulnerable in the context of the current crisis. Remittances, which are significant private financial resources for households in countries of origin of migration, have been seriously affected by rising unemployment and weak earnings growth among migrant workers, particularly in advanced economies. We should resist unfair and discriminatory treatment of migrant workers and the imposition of unreasonable restrictions on labour migration in order to maximize the benefits of international migration, while complying with the relevant national legislation and applicable international instruments. We recognize the important contribution of migrant workers for both countries of origin and destination. We commit ourselves to allowing labour migration to meet labour market needs.

28. An effective response to the current economic crisis requires timely implementation of existing aid commitments. There is an urgent need for all donors to maintain and deliver on their existing bilateral and multilateral official development assistance (ODA) commitments and targets made, inter alia, in the United Nations Millennium Declaration,[4] the Monterrey Consensus[5] and the 2005 World Summit Outcome,[6] at the G8 summit in Gleneagles, in the Doha Declaration[7] and at the G20 London summit. We underline that

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[2] World Trade Organization, document WT/MIN(05)/DEC. Available from http://docsonline.wto.org.

[3] A/C.2/56/7, annex.

[4] See resolution 55/2.

[5] *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18–22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex.

[6] See resolution 60/1.

[7] See resolution 63/239, annex.

the fulfilment of all ODA commitments is crucial, including the commitments by many developed countries to achieve the target of 0.7 per cent of gross national product (GNP) for ODA to developing countries by 2015 and to reach the level of at least 0.5 per cent of GNP for ODA by 2010, as well as a target of 0.15 to 0.20 per cent of GNP for ODA to least developed countries. We recognize that many developed countries have established timetables to reach the level of at least 0.5 per cent for ODA by 2010. We encourage other donors to work on national timetables, by the end of 2010, to increase aid levels within their respective budget allocation processes towards achieving the established ODA targets. The full implementation of these commitments will substantially boost the resources available to push forward the international development agenda and to assist developing countries to mitigate and more effectively respond to the crisis in accordance with their national strategies. Donors should review and, if appropriate, increase or redirect their assistance to developing countries to enable them to mitigate and more effectively respond to the crisis in accordance with their national strategies.

29. We emphasize the importance for all development actors to continue to pursue economic and governance reforms and other steps to improve the effectiveness of aid based on the fundamental principles of national ownership, alignment, harmonization and managing for results.

30. We also encourage developing countries in a position to do so to continue to make concrete efforts to increase and make more effective their South-South cooperation initiatives, in accordance with the principles of aid effectiveness. We reiterate our support for South-South cooperation, as well as triangular cooperation, which provide much-needed additional resources for the implementation of development programmes.

31. New voluntary and innovative forms of financing can contribute to addressing our global problems. We encourage the scaling up of development finance from existing sources and the establishment, where appropriate, of new voluntary and innovative sources of financing initiatives to provide additional stable sources of development finance, which should supplement and not be a substitute for traditional sources of finance and should be disbursed in accordance with the priorities of developing countries and not unduly burden them. We reiterate our request to the Secretary-General to produce a progress report by the sixty-fourth session of the General Assembly, taking into account all existing initiatives.

32. The crisis must not delay the necessary global response to climate change and environmental degradation, taking into account the principle of common but differentiated responsibilities and respective capabilities. We acknowledge that the response to the crisis presents an opportunity to promote green economy initiatives. In this regard, we encourage the utilization of national stimulus packages, for those countries in a position to do so, to contribute to sustainable development, sustainable long-term growth, promotion of full and productive employment and decent work for all and poverty eradication. It is important that global green initiatives and proposals be inclusive and address sustainable development and environmental challenges and opportunities, including climate change mitigation and adaptation, financing and technology transfer to developing countries and sustainable forest management. We also encourage private-sector participation in these initiatives at the national level in accordance with national development strategies and priorities. We look forward to a successful outcome of the fifteenth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change, to be held in Copenhagen in December 2009, as part of our overall efforts for a green recovery from the crisis.

33. The deepening crisis threatens to increase the debt and therefore threatens the debt sustainability of developing countries. This growing pressure limits the ability of these States to enact the appropriate fiscal measures to mitigate the impact of the crisis or engage

in development financing. We affirm that the appropriate measures must be taken to mitigate the negative effects of the crisis on the indebtedness of developing States and to avoid a new debt crisis. In that regard, we support making full use of the existing flexibility within the Debt Sustainability Framework.

34. We call upon States to redouble efforts to honour their commitments regarding debt relief and stress the responsibility of all debtors and creditors on the issue of debt sustainability, and emphasize the importance of equivalent treatment of all creditors. Donors and multilateral financial institutions should also increasingly consider providing grants and concessional loans as the preferred modalities of their financial support instruments to ensure debt sustainability. We will also explore enhanced approaches to the restructuring of sovereign debt based on existing frameworks and principles, broad creditors' and debtors' participation and comparable burden-sharing among creditors. We will also explore the need and feasibility of a more structured framework for international cooperation in this area.

35. We recognize that increases in global liquidity play a useful role in overcoming the financial crisis. Therefore, we strongly support and call for early implementation of the new general special drawing right (SDR) allocation of $250 billion. We also call for the urgent ratification of the fourth amendment to the IMF Articles of Agreement for a special one-time allocation of SDRs, as approved by the IMF Board of Governors in September 1997. We recognize the need for keeping under review the allocation of SDRs for development purposes. We also recognize the potential of expanded SDRs to help increase global liquidity in response to the urgent financial shortfalls caused by this crisis and to help prevent future crises. This potential should be further studied.

36. The crisis has intensified calls by some States for reform of the current global reserve system to overcome its insufficiencies. We acknowledge the calls by many States for further study of the feasibility and advisability of a more efficient reserve system, including the possible function of SDRs in any such system and the complementary roles that could be played by various regional arrangements. We also acknowledge the importance of seeking consensus on the parameters of such a study and its implementation. We recognize the existence of new and existing regional and subregional economic and financial cooperation initiatives to address, inter alia, the liquidity shortfalls and the short-term balance-of-payment difficulties among its members.

Improved regulation and monitoring

37. The current crisis has revealed many deficiencies in national and international financial regulation and supervision. We recognize the critical need for expanding the scope of regulation and supervision and making it more effective, with respect to all major financial centres, instruments and actors, including financial institutions, credit rating agencies and hedge funds. The need for tighter and more coordinated regulation of incentives, derivatives and the trading of standardized contracts is also apparent. We reject the imposition of needlessly onerous regulatory requirements, and call for effective, credible and enforceable regulations at all levels to ensure the needed transparency and oversight of the financial system. Every relevant institution must be subject to adequate and proportionate surveillance and regulation. We underscore that each country should adequately regulate its financial markets, institutions and instruments consistent with its development priorities and circumstances, as well as its international commitments and obligations. We underscore the importance of political commitment and of capacity-building to ensure that the measures taken are fully implemented.

38. We emphasize the need to ensure that all tax jurisdictions and financial centres comply with standards of transparency and regulation. We reiterate the need to further promote international cooperation in tax matters, including within the United Nations,

inter alia, by promoting double taxation agreements. Inclusive and cooperative frameworks should ensure the involvement and equal treatment of all jurisdictions. We call for consistent and non-discriminatory implementation of transparency requirements and international standards for exchange of information.

39. Illicit financial flows are estimated to amount to several times global ODA and have a harmful effect on development financing. Measures to enhance regulation and supervision of and transparency in the formal and informal financial system should include steps to curb illicit financial flows in all countries. Improving the transparency of the global financial system also deters illicit financial flows, including to international financial centres, and enhances the ability to detect illicit activities.

40. The current crisis has been compounded by an initial failure to appreciate the full scope of the risks accumulating in the financial markets and their potential to destabilize the international financial system and the global economy. We recognize the need for even-handed and effective IMF surveillance of major financial centres, international capital flows and financial markets. In this context, we welcome the improvement of early warning systems by the relevant international institutions to provide early warning of macroeconomic and financial risks and the actions needed to address them.

41. The ongoing crisis has highlighted the extent to which our economies are integrated, the indivisibility of our collective well-being and the unsustainability of a narrow focus on short-term gains. We reaffirm the principles of sustainable development and underscore the need for a global consensus on the key values and principles that will promote sustainable, fair and equitable economic development. We believe that corporate social and environmental responsibility are important elements of such a consensus. In this regard we recognize the importance of the 10 principles of the United Nations Global Compact.

Reform of the international financial and economic system and architecture

42. This crisis has added new impetus to ongoing international discussions on the reform of the international financial system and architecture, including issues related to mandate, scope, governance, responsiveness and development orientation as appropriate. There is consensus on the need for continued reform and modernization of the international financial institutions to better enable them to respond to the current financial and economic challenges and to the needs of Member States, and to better equip them to strengthen existing monitoring, surveillance, technical assistance and coordination roles to help prevent the occurrence of similar crises in the future, in accordance with their respective mandates.

43. We stress the urgent need for further reform of the governance of the Bretton Woods institutions, on the basis of a fair and equitable representation of developing countries, in order to increase the credibility and accountability of these institutions. These reforms must reflect current realities and should enhance the perspective and voice and participation of dynamic emerging markets and developing countries, including the poorest.

44. We call for an expeditious completion of the reform process of the World Bank's governance and of an accelerated road map for further reforms on voice and participation of developing countries, with a view to reaching agreement by April 2010, based on an approach that reflects its development mandate and with the involvement of all shareholders in a transparent, consultative and inclusive process. We also call for inclusive consultations on further reforms to improve the responsiveness and adaptability of the World Bank.

45. It is imperative that the reformed World Bank emerge with the requisite technical capacities, credit facilities and financial resources needed to assist and complement the efforts of developing countries aimed at achieving their overall development needs.

46. We recognize the importance of strengthening regional development banks, taking into account the interests of all their member countries. It is also important for them to provide medium- and long-term assistance to meet the development needs of their clients. We support measures to enhance the financial and lending capacity of regional development banks. Furthermore, we recognize the importance of other regional, interregional and subregional initiatives and arrangements aimed at promoting development, cooperation and solidarity among their members.

47. We recognize that it is imperative to undertake, as a matter of priority, a comprehensive and fast-tracked reform of IMF. We look forward to this accelerated progress in order to increase its credibility and accountability. We acknowledge the agreement to accelerate the implementation of the package of IMF quota and voice reforms agreed in April 2008. We strongly support completion of the next quota review, which, based on current trends, is expected to result in an increase in the quota shares of dynamic economies, particularly in the share of emerging market and developing countries as a whole, to be completed no later than January 2011, thus enhancing the legitimacy and effectiveness of the Fund.

48. We reaffirm the need to address the often expressed concern at the extent of representation of developing countries in the major standard-setting bodies. We therefore welcome, as a step in the right direction, the expansion of the membership in the Financial Stability Board and the Basel Committee on Banking Supervision and encourage the major standard-setting bodies to further review their membership promptly while enhancing their effectiveness, with a view to enhancing the representation of developing countries as appropriate.

49. We agree that the heads and senior leadership of the international financial institutions, particularly the Bretton Woods institutions, should be appointed through open, transparent and merit-based selection processes, with due regard to gender equality and geographical and regional representation.

50. The United Nations and the international financial institutions have complementary mandates that make the coordination of their actions crucial. Accordingly, we encourage continued and increasing cooperation, coordination and coherence and exchanges between the United Nations and the international financial institutions. In this regard, we believe that this Conference represents an important step to ensure increased cooperation.

The way forward

51. We have come together to raise our collective understanding of the impacts of the crisis and to contribute in the fashioning of the global response, in an inclusive manner, with actions at the national, regional and international levels.

52. We will strive to combine our short-term responses to meet the immediate impact of the financial and economic crisis, particularly on the most vulnerable countries, with medium- and long-term responses that necessarily involve the pursuit of development and the review of the global economic system. In this context, we propose the following course of action:

(*a*) Strengthen the capacity, effectiveness and efficiency of the United Nations; enhance the coherence and coordination of policies and actions between the United Nations, international financial institutions and relevant regional organizations;

(*b*) Further develop the United Nations development system's comprehensive crisis response in support of national development strategies through a coordinated approach by United Nations funds and programmes, specialized agencies and the international financial institutions at the country level. The response must continue to be led by programme countries and, in this context, address vulnerabilities caused or exacerbated by the crisis and further strengthen national ownership. It should build on steps already taken by the United Nations development system, in particular at the country level. We urge the international community to ensure adequate support to the United Nations development system's crisis response;

(*c*) Explore ways to strengthen international cooperation in the area of international migration and development, in order to address the challenges of the current economic and financial crisis on migration and migrants, taking into account the related work and activities of the United Nations funds and programmes, regional commissions and specialized agencies and of other international organizations, such as the International Organization for Migration.

53. We request the General Assembly and the Economic and Social Council, as well as the United Nations funds and programmes and specialized agencies, to take full advantage of their advocacy role to promote the recovery and development of the developing countries, especially the most vulnerable among them.

54. We invite the General Assembly to establish an ad hoc open-ended working group of the General Assembly to follow up on the issues contained in the present outcome document, and to submit a report on the progress of its work to the General Assembly before the end of the sixty-fourth session.

55. We encourage the President of the General Assembly to make the world financial and economic crisis and its impact on development a main theme of the general debate of the sixty-fourth session of the General Assembly.

56. We request the Economic and Social Council:

(*a*) To consider the promotion and enhancement of a coordinated response of the United Nations development system and specialized agencies in the follow-up to and implementation of this outcome document, in order to advance consistency and coherence in support of consensus-building around policies related to the world financial and economic crisis and its impact on development;

(*b*) To make recommendations to the General Assembly, in accordance with the Doha Declaration of 2 December 2008, for a strengthened and more effective and inclusive intergovernmental process to carry out the financing for development follow-up;

(*c*) Examine the strengthening of institutional arrangements to promote international cooperation in tax matters, including the United Nations Committee of Experts on International Cooperation in Tax Matters;

(*d*) Review the implementation of the agreements between the United Nations and the Bretton Woods institutions in collaboration with these institutions, focusing in particular on enhancing collaboration and cooperation between the United Nations and the Bretton Woods institutions, as well as on the opportunities for contributing to advancing their respective mandates;

(*e*) Consider and make recommendations to the General Assembly regarding the possible establishment of an ad hoc panel of experts on the world economic and financial crisis and its impact on development. The panel could provide independent technical expertise and analysis, which would contribute to informing international action and political decision-making and fostering constructive dialogues and exchanges among policymakers, academics, institutions and civil society.

57. We request the Secretary-General to report to the Economic and Social Council on a regular basis on the work of the High-level Task Force on the Global Food Security Crisis.

58. We invite the International Labour Organization to present the "Global Jobs Pact", adopted at the ninety-eighth session of the International Labour Conference, to the substantive session of the Economic and Social Council in July 2009, which intends to promote a job-intensive recovery from the crisis, drawing on the decent work agenda, and to shape a pattern for sustainable growth.

59. We encourage the Inter-Parliamentary Union to continue to contribute to the development of global responses to the crisis.

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CONTENTS

RULES OF PROCEDURE

* The annex provides the relevant references with regard to the rules of procedure including the decisions by which they were adopted.

RULES OF PROCEDURE

I. SESSIONS

ORGANIZATIONAL AND SUBSTANTIVE SESSIONS

Rule 1

The Council shall normally hold an organizational session and one substantive session a year.

DATES OF CONVENING AND ADJOURNMENT

Rule 2

Subject to rule 3, and following a meeting early in the year for the purpose of electing the President and the Bureau, the organizational session shall be convened on the first Tuesday in February and resumed at the end of April. The substantive session shall take place between May and July and shall be adjourned at least six weeks before the opening of the regular session of the General Assembly.

Rule 3

Any member of the Council or the Secretary-General may request an alteration of the date of the substantive session. The President shall, through the Secretary-General, forthwith communicate the request to all members of the Council, together with such observation as the Secretary-General may present. If a majority of the members of the Council concurs in the request within eight days of the communication, the Council shall be convened accordingly.

SPECIAL SESSIONS

Rule 4

1. Special sessions of the Council shall be held:

(a) By decision of the Council;

(b) Upon the request or with the concurrence of a majority of the members of the Council;

(c) Upon the request of the General Assembly or the Security Council.

2. The President, with the concurrence of the Vice-Presidents and, as appropriate, in consultation with members of the Council, may also call a special session of the Council.

3. Should a request for a special session be made by the Trusteeship Council, by any Member of the United Nations or by a specialized agency, 1/ the President shall, through the Secretary-General, forthwith communicate the request to all members of the Council. Unless the President and the Vice-Presidents, as appropriate in consultation with members of the Council, have agreed to the request within four days of its receipt, the President shall, through the Secretary-General, inquire of all members of the Council whether or not they concur in the request; the replies to such an inquiry shall be communicated to the Secretary-General within eight days. If a majority of the members concurs in the request, the Council shall be convened accordingly.

4. Unless otherwise indicated in a decision or by a majority of the members of the Council, special sessions shall be convened within six weeks of a

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1/ When the term "specialized agency" is used in these rules, it refers to specialized agencies brought into relationship with the United Nations; it also includes the International Atomic Energy Agency.

decision to hold such a session or of receipt by the President of a request for such a session, at a date fixed by the President.

PLACE OF SESSIONS

Rule 5

Sessions shall be held at the Headquarters of the United Nations unless, in pursuance of a previous decision of the Council or at the request of a majority of its members, another place is designated for the whole or part of a session.

NOTIFICATION OF OPENING DATE OF SESSIONS

Rule 6

The President shall, through the Secretary-General, notify the Members of the United Nations, the President of the Security Council, the President of the Trusteeship Council, the specialized agencies, the intergovernmental organizations referred to in rule 79 and the non-governmental organizations in category I or II or on the Roster of the date of the opening of each session. Such notification shall be sent at least six weeks in advance of the organizational session or the substantive session and at least twelve days in advance of a special session. If a special session is requested by the General Assembly or the Security Council, the President may reduce the period of notice to not less than eight days.

ADJOURNMENT OF SESSIONS

Rule 7

The Council may decide at any session to adjourn temporarily and resume its meetings at a later date.

II. AGENDA

BASIC PROGRAMME OF WORK

Rule 8

In the course of the organizational session the Council shall draw up, with the assistance of the Secretary-General, the basic programme of its work for the year.

DRAWING UP OF THE PROVISIONAL AGENDA

Rule 9

1. The Secretary-General shall draw up the provisional agenda for each session of the Council. He shall submit to the Council:

(a) The provisional agenda for the organizational session at least three weeks in advance of the opening of that session;

(b) The provisional agenda for the substantive session at the organizational session.

2. The provisional agenda shall include all items required by these rules and by the basic programme of work, or proposed by:

(a) The Council;

(b) The General Assembly;

(c) The Security Council;

(d) The Trusteeship Council;

(e) A Member of the United Nations;

(f) The Secretary-General;

(g) A specialized agency, subject to rule 76.

3. A non-governmental organization in category I may request that the Committee on

Non-Governmental Organizations recommend that items of special interest to the organization be included in the provisional agenda of the Council. In considering the request the Committee shall take into account:

(*a*) The adequacy of the documentation submitted by the organization;

(*b*) The extent to which the item may lend itself to early and constructive action by the Council;

(*c*) The possibility that the item might more appropriately be dealt with elsewhere than in the Council.

Any decision by the Committee not to grant a request submitted by a non-governmental organization to recommend that an item be placed on the provisional agenda of the Council shall be considered as final.

4. The agenda for the organizational session shall include the consideration of the provisional agenda for the substantive session of the Council.

5. Agenda items shall be arranged in an integrated manner, so that similar or connected issues can be discussed in one debate and under a single heading.

COMMUNICATION OF THE PROVISIONAL AGENDA

Rule 10

After the Council has considered the provisional agenda for the substantive session as provided in paragraph 4 of rule 9, that agenda, incorporating any amendments made by the Council, shall be communicated by the Secretary-General to the Members of the United Nations, the President of the Security Council, the President of the Trusteeship Council, the specialized agencies, the intergovernmental organizations referred to in rule 79 and the non-governmental organizations in category I or II or on the Roster.

PROVISIONAL AGENDA FOR A SPECIAL SESSION

Rule 11

The provisional agenda for a special session shall consist only of those items proposed for consideration in the request for the holding of the session, subject, when appropriate, to rule 18. It shall be transmitted to the authorities listed in rule 10 at the same time as the notice convening the Council.

SUPPLEMENTARY ITEMS

Rule 12

1. The inclusion of supplementary items in a provisional agenda that has been considered by the Council under paragraph 4 of rule 9 may be proposed by the General Assembly, the Security Council, the Trusteeship Council, a Member of the United Nations, the Secretary-General or, subject to rule 76, a specialized agency, or by the Committee on Non-Governmental Organizations in accordance with the procedure provided in paragraph 3 of rule 9. The proposal shall, except if made by the General Assembly, the Security Council or the Trusteeship Council, be accompanied by a supporting statement from the authority initiating it, indicating the urgency of the consideration of the item and the reasons that precluded its submission before the consideration of the provisional agenda by the Council.

2. The supplementary items shall be placed by the Secretary-General on a supplementary list and communicated to the Council together with the supporting statements and such observations as the Secretary-General may wish to offer.

ADOPTION OF THE AGENDA

Rule 13

1. The Council shall at the beginning of each session, after the election of the Bureau when required under rule 18, adopt the agenda for that session on the basis of the provisional agenda and the supplementary list referred to in rule 12.

2. An organ of the United Nations, a Member of the United Nations or a specialized agency that has proposed the inclusion of an item in the provisional agenda or the supplementary list shall be entitled to be heard by the Council, or by the appropriate sessional committee designated by the Council, on the inclusion of the item in the agenda.

3. In the case of an item placed on the provisional agenda or on the supplementary list at the request of the Committee on Non-Governmental Organizations under paragraph 3 of rule 9 or under paragraph 1 of rule 12, the non-governmental organization that proposed the item to the Committee shall be entitled to be heard by the Council, or by the appropriate sessional committee designated by the Council, on the inclusion of the item in the agenda.

4. Unless the Council decides otherwise, if the documentation relating to an item of the agenda has not been circulated, in all working languages, six weeks before the opening of a regular session, the item shall be postponed to the following session, except in the case of reports of subsidiary and other bodies on meetings that have been concluded twelve weeks or less before the opening of the session of the Council.

ALLOCATION OF ITEMS

Rule 14

The Council shall allocate items between the plenary meetings and its sessional committees, and may refer items without preliminary debate:

(a) To a specialized agency, another organization or programme of the United Nations system, one or more of its commissions or standing committees, or the Secretary-General, for study and report to the Council at a subsequent session;

(b) To the proposer of the item, for further information or documentation.

REVISION OF THE AGENDA

Rule 15

During a session, the Council may revise the agenda by adding, deleting, deferring or amending items. Only important and urgent items shall be added to the agenda during a session. The Council may refer to a committee any request to add an item to the agenda.

III. REPRESENTATION, CREDENTIALS

REPRESENTATIVES, ALTERNATES AND ADVISERS

Rule 16

Each member of the Council shall be represented by an accredited representative, who may be accompanied by such alternate representatives and advisers as may be required.

CREDENTIALS

Rule 17

The credentials of representatives and the names of alternate representatives and advisers shall be submitted to the Secretary-General not less than three days before the first meeting they are to attend. The Bureau shall examine the credentials and submit a report thereon to the Council.

IV. BUREAU

ELECTION AND SPECIAL RESPONSIBILITIES

Rule 18

1. Each year, at the commencement of its first meeting, the Council shall elect a President and four Vice-Presidents 2/ from among the representatives of its members. The President and the Vice-Presidents shall constitute the Bureau.

2. The Council, upon the recommendation of the President, shall decide on the special responsibilities of each of the Vice-Presidents.

TERM OF OFFICE

Rule 19

The President and the Vice-Presidents shall, subject to rule 22, hold office until their successors are elected. They shall be eligible for re-election.

ACTING PRESIDENT

Rule 20

1. If the President finds it necessary to be absent during a meeting or any part thereof, he shall designate one of the Vice-Presidents to take his place.

2/ In the election of the President of the Council, regard shall be had for the equitable geographical rotation of this office among the following regional groups: African States, Asian States, Eastern European States, Latin American and Caribbean States, and Western European and other States. The four Vice-Presidents of the Council shall be elected on the basis of equitable geographical distribution from the regional groups other than the one to which the President belongs.

2. If the President ceases to hold office pursuant to rule 22, the remaining members of the Bureau shall designate one of the Vice-Presidents to take his place until the election of a new President.

POWERS OF THE ACTING PRESIDENT

Rule 21

A Vice-President acting as President shall have the powers and duties of the President.

REPLACEMENT OF THE PRESIDENT OR
A VICE-PRESIDENT

Rule 22

If the President or any Vice-President ceases to be able to carry out his functions or ceases to be a representative of a member of the Council, or if the Member of the United Nations of which he is a representative ceases to be a member of the Council, he shall cease to hold such office and a new President or Vice-President shall be elected for the unexpired term.

VOTING RIGHTS OF THE PRESIDENT

Rule 23

The President, or a Vice-President acting as President, may delegate his right to vote to another member of his delegation.

V. SESSIONAL BODIES AND SUBSIDIARY ORGANS

ESTABLISHMENT

Rule 24

1. The Council may establish and define the composition and the terms of reference of:

(a) Functional commissions and regional commissions;

(b) Sessional committees of the whole and other sessional bodies;

(c) Standing and ad hoc committees.

2. Except for the regional commissions, the commissions and committees of the Council shall not create either standing or ad hoc intersessional subsidiary bodies without prior approval of the Council.

MEMBERSHIP

Rule 25

Unless the Council decides otherwise, the members of any body or organ of limited membership, other than those subsidiary to a regional commission, shall be elected by the Council.

OFFICERS

Rule 26

1. The Chairman of a sessional committee of the whole shall be one of the Vice-Presidents, designated by the Council upon the recommendation of the President. Each sessional committee of the whole shall elect two Vice-Chairmen.

2. Unless the Council decides otherwise, all other bodies and organs shall elect their own officers.

RULES OF PROCEDURE

Rule 27

1. The rules of procedure contained in chapters VI and VIII to XII shall apply to the proceedings of the committees and sessional bodies of the Council and their subsidiary bodies, unless provided otherwise.

2. The rules of procedure of the commissions and their subsidiary bodies shall be drawn up by the Council, unless it decides otherwise.

VI. SECRETARIAT

DUTIES OF THE SECRETARY-GENERAL

Rule 28

1. The Secretary-General shall act in that capacity in all meetings of the Council. He may designate a member of the Secretariat to act as his representative.

2. He shall provide and direct the staff required by the Council and be responsible for all the arrangements that may be necessary for its meetings.

3. He shall keep the members of the Council informed of any questions that may be brought before it for consideration.

DUTIES OF THE SECRETARIAT

Rule 29

The Secretariat shall:

(a) Interpret speeches made at meetings;

(b) Receive, translate and circulate documents;

(c) Print, publish and circulate the records of the sessions, the resolutions of the Council and the required documentation;

(d) Have custody of the documents in the archives;

(e) Generally perform all other work that may be required.

STATEMENTS BY THE SECRETARIAT

Rule 30

The Secretary-General, or his representative, may, subject to rule 44, make oral as well as written statements to the Council concerning any question under consideration.

ESTIMATES OF EXPENDITURE

Rule 31

1. The Secretary-General shall circulate to the Council for its consideration every odd-numbered year a draft four-year medium-term plan and biennial programme budget covering activities in the economic, social and human rights fields, prepared on the basis of programme objectives approved and priorities established by the Council and other competent bodies.

2. Programme budget proposals recommended by a committee or commission of the Council for its approval must be stated in terms of the objectives to be achieved. The Secretary-General shall have an opportunity to determine the most effective and economical means of implementing those proposals and make appropriate recommendations to the Council thereon.

3. Before a proposal involving the expenditure of United Nations funds is approved by the Council, the Secretary-General shall prepare and provide to the Council an estimate of the programme budget implications of implementing the proposal. The President shall draw attention to that estimate and invite discussion on it when the proposal is considered by the Council. In accordance with the proposal approved by the Council, the Secretary-General shall make appropriate recommendations in the biennial programme budget and medium-term plan he subsequently presents to the General Assembly.

4. In cases of exceptional urgency, the Council may request the Secretary-General to implement a new programme decision, as a matter of priority, during the current biennium. Such a new programme shall be implemented either within the current programme budget or by additional appropriations to be approved by the General Assembly in accordance with the Financial Regulations and Rules of the United Nations.

VII. LANGUAGES

OFFICIAL AND WORKING LANGUAGES

Rule 32

Arabic, Chinese, English, French, Russian and Spanish shall be the official languages and English, French and Spanish the working languages of the Council.

INTERPRETATION

Rule 33

1. Speeches made in an official language shall be interpreted into the other official languages.

2. A speaker may make a speech in a language other than an official language if he provides for interpretation into one of the official languages. Interpretation into the other official languages by the interpreters of the Secretariat may be based on the interpretation given in the first such language.

LANGUAGES OF RECORDS

Rule 34

Records shall be drawn up in the working languages. A translation of the whole or part of any record into either of the other official languages shall be furnished if requested by a representative.

LANGUAGES OF RESOLUTIONS AND OTHER FORMAL DECISIONS

Rule 35

All resolutions and other formal decisions of the Council shall be published in the official languages. 3/

VIII. PUBLIC AND PRIVATE MEETINGS

GENERAL PRINCIPLES

Rule 36

The meetings of the Council shall be held in public unless it decides otherwise.

IX. RECORDS

SOUND RECORDINGS OF MEETINGS

Rule 37

Sound recordings of the meetings of the Council and of its sessional committees of the whole shall be made and kept by the Secretariat. Such recordings may also be made and kept of the meetings of other subsidiary organs if so decided by the Council.

RECORDS OF PUBLIC MEETINGS

Rule 38

1. Summary records of public meetings of the Council, and its subsidiary organs where authorized, shall be prepared by the Secretariat in the working languages of the Council. They shall be distributed

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3/ Such resolutions and decisions shall also be published in other languages as may be provided by the General Assembly.

in provisional form as soon as possible to all members of the Council or of the organ concerned, and to any other participants in the meeting, who may, within three working days of their receipt, submit corrections to the Secretariat; at the end of sessions and in other special circumstances, the presiding officer may, in consultation with the Secretary-General, extend the time for submitting corrections. Any disagreement concerning such corrections shall be decided by the presiding officer of the body to which the record relates, after consulting, where necessary, the sound recordings of the proceedings. Separate corrigenda to provisional records shall not normally be issued.

2. The summary records, with any corrections incorporated, shall be distributed promptly to the Members of the United Nations and to the specialized agencies. On publication, these records may be consulted by the public.

3. Neither verbatim nor summary records shall be provided for newly established subsidiary organs of the Council unless they have been specifically authorized by the Council.

RECORDS OF PRIVATE MEETINGS

Rule 39

The records of private meetings of the Council shall be distributed promptly to all members of the Council and to any other participants in these meetings. They shall be made available to other Members of the United Nations upon decision of the Council. They may be made public at such time and under such conditions as the Council may decide.

RESOLUTIONS AND OTHER FORMAL DECISIONS

Rule 40

As soon as possible, the text of the resolutions and other formal decisions adopted by the Council shall be distributed to all members of the Council and to any other participants in the session. The printed text of such resolutions and other formal decisions shall be distributed as soon as possible after the close of the session to the Members of the United Nations, to the specialized agencies and to the intergovernmental organizations referred to in rule 79.

X. CONDUCT OF BUSINESS

QUORUM

Rule 41

The President may declare a meeting open and permit the debate to proceed when representatives of at least one third of the members of the Council are present. The presence of representatives of a majority of the members of the body concerned shall be required for any decision to be taken.

GENERAL POWERS OF THE PRESIDENT

Rule 42

1. In addition to exercising the powers conferred upon him elsewhere by these rules, the President shall declare the opening and closing of each plenary meeting of the Council, direct the discussions, ensure observance of these rules, accord the right to speak, put questions to the vote and announce decisions. The President, subject to these rules, shall have complete control of the proceedings of the Council and over the maintenance of order at its meetings. He shall rule on points of order. He may propose to the Council the closure of the list of speakers, a limitation on the time to be allowed to speakers and on the number of times the representative of each member may speak on an item, the adjournment or closure of the debate, and the suspension or adjournment of a meeting.

2. The President, in the exercise of his functions, remains under the authority of the Council.

POINTS OF ORDER

Rule 43

1. During the discussion of any matter, a representative may at any time raise a point of order, which shall be decided immediately by the President in accordance with these rules. A representative may appeal against the ruling of the President. The appeal shall be immediately put to the vote, and the ruling of the President shall stand unless overruled by a majority of the members present and voting.

2. A representative may not, in raising a point of order, speak on the substance of the matter under discussion.

SPEECHES

Rule 44

1. No one may address the Council without having previously obtained the permission of the President. Subject to rules 43, 46 and 49 to 51, the President shall call upon speakers in the order in which they signify their desire to speak.

2. Debate shall be confined to the question before the Council, and the President may call a speaker to order if his remarks are not relevant to the subject under discussion.

3. The Council may limit the time allowed to speakers and the number of times the representative of each member may speak on any question; permission to speak on a motion to set such limits shall be accorded only to two representatives favouring and to two opposing such limits, after which the motion shall be put to the vote immediately. Interventions on procedural questions shall not exceed five minutes unless the Council decides otherwise. When debate is limited and a speaker exceeds the allotted time, the President shall call him to order without delay.

CLOSING OF LIST OF SPEAKERS

Rule 45

During the course of a debate the President may announce the list of speakers and, with the consent of the Council, declare the list closed. When there are no more speakers, the President shall, with the consent of the Council, declare the debate closed. Such closure shall have the same effect as closure by decision of the Council.

RIGHT OF REPLY

Rule 46

The right of reply shall be accorded by the President to any member who requests it. Representatives should attempt, in exercising this right, to be as brief as possible and preferably to deliver their statements at the end of the meeting at which this right is requested.

CONGRATULATIONS

Rule 47

Congratulations to the newly elected members of the Bureau shall be expressed only by the outgoing President or a member of his delegation, or by a representative designated by the outgoing President.

CONDOLENCES

Rule 48

Condolences shall be expressed solely by the President on behalf of all members. The President, with the agreement of the Council, may dispatch a message on behalf of all members of the Council.

SUSPENSION OR ADJOURNMENT OF THE MEETING

Rule 49

During the discussion of any matter, a representative may at any time move the suspension or the adjournment of the meeting. No discussion on such motions shall be permitted, and they shall be put to the vote immediately.

ADJOURNMENT OF DEBATE

Rule 50

A representative may at any time move the adjournment of the debate on the item under discussion. Permission to speak on the motion shall be accorded only to two representatives favouring and to two opposing the adjournment, after which the motion shall be put to the vote immediately.

CLOSURE OF DEBATE

Rule 51

A representative may at any time move the closure of the debate on the item under discussion, whether or not any other representative has signified his wish to speak. Permission to speak on the motion shall be accorded only to two representatives opposing the closure, after which the motion shall be put to the vote immediately.

ORDER OF MOTIONS

Rule 52

Subject to rule 43, the motions indicated below shall have precedence in the following order over all proposals or other motions before the meeting:

(a) To suspend the meeting;

(b) To adjourn the meeting;

(c) To adjourn the debate on the item under discussion;

(d) To close the debate on the item under discussion.

DISCUSSION OF REPORTS OF SESSIONAL COMMITTEES OF THE WHOLE

Rule 53

Discussion of a report of a sessional committee of the whole in a plenary meeting of the Council shall take place if at least one third of the members present and voting at the plenary meeting consider such discussion to be necessary. A motion to this effect shall not be discussed but shall be put to the vote immediately.

SUBMISSION OF PROPOSALS AND SUBSTANTIVE AMENDMENTS

Rule 54

Proposals and substantive amendments shall normally be submitted in writing to the Secretary-General who shall circulate copies to the members of the Council in all the official languages. Unless the Council decides otherwise, proposals and substantive amendments shall be discussed or put to the vote no earlier than twenty-four hours after copies have been circulated to all members.

WITHDRAWAL OF PROPOSALS AND MOTIONS

Rule 55

A proposal or a motion may be withdrawn by its sponsor at any time before voting on it has commenced, provided that it has not been amended. A proposal or a motion thus withdrawn may be reintroduced by any representative.

DECISIONS ON COMPETENCE

Rule 56

A motion calling for a decision on the competence of the Council to adopt a proposal submitted to it shall be put to the vote before a vote is taken on the proposal in question.

RECONSIDERATION OF PROPOSALS

Rule 57

When a proposal has been adopted or rejected, it may not be reconsidered at the same session unless the Council so decides. Permission to speak on a motion to reconsider shall be accorded only to two representatives opposing the motion, after which it shall be put to the vote immediately.

XI. VOTING AND ELECTIONS

VOTING RIGHTS

Rule 58

Each member of the Council shall have one vote.

REQUEST FOR A VOTE

Rule 59

A proposal or motion before the Council for decision shall be voted upon if any member so requests. Where no member requests a vote, the Council may adopt proposals or motions without a vote.

MAJORITY REQUIRED

Rule 60

1. Decisions of the Council shall be made by a majority of the members present and voting.

2. For the purpose of these rules, the phrase "members present and voting" means members casting an affirmative or negative vote. Members which abstain from voting are considered as not voting.

METHOD OF VOTING

Rule 61

1. Except as provided in rule 68, the Council shall normally vote by show of hands, except that a representative may request a roll-call, which shall then be taken in the English alphabetical order of the names of the members, beginning with the member whose name is drawn by lot by the President. The name of each member shall be called in all roll-calls, and its representative shall reply "yes", "no" or "abstention".

2. When the Council votes by mechanical means, a non-recorded vote shall replace a vote by show of hands and a recorded vote shall replace a roll-call. A representative may request a recorded vote. In the case of a recorded vote, the Council shall, unless a representative requests otherwise, dispense with the procedure of calling out the names of the members.

3. The vote of each member participating in a roll-call or a recorded vote shall be inserted in the record.

EXPLANATION OF VOTE

Rule 62

Representatives may make brief statements consisting solely of explanation of their votes, before the voting has commenced or after the voting has been completed. The representative of a member sponsoring a proposal or motion shall not speak in explanation of vote thereon, except if it has been amended.

CONDUCT DURING VOTING

Rule 63

After the President has announced the commencement of voting, no representative may interrupt the voting except on a point of order in connection with the actual process of voting.

DIVISION OF PROPOSALS AND AMENDMENTS

Rule 64

Parts of a proposal or an amendment shall be voted on separately if a representative requests that the proposal be divided. Those parts of the proposal or the amendment which have been approved shall then be put to the vote as a whole; if all the operative parts of a proposal or an amendment have been rejected, the proposal or amendment shall be considered to have been rejected as a whole.

AMENDMENTS

Rule 65

An amendment is a proposal that does no more than add to, delete from or revise part of another proposal.

ORDER OF VOTING ON AMENDMENTS

Rule 66

When an amendment is moved to a proposal, the amendment shall be voted on first. When two or more amendments are moved to a proposal, the amendment furthest removed in substance from the original proposal shall be voted on first and then the amendment next furthest removed therefrom, and so on until all the amendments have been put to the vote. Where, however, the adoption of one amendment necessarily implies the rejection of another amendment, the latter shall not be put to the vote. If one or more amendments are adopted, the amended proposal shall then be voted on.

ORDER OF VOTING ON PROPOSALS

Rule 67

1. If two or more proposals, other than amendments, relate to the same question, they shall, unless the Council decides otherwise, be voted on in the order in which they were submitted. The Council may, after each vote on a proposal, decide whether to vote on the next proposal.

2. A motion requiring that no decision be taken on a proposal shall have priority over that proposal.

ELECTIONS

Rule 68

All elections shall be held by secret ballot, unless, in the absence of any objection, the Council decides to proceed without taking a ballot on an agreed candidate or slate. When candidates are to be nominated, each nomination shall be made only by one representative, after which the Council shall immediately proceed to the election.

Rule 69

1. If, when only one elective place is to be filled, no candidate obtains in the first ballot the majority required, a second ballot shall be taken, confined to the two candidates having obtained the largest number of votes. If in the second ballot the votes are equally divided, the President shall decide between the candidates by drawing lots.

2. In the case of a tie in the first ballot among the candidates obtaining the second largest number of votes, a special ballot shall be held among

such candidates for the purpose of reducing their number to two; similarly, in the case of a tie among three or more candidates obtaining the largest number of votes, a special ballot shall be held. If a tie again results in the special ballot, the President shall eliminate one candidate by drawing lots, and thereafter another ballot shall be taken among all the remaining candidates. The procedure prescribed by these rules shall, if necessary, be repeated until one candidate is duly elected.

Rule 70

1. When two or more elective places are to be filled at one time under the same conditions, those candidates, in a number not exceeding the number of such places, obtaining in the first ballot the majority required and the largest number of votes shall be elected.

2. If the number of candidates obtaining such majority is less than the number of places to be filled, additional ballots shall be held to fill the remaining places, provided that if only one place remains to be filled the procedures in rule 69 shall be applied. The ballot shall be restricted to the unsuccessful candidates having obtained the largest number of votes in the previous ballot, but not exceeding twice the number of places remaining to be filled. However, in the case of a tie between a greater number of unsuccessful candidates, a special ballot shall be held for the purpose of reducing the number of candidates to the required number; if a tie again results among more than the required number of candidates, the President shall reduce their number to that required by drawing lots.

3. If such a restricted ballot (not counting a special ballot held under the conditions specified in the last sentence of paragraph 2) is inconclusive, the President shall decide among the remaining candidates by drawing lots.

EQUALLY DIVIDED VOTES

Rule 71

If a vote is equally divided on a matter other than an election, the proposal or motion shall be regarded as rejected.

XII. PARTICIPATION OF NON-MEMBERS OF THE COUNCIL

PARTICIPATION OF NON-MEMBER STATES

Rule 72

1. The Council shall invite any Member of the United Nations that is not a member of the Council, and any other State, 4/ to participate in its deliberations on any matter of particular concern to that State.

2. A committee or sessional body of the Council shall invite any State 4/ that is not one of its own members to participate in its deliberations on any matter of particular concern to that State.

3. A State thus invited shall not have the right to vote, but may submit proposals which may be put to the vote on request of any member of the body concerned.

4/ It is the understanding of the Economic and Social Council that in discharging its functions under this rule it will follow the practice of the General Assembly in implementing an "all States" clause, and that in all cases where it is advisable it will request the opinion of the Assembly before taking appropriate decisions.

PARTICIPATION OF NATIONAL LIBERATION MOVEMENTS

Rule 73

The Council may invite any national liberation movement recognized by or in accordance with resolutions of the General Assembly to participate, without the right to vote, in its deliberations on any matter of particular concern to that movement.

PARTICIPATION OF THE PRESIDENT OF THE TRUSTEESHIP COUNCIL

Rule 74

The President of the Trusteeship Council, or his representative, may participate, without the right to vote, in the deliberations of the Economic and Social Council on any matter of particular concern to the Trusteeship Council, including questions that have been proposed by the Trusteeship Council for inclusion in the provisional agenda of the Economic and Social Council.

PARTICIPATION OF AND CONSULTATION WITH SPECIALIZED AGENCIES 5/

Rule 75

In accordance with the agreements concluded between the United Nations and the specialized agencies, the specialized agencies shall be entitled:

(a) To be represented at meetings of the Council, its committees and sessional bodies;

(b) To participate, without the right to vote, through their representatives, in deliberations with respect to items of concern to them and to submit

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5/ See footnote 1.

proposals regarding such items, which may be put to the vote at the request of any member of the Council or of the committee or sessional body concerned.

Rule 76

Before the Secretary-General places an item proposed by a specialized agency on the provisional agenda, he shall carry out with the agency concerned such preliminary consultation as may be necessary.

Rule 77

1. Where an item proposed for inclusion in the provisional agenda or the supplementary list contains a proposal for new activities to be undertaken by the United Nations relating to matters that are of direct concern to one or more specialized agencies, the Secretary-General shall enter into consultation with the agencies concerned and report to the Council on the means of achieving a coordinated use of the resources of the organizations concerned.

2. When in the course of a meeting of the Council a proposal for new activities to be undertaken by the United Nations relates to matters that are of direct concern to one or more specialized agencies, the Secretary-General shall, after such consultation as may be possible with the representatives of the agencies concerned, draw the attention of the Council to the implications of the proposal.

3. Before deciding on proposals referred to above, the Council shall satisfy itself that adequate consultations have taken place with the agencies concerned.

Rule 78

Whenever the Council is to consider a proposed international convention, the Secretary-General shall, at the same time that he requests Governments to comment on the proposed convention, consult the specialized agencies in respect of any provision of the proposed convention that may affect the activities of such agencies. The views of such agencies shall be brought before the Council together with the comments received from Governments.

PARTICIPATION OF OTHER INTERGOVERNMENTAL ORGANIZATIONS

Rule 79

Representatives of intergovernmental organizations accorded permanent observer status by the General Assembly and of other intergovernmental organizations designated on an ad hoc or a continuing basis by the Council on the recommendation of the Bureau, may participate, without the right to vote, in the deliberations of the Council on questions within the scope of the activities of the organizations.

XIII. CONSULTATION WITH NON-GOVERNMENTAL ORGANIZATIONS

COMMITTEE ON NON-GOVERNMENTAL ORGANIZATIONS

Rule 80

1. The Committee on Non-Governmental Organizations shall consist of nineteen Members of the United Nations elected for four years on the basis of equitable geographical representation. Accordingly, the membership of the Committee shall include:

(a) Five members from African States;

(b) Four members from Asian States;

(c) Four members from Latin American and Caribbean States;

(*d*) Four members from Western European and other States;

(*e*) Two members from Eastern European States.

2. The Committee shall carry out the functions assigned to it by the Council in connection with the arrangements for consultations with non-governmental organizations adopted by the Council in accordance with Article 71 of the Charter.

3. The Committee shall elect its own officers.

4. When considering applications for granting consultative status to non-governmental organizations, the Committee shall be guided by the rules of procedure of the Council. Non-governmental organizations applying for consultative status shall have an opportunity to submit written statements or be heard by the Committee, at the request of the latter, by means of an oral statement made by a duly authorized representative.

REPRESENTATION

Rule 81

Non-governmental organizations in category I or II may designate authorized representatives to sit as observers at public meetings of the Council, its committees and sessional bodies. Those on the Roster may have representatives present at such meetings when matters within their field of competence are being discussed.

GENERAL CONSULTATION OF THE COMMITTEE WITH ORGANIZATIONS IN CONSULTATIVE STATUS

Rule 82

The Committee on Non-Governmental Organizations may consult, in connection with sessions of the Council or at such other times as it may decide, with organizations in categories I and II on matters within their competence, other than items on the agenda of the Council, on which the Council or the Committee or the organization requests consultation. The Committee shall report to the Council on such consultations.

CONSULTATION OF THE COMMITTEE WITH ORGANIZATIONS IN CATEGORIES I AND II ON ITEMS ON THE PROVISIONAL AGENDA OF THE COUNCIL

Rule 83

The Committee on Non-Governmental Organizations may consult, in connection with any particular session of the Council, with organizations in categories I and II on matters within the competence of the organizations concerning specific items already on the provisional agenda of the Council on which the Council or the Committee or the organization requests consultation, and shall make recommendations as to which organizations, subject to the provisions of paragraph 1 of rule 84, should be heard by the Council or the appropriate committee and regarding which subjects on which they should be heard. Organizations desiring such consultation shall apply in writing so that the request may reach the Secretary-General as soon as possible after the issue of the provisional agenda for the session, and in any case not later than five days after the adoption of the agenda. The Committee shall report to the Council on such consultations.

HEARING OF ORGANIZATIONS IN CATEGORY I BY THE COUNCIL OR ITS COMMITTEES

Rule 84

1. The Committee on Non-Governmental Organizations shall make recommendations to the Council as to which organizations in category I should be heard by the Council or by its sessional committees and on which items they should be heard. Such organizations shall be entitled to make one statement on each such item to the Council or the appropriate sessional committee, subject to the

approval of the Council or of the sessional committee concerned. In the absence of the subsidiary body of the Council with jurisdiction in a major field of interest to the Council and to an organization in category II, the Committee may recommend that an organization in category II be heard by the Council on the subject in its field of interest.

2. Whenever the Council discusses the substance of an item proposed by a non-governmental organization in category I and included in the agenda of the Council, such an organization shall be entitled to present orally to the Council or a sessional committee of the Council, as appropriate, an introductory statement of an expository nature. Such an organization may be invited by the President of the Council or the Chairman of the committee, with the consent of the relevant body, to make, in the course of the discussion of the item before the Council or before the committee, an additional statement for purposes of clarification.

XIV. AMENDMENT AND SUSPENSION OF RULES OF PROCEDURE

METHOD OF AMENDMENT

Rule 85

Any of these rules may be amended by the Council. These rules may, however, not be amended until the Council has received a report on the proposed amendment from a committee of the Council.

METHOD OF SUSPENSION

Rule 86

Any of these rules may be suspended by the Council provided that twenty-four hours notice of the proposal for the suspension has been given, which may be waived if no representative objects. Any such suspension shall be limited to a specific and stated purpose and to a period required to achieve that purpose.

ANNEX

1. The Preparatory Commission of the United Nations, at its second session in London in 1945, prepared draft rules of procedure for the Council (PC/20, chap. III, sect. 3). These provisional rules were approved, without change, at the first meeting of the Joint Subcommittee of the Second and Third Committees during the first session of the General Assembly on 22 January 1946 (A/C.2/7 and A/C.3/3). The General Assembly adopted the conclusions of the reports of the Second and Third Committees at its 19th plenary meeting, on 29 January 1946 (A/16 and A/17). At its 12th meeting, during its first session, on 16 February 1946, the Council adopted these provisional rules of procedure, as contained in chapter III, section 3 (E/33).

2. The Council subsequently revised its rules of procedure at its second, fourth, fifth, seventh, eighth, tenth, fourteenth, fifteenth, fortieth, forty-first, forty-second, forty-sixth, resumed forty-seventh, organizational sessions for 1973, 1974 and 1975, fifty-eighth session, first regular session of 1982 and organizational session for 1992.

3. At the eighth session of the Council the revisions were of a comprehensive character (resolution 217 (VIII) (text of rules in E/33/Rev.5)). At the fourteenth session, the rules dealing with sessions and the agenda of the Council were revised by resolution 456 (XIV), as a consequence of the provisions of Council resolution 414 (XIII) on the organization and operation of the Council, and additional rules were adopted regarding inter-agency consultation, on the basis of the Council's recommendations contained in its resolution 402 B (XIII) (annex, para. 39) (text of rules in E/2336). At the fifteenth session, the rules concerning languages were amended by resolution 481 (XV) (text of rules in E/3063, rules 35-38). At the fortieth session, by resolution 1099 (XL), amendments were made in the rule regarding the Council Committee on Non-Governmental Organizations (text of rule in E/3063/Rev.1, rule 82). Amendments made by resolution 1193 (XLI) at the resumed

forty-first session related to rules 20, 22 and 23 (text of rules in E/3063/Rev.1) and those made at the forty-second session to rules 4, 19, 26 and 27 (text of rules in E/3063/Rev.1). At the forty-sixth session, _pro forma_ changes were made by resolution 1392 (XLVI) to rules 7, 10 and 12, and rules 83, 84, 85 and 86 were amended (text of amended rules in E/3063/Rev.1). At the resumed forty-seventh session, as a result of the measures adopted by the Council during its forty-seventh session to improve the organization of its work and in consequence of its approval of the calendar of conferences and meetings for 1970 and 1971 (Council decisions taken at its 1637th meeting, on 8 August 1969; see also _Official Records of the Economic and Social Council, Forty-seventh Session, Supplement No. 1_ (E/4735), pp. 18-20), the Council decided, _inter alia_, to adopt, on a provisional basis, the Secretary-General's proposals for the amendment of the relevant rules of procedure of the Council and other organizational changes (E/4757 and Corr.1, paras. 4-8) and to suspend rules 2, 9 and 14 of its rules of procedure which appear in E/3063/Rev.1 (Council decision taken at its 1647th meeting, on 17 November 1969; see also _Official Records of the Economic and Social Council, Resumed Forty-seventh Session, Supplement No. 1A_ (E/4735/Add.1), p. 5). At its organizational session for 1973, the Council decided to suspend that part of rule 82 (text of rule in E/3063/Rev.1) which stipulates that the members of the Council Committee on Non-Governmental Organizations shall be members of the Council, in order to permit members of the sessional committees also to serve on that Committee (Council decision taken at its 1848th meeting, on 8 January 1973; see also _Official Records of the Economic and Social Council, Fifty-fourth Session, Supplement No. 1_ (E/5367), p. 41). At its organizational session for 1974, the Council decided to suspend rule 20 in order to provide for the representation of all regional groups of countries among its officers and elected four Vice-Presidents instead of three as a consequence of paragraph 6 of Council resolution 1807 (LV) (Council decision taken at its 1887th meeting, on 7 January 1974; see _Official Records of the Economic and Social Council, Organizational Session for 1974_, p. 2). At its organizational session for 1975, the Council decided to suspend that part of rule 82 (text of rule in E/3063/Rev.1) which stipulates that the members of the Council Committee on Non-Governmental Organizations shall serve for one year, in order to permit members of the Committee to serve for four years (Council decision taken at its 1939th meeting, on 28 January 1975; see also Official Records of the Economic and Social Council, Fifty-eighth Session, Supplement No. 1 (E/5683), decision 70 (ORG-75)). At the fifty-eighth session of the Council the revisions were of a comprehensive character (Council resolution 1949 (LVIII)). At the 8th plenary meeting of its first regular session of 1982, on 15 April 1982, the Council, in pursuance of General Assembly resolution 35/219 A of 17 December 1980, decided to include Arabic among its official languages, with effect from 1 January 1983 (decision 1982/147); see Official Records of the Economic and Social Council, 1982, Supplement No. 1 (E/1982/82). At the 3rd plenary meeting of its organizational session for 1992, on 7 February 1992, the Council amended rules 1, 2 and 9 of its rules of procedure (resolution 1992/2); see Official Records of the Economic and Social Council, 1992, Supplement No. 1 (E/1992/92).

4. The relevant references are as follows:

(a) Decision of 4 June 1946 - See Official Records of the Economic and Social Council, First Year, Second Session, 7th meeting, page 49;

(b) Decisions of 28 February and 11 March 1947 - See Official Records of the Economic and Social Council, Second Year, Fourth Session, 52nd and 65th meetings, pages 6-8; 91 and 292; text of the rules in E/33/Rev.3;

(c) Resolution 99 (V) of 12 August 1947 - See Official Records of the Economic and Social Council, Fifth Session [Resolutions of the Council] (E/573 and Corr.1), page 91; text of the rules in E/33/Rev.4;

(d) Resolution 138 (VI) of 8 March 1948 - See Official Records of the Economic and Social Council, Sixth Session [Resolutions of the Council], pages 46 and 47;

(*e*) Resolution 176 (VII) of 28 August 1948 and decision of 28 August 1948 - See Official Records of the Economic and Social Council, Seventh Session [Resolutions of the Council] (E/1065 and Corr.1), pages 76, 77 and 78;

(*f*) Resolution 217 (VIII) of 18 March 1949 - See Official Records of the Economic and Social Council, Eighth Session, Supplement No. 1 (E/1310), pages 26-40; text of the rules in E/33/Rev.5;

(*g*) Decision of 6 March 1950, consequent on resolution 288 (X) of 27 February 1950 - See Official Records of the Economic and Social Council, Tenth Session, Supplement No. 1 (E/1661), pages 33-37; text of the rules in E/1662;

(*h*) Resolutions 456 A, B and C (XIV) of 22 and 29 July 1952 - See Official Records of the Economic and Social Council, Fourteenth Session, Supplement No. 1 (E/2332), pages 61-67; text of the rules in E/2336;

(*i*) Resolution 481 (XV) of 1 April 1953 - See Official Records of the Economic and Social Council, Fifteenth Session, Supplement No. 1 (E/2419), pages 25 and 26;

(*j*) Decision of 5 August 1954 - See Official Records of the Economic and Social Council, Eighteenth Session, Supplement No. 1 (E/2654), page 28;

(*k*) Resolution 1099 (XL) of 4 March 1966 - See Official Records of the Economic and Social Council, Fortieth Session, Supplement No. 1 (E/4176), page 7;

(*l*) Resolution 1193 (XLI) of 20 December 1966 - See Official Records of the Economic and Social Council, Resumed Forty-first Session, Supplement No. 1A (E/4264/Add.1), page 3;

(*m*) Decision of 29 May 1967 - See Official Records of the Economic and Social Council, Forty-second Session, Supplement No. 1 (E/4393), pages 30 and 31;

(*n*) Resolution 1392 (XLVI) of 3 June 1969 - See Official Records of the Economic and Social Council, Forty-sixth Session, Supplement No. 1 (E/4715 and Corr.1), page 20;

(*o*) Decision of 17 November 1969 - See Official Records of the Economic and Social Council, Resumed Forty-seventh Session, Supplement No. 1A (E/4735/Add.1), page 5; text of the rules in E/4757 and Corr.1, paragraphs 4-8;

(*p*) Decision of 8 January 1973 - See Official Records of the Economic and Social Council, Fifty-fourth Session, Supplement No. 1 (E/5367), page 41;

(*q*) Decision of 7 January 1974 - See Official Records of the Economic and Social Council, Organizational Session for 1974, 1887th meeting, page 2;

(*r*) Decision of 28 January 1975 - See Official Records of the Economic and Social Council, Fifty-eighth Session, Supplement No. 1 (E/5683), decision 70 (ORG-75);

(*s*) Resolution 1949 (LVIII) of 7 May 1975 - See Official Records of the Economic and Social Council, Fifty-eighth Session, Supplement No. 1 (E/5683);

(*t*) Decision 1982/147 of 15 April 1982 - See Official Records of the Economic and Social Council, 1982, Supplement No. 1 (E/1982/82);

(*u*) Resolution 1992/2 of 7 February 1992 - See Official Records of the Economic and Social Council, 1992, Supplement No. 1 (E/1992/92).

5. The previous versions of the rules of procedure have been issued under the following symbols:

February 1946	E/33
June 1946	E/33/Rev.1
March 1947	E/33/Rev.2
March 1947	E/33/Rev.3
August 1947	E/33/Rev.4
March 1949	E/33/Rev.5
April 1950	E/1662
November 1952	E/2336
March 1958	E/3063
October 1967	E/3063/Rev.1
June 1975	E/5715
April 1983	E/5715/Rev.1

6. References to certain resolutions and decisions of the Council bearing on the present rules of procedure are given below:

Rule 1: Adopted on 16 February 1946, first session (E/33), amended by resolution 217 (VIII) (E/33/Rev.5), amended by resolution 456 (XIV) (E/2336) as a consequence of resolution 414 (XIII), paragraph 8 (a), amended by resolution 1949 (LVIII) as a consequence of resolution 1623 (LI), paragraph 2, and further amended by resolution 1992/2 of 7 February 1992;

Rule 2: Adopted on 16 February 1946, first session (E/33), amended by resolution 456 (XIV) (E/2336) as a consequence of resolution 414 (XIII), paragraph 8 (b), (c), (d) and (e), suspended and provisionally amended by decision of 17 November 1969, resumed forty-seventh session (E/4735/Add.1, p. 5), amended by resolution 1949 (LVIII), and further amended by decision 1978/72 of 4 August 1978, resolution 1982/50 of 28 July 1982 and resolution 1992/2 of 7 February 1992;

Rule 3: Adopted by resolution 217 (VIII) (E/33/Rev.5, rule 4) and amended by resolution 1949 (LVIII);

Rule 4: Adopted on 16 February 1946, first session (E/33, rule 3), and amended by resolution 217 (VIII) (E/33/Rev.5, rule 4) and resolution 456 (XIV) (E/2336, rule 4), decision of

29 May 1967, forty-second session (E/4393, p. 30), and resolution 1949 (LVIII). Former rule 5, adopted on 16 February 1946, first session (E/33, rule 5), and amended by resolution 217 (VIII) (E/33/Rev.5, rule 5), was incorporated in paragraph 2 of present rule 4;

Rule 5: Adopted on 16 February 1946, first session (E/33, rule 6), and amended by resolution 456 (XIV) (E/2336, rule 6) and resolution 1949 (LVIII);

Rule 6: Adopted on 16 February 1946, first session (E/33, rule 7), and amended by resolution 217 (VIII) (E/33/Rev.5, rule 7) and decision of 6 March 1950, tenth session (E/1661, p. 34); pro forma changes were introduced pursuant to resolution 1392 (XLVI); amended and renumbered by resolution 1949 (LVIII);

Rule 7: Adopted on 16 February 1946, first session (E/33, rule 8), amended by resolution 217 (VIII) (E/33/Rev.5, rule 8) and decision of 6 March 1950, tenth session (E/1661, p. 34), and renumbered by resolution 1949 (LVIII);

Rules 8-15: Original rules relating to the agenda were adopted on 16 February 1946, first session (E/33, rules 9-13), and subsequently amended by decision of 11 March 1947, fourth session (65th meeting) (E/33/Rev.3, rules 9-15), and resolutions 55 (IV), 57 (IV) and 99 (V), decision of 28 August 1948, seventh session (E/1065 and Corr.1, p. 77), resolution 217 (VIII), decision of 6 March 1950, tenth session (E/1661, pp. 34-36), and by resolution 456 (XIV) (E/2336, rules 9-17) as a consequence of resolution 414 (XIII), paragraph 8 (c), (d), (e), (f) and (g); pro forma changes were introduced in rules 10 and 12 by resolution 1392 (XLVI), and rules 9 and 14 were suspended and provisionally amended by decision of 17 November 1969, resumed forty-seventh session (E/4735/Add.1, p. 5). Rules 9 to 17 (E/2336) were amended and restructured by resolution 1949 (LVIII); rule 9 was further amended by resolution 1992/2 of 7 February 1992;

Rule 16: Adopted on 16 February 1946, first session (E/33, rule 14), amended by resolution 217 (VIII) (E/33/Rev.5, rule 17) and renumbered by resolution 456 (XIV) (E/2336, rule 18) and resolution 1949 (LVIII);

Rule 17: Adopted on 16 February 1946, first session (E/33, rule 15), amended by resolution 217 (VIII) (E/33/Rev.5, rule 18), renumbered by resolution 456 (XIV) (E/2336, rule 19), amended by decision of 29 May 1967, forty-second session (E/4393, p. 30), and further amended and renumbered by resolution 1949 (LVIII);

Rule 18: Adopted on 16 February 1946, first session (E/33, rule 16), amended by resolution 217 (VIII) (E/33/Rev.5, rule 19), renumbered by resolution 456 (XIV) (E/2336, rule 20), amended by resolution 1193 (XLI), suspended by decision of 7 January 1974, during the organizational session for 1974 (1887th meeting), and amended and renumbered by resolution 1949 (LVIII);

Rule 19: Adopted on 16 February 1946, first session (E/33, rule 17), amended by resolution 217 (VIII) (E/33/Rev.5, rule 20), renumbered by resolution 456 (XIV) (E/2336, rule 21), and amended and renumbered by resolution 1949 (LVIII);

Rule 20: Adopted on 16 February 1946, first session (E/33, rule 18), renumbered as a consequence of decision of 11 March 1947, fourth session (65th meeting) (E/33/Rev.3, rule 20), renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 21), renumbered by resolution 456 (XIV) (E/2336, rule 22), amended and renumbered by resolution 1193 (XLI), and amended and renumbered by resolution 1949 (LVIII);

Rule 21: Adopted on 16 February 1946, first session (E/33, rule 20), renumbered as a consequence of decision of 11 March 1947, fourth session (65th meeting) (E/33/Rev.3, rule 22), and of resolution 217 (VIII) (E/33/Rev.5, rule 23) and resolution 456 (XIV) (E/2336, rule 24), and amended and renumbered by resolution 1949 (LVIII);

Rule 22: Adopted on 16 February 1946, first session (E/33, rule 19), renumbered as a consequence of decision of 11 March 1947, fourth session (65th meeting) (E/33/Rev.3, rule 21), amended by resolution 217 (VIII) (E/33/Rev.5, rule 22), renumbered by resolution 456 (XIV) (E/2336, rule 23), amended by resolution 1193 (XLI), and amended and renumbered by resolution 1949 (LVIII);

Rule 23: Adopted on 4 June 1946, second session (E/33/Rev.1, rule 21), renumbered as a consequence of decision of 11 March 1947, fourth session (65th meeting) (E/33/Rev.3, rule 23), renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 24) and resolution 456 (XIV) (E/2336, rule 25), and amended and renumbered by resolution 1949 (LVIII);

Rules 24-27: Adopted by resolution 1949 (LVIII). The provisions of former rules 26 and 27 of chapter V and former rules 71 to 74 of chapter XII (E/3063/Rev.1) were revised and combined into present chapter V.

Rule 26 (E/3063/Rev.1): adopted on 16 February 1946, first session (E/33, rule 21), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 22), and decision of 11 March 1947, fourth session (65th meeting) (E/33/Rev.3, rule 24), amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 25), renumbered by resolution 456 (XIV) (E/2336, rule 26) and amended by decision of 29 May 1957, forty-second session (E/4393, p. 31).

Rule 27 (E/3063/Rev.1): adopted by resolution 217 (VIII) (E/33/Rev.5, rule 26), renumbered by resolution 456 (XIV) (E/2336, rule 27) and amended by decision of 29 May 1967, forty-second session (E/4393, p. 32).

Rule 71 (E/3063/Rev.1): adopted on 16 February 1946 (E/33, rule 60), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 61), and of decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 64), amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 70), and renumbered by resolution 456 (XIV) (E/2336, rule 71).

Rule 72 (E/3063/Rev.1): adopted by resolution 217 (VIII) (E/33/Rev.5, rule 71) and renumbered by resolution 456 (XIV) (E/2336, rule 72).

Rule 73 (E/3063/Rev.1): adopted on 16 February 1946, first session (E/33, rule 61), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 62) and of decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 65), amended by resolution 99 (V) (E/33/Rev.4, rule 65), amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 72) and renumbered by resolution 456 (XIV) (E/2336, rule 73).

Rule 74 (E/3063/Rev.1): adopted on 16 February 1946, first session (E/33, rule 62), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 63), and of decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 66), amended by resolution 99 (V) (E/33/Rev.4, rule 66), and amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 74);

Rules 28 and 30: Adopted by resolution 1949 (LVIII). The provisions of former rules 28 to 32 (E/3063/Rev.1) were amended and restructured into present rules 28 and 30. Rules 28-32 (E/3063/Rev.1): adopted on 16 February 1946, first session (E/33, rules 22-26), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rules 23-27), and of decision of 11 March 1947, fourth session (65th meeting) (E/33/Rev.3, rules 25-29), amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rules 27-31) and renumbered by resolution 456 (XIV) (E/2336, rules 28-32);

Rule 29: Adopted by resolution 217 (VIII) (E/33/Rev.5, rule 32), renumbered by resolution 456 (XIV) (E/2336, rule 33), and amended and renumbered by resolution 1949 (LVIII);

Rule 30: See rules 28 and 30 above;

Rule 31: Original rule adopted by decision of 28 February 1947, fourth session (52nd meeting), in pursuance of regulation 25 of the Provisional Financial Regulations of the United Nations (E/33/Rev.3, rule 30). Amended by decision of 28 August 1948, seventh session (E/1065 and Corr.1, p. 77), based on resolution 175 (VII), pursuant to General Assembly resolutions 125 (II) and 163 (II) and financial regulation 38 (E/33/Rev.5, rule 33). Pursuant to General Assembly resolutions 413 (V) and 456 (V) (regulation 13.1 of the Financial Regulations of the United Nations) and Council resolution 402 (XIII), further amended and renumbered by resolution 456 B (XIV) (E/2336, rule 34). Taking into account financial regulations 3.1, 13.1 and 13.2 of the United Nations, the rule was further amended and renumbered by resolution 1949 (LVIII);

Rule 32: Adopted on 16 February 1946 (E/33, rule 27), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 28), and of decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 31), and by resolution 217 (VIII) (E/33/Rev.5, rule 34) and resolution 456 (XIV) (E/2336, rule 35), amended by resolution 481 (XV) and renumbered by resolution 1949 (LVIII), and further amended by decision 1982/147 of 15 April 1982;

Rule 33: Adopted by resolution 1949 (LVIII). The provisions of rules 36 to 38 (E/3063/Rev.1) were amended and restructured within the present rule 33. Rules 36-38 (E/3063/Rev.1): adopted on 16 February 1946 (E/33, rules 28-30), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rules 29-31), and decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rules 32-34), and by resolution 217 (VIII) (E/33/Rev.5, rules 35-37) and resolution 456 (XIV) (E/2336, rules 36-38); rules 36 to 37 were amended by resolution 481 (XV);

Rule 34: Adopted on 16 February 1946 (E/33, rule 31), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 32), and of decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 35), amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 38), renumbered by resolution 456 (XIV) (E/2336, rule 39) and further renumbered by resolution 1949 (LVIII);

Rule 35: Adopted on 16 February 1946 (E/33, rule 34), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 35), and decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 38), and by resolution 217 (VIII) (E/33/Rev.5, rule 39), resolution 456 (XIV) (E/2336, rule 40) and resolution 1949 (LVIII);

Rule 36: Adopted on 16 February 1946 (E/33, rule 43), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 44), and decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 47), and by resolution 217 (VIII) (E/33/Rev.5, rule 40), resolution 456 (XIV) (E/2336, rule 41) and resolution

1949 (LVIII). Former rule 42 (E/3063/Rev.1), providing that "at the close of each private meeting, the Council may issue a communiqué through the Secretary-General", originally adopted on 16 February 1946 (E/33, rule 44), was deleted during the consideration of the present rules;

Rule 37: Adopted on 16 February 1946 (E/33, rule 46), suspended by resolutions 138 (VI) and 176 (VII) and replaced by a new rule in accordance with resolution 456 (XIV) (E/2336, rule 46), and amended and renumbered by resolution 1949 (LVIII);

Rule 38: Adopted on 16 February 1946 (E/33, rule 45), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 46), and decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 49), and amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 42), resolution 456 (XIV) (E/2336, rule 43) and resolution 1949 (LVIII);

Rule 39: Adopted on 16 February 1946 (E/33, rule 48), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 49), and decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 52), and amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 44), resolution 456 (XIV) (E/2336, rule 44) and resolution 1949 (LVIII);

Rule 40: Adopted on 16 February 1946 (E/33, rule 47), renumbered as a consequence of decision of 4 June 1946, second session (7th meeting) (E/33/Rev.1, rule 48), and decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 51), and amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 45) and resolution 1949 (LVIII);

Rules 41-71: The original rules dealing with conduct of business and voting, adopted on 16 February 1946 (E/33, rules 49-59 and 35-42), were substantially restructured by resolution 217 (VIII), using as far as applicable the text employed in the corresponding rules of the General Assembly (E/33/Rev.5, rules 46-49). Rule 60, first part, reproduced textually Article 67, paragraph 2, of the Charter, renumbered as a consequence of resolution 456 (XIV) (E/2336, rules 47-70) and substantially restructured by resolution 1949 (LVIII) (rules 41-71), using as far as applicable the text employed in the corresponding rules of the General Assembly (A/520/Rev.12), as well as relevant resolutions and decisions taken by the Council (see comments listed in E/5450, opposite proposed rules 47-70). Under the present rules, separate rules are provided concerning "Right of reply" (rule 46), "Congratulations" (rule 47), "Condolences" (rule 48), "Discussion of reports of sessional committees of the whole" (rule 53), "Reconsideration of proposals" (rule 57), "Request for a vote" (rule 59), "Explanation of vote" (rule 62) and "Amendments" (rule 65);

Rule 72: The rules concerning the participation of Members of the United Nations not members of the Council were originally adopted by resolution 217 (VIII) (E/33/Rev.5, rules 74-75), based on Article 69 of the Charter, renumbered as a consequence of resolution 456 (XIV) (E/2336, rules 75-76), and amended and replaced by present rule 72 (resolution 1949 (LVIII);

Rule 73: Adopted by resolution 1949 (LVIII), taking into account, inter alia, General Assembly resolutions 3237 (XXIX) of 22 November 1974 and 3280 (XXIX) of 10 December 1974 (in particular para. 7) relating to national liberation movements, adopted by the Assembly at its twenty-ninth session;

Rule 74: For arrangements for cooperation between the Economic and Social Council and the Trusteeship Council in matters of common concern, see Official Records of the Economic and Social Council, Second Year, Fifth Session, annex 20, pp. 477-486; pursuant to resolution 216 (VIII), a new rule was adopted by resolution 217 (VIII) (E/33/Rev.5, rule 76); renumbered by resolution 456 (XIV) (E/2336, rule 77) and resolution 1949 (LVIII);

Rule 75: Based on Article 70 of the Charter, adopted by resolution 217 (VIII) (E/33/Rev.5, rule 77) and renumbered as a consequence of resolution 456 (XIV) (E/2336, rule 78) and resolution 1949 (LVIII);

Rule 76: Adopted by decision of 11 March 1974, fourth session (65th meeting) (E/33/Rev.3, rule 11), amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 12), amended and renumbered by resolution 456 (XIV) (E/2336, rule 79) and renumbered by resolution 1949 (LVIII);

Rules 77-78: Adopted by resolution 456 (XIV) (E/2336, rules 80 and 81) and renumbered as a consequence of resolution 1949 (LVIII);

Rule 79: Adopted by resolution 1949 (LVIII);

Rule 80: Arrangements for consultation with non-governmental organizations were originally based on resolution 2/3 (second session) adopted on 21 June 1946 (see Official Records of the Economic and Social Council, First Year, Second Session, pp. 360-365). The original rule was adopted by resolution 217 (VIII) (E/33/Rev.5, rule 78) as a consequence of resolution 288 B (X), amended by decision of 6 March 1950, tenth session (E/1661, p. 36), renumbered as a consequence of resolution 456 (XIV) (E/2336, rule 82), amended by decision of 5 August 1954, eighteenth session (E/2654, p. 28) and further amended by resolution 1099 (XL) (E/3063, rule 82). By its decision of 8 January 1973, during the organizational session for 1973

(E/5367, p. 41), the Council decided to suspend that part of the rule which stipulates that the members of the Council Committee on Non-Governmental Organizations shall be members of the Council, in order to permit the additional members of the sessional committees also to serve on the Committee; further, by decision 70 (ORG-75) of 28 January 1975, during the organizational session for 1975 (E/5683), the Council decided to suspend that part of the rule which stipulates that the members of the Council Committee on Non-Governmental Organizations shall serve for one year, in order to permit members of the Committee to serve for four years; amended and renumbered by resolution 1949 (LVIII). The Council decided to enlarge the membership of the Committee on Non-Governmental Organizations by its resolution 1981/50 of 20 July 1981;

Rules 81-84: Arrangements for consultation with non-governmental organizations were originally based on resolution 2/3 (second session) adopted on 21 June 1946 (see *Official Records of the Economic and Social Council, First Year, Second Session*, pp. 360-365). The original rules were adopted by resolution 217 (VIII) (E/33/Rev.5, rules 79-81) consequent to resolution 288 B (X), amended by decision of 6 March 1950, tenth session (E/1661, pp. 36-37), renumbered as a consequence of resolution 456 (XIV) (E/2336, rules 83-86), amended by resolution 1392 (XLVI) and renumbered as a consequence of resolution 1949 (LVIII);

Rules 85-86: Adopted by resolution 1949 (LVIII), restructured former rules 87 to 89 (E/3063/Rev.1). Rule 87 (E/3063/Rev.1) was adopted on 16 February 1946 (E/33, rule 64), renumbered as a consequence of decision of 6 June 1946, second session (7th meeting) (E/33/Rev.1, rule 65), and decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rule 68), amended and renumbered by resolution 217 (VIII) (E/33/Rev.5, rule 82), and renumbered as a consequence of resolution 456 (XIV) (E/2336, rule 87). Rules 88 and 89 were adopted on 16 February 1946 (E/33, rules 65 and 66) and renumbered as a consequence of decision of 6 June 1946, second session (7th meeting) (E/33/Rev.1, rules 66 and 67), and decisions of 28 February and 11 March 1947, fourth session (52nd and 65th meetings) (E/33/Rev.3, rules 69 and 70), and resolution 456 (XIV) (E/2336, rules 88 and 89).

COMPENSEM O TRABALHO, NÃO A RIQUEZA

Para pôr fim ao estado de desigualdades no qual estamos, precisamos construir uma economia voltada para os trabalhadores, não só para os super-ricos.

OXFAM

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O ano passado registrou o maior aumento no número de bilionários da história – um novo bilionário a cada dois dias. Esse aumento teria sido suficiente para acabar mais de sete vezes com a pobreza extrema global. Oitenta e dois por cento de toda a riqueza gerada no ano passado ficaram nas mãos do 1% mais rico e nada ficou com os 50% mais pobres.

O trabalho insalubre e mal remunerado de muitos garante a riqueza extrema de poucos. As mulheres estão nos piores postos de trabalho e quase todos os bilionários do planeta são homens. Governos devem criar uma sociedade mais igualitária, priorizando trabalhadores e pequenos produtores de alimentos e não os super-ricos e poderosos.

Este artigo é dedicado às mulheres e homens ao redor do mundo que lutam contra a desigualdade e a injustiça, muitas vezes com grande risco para si mesmos, diante de crescente repressão na maioria dos países.

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Para mais informações sobre as questões abordadas neste documento, envie um e-mail para Oxfam Brasil contato@oxfam.org.br.

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Foto da capa: Jovens trabalhadoras em uma fábrica de vestuário em Bangladesh. Foto: Jonathan Silvers/Saybrook Productions

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OXFAM

A Oxfam é uma confederação internacional de 20 organizações que trabalham em rede em mais de 90 países como parte de um movimento global em prol de mudanças necessárias e no intuito de construir um futuro livre da injustiça da pobreza. Para obter informações adicionais, entre em contato com qualquer dessas organizações ou visite o site www.oxfam.org.br.

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PREFÁCIO

A campanha da Oxfam e o apelo à ação são muito oportunos, porque a crise da desigualdade é real. Como o relatório aponta, em muitos países a desigualdade salarial aumentou e a participação da remuneração trabalhista no PIB diminuiu porque os lucros aumentaram mais rapidamente do que os salários. Embora a proporção de renda dos 1% que estão no topo tenha crescido substancialmente, muitos outros não compartilharam os frutos do progresso econômico. Mesmo em países emergentes com rápido crescimento econômico, muitos trabalhadores, incluindo uma parte desproporcionalmente grande de mulheres, permanecem presos a salários baixos e de pobreza.

A pesquisa realizada como parte deste relatório da Oxfam confirma que a maioria das pessoas quer viver em sociedades muito mais iguais. Refletindo essas preocupações, a redução da desigualdade aumentou rapidamente a sua importância na agenda de instituições globais e líderes mundiais. Isso se reflete mais proeminentemente nos Objetivos de Desenvolvimento Sustentável da Agenda 2030 das Nações Unidas, onde o Objetivo 10 é um chamado para "reduzir a desigualdade dentro e entre os países" e o Objetivo 8 clama por um crescimento econômico inclusivo, com emprego completo e produtivo e trabalho decente para todos. Eu não poderia concordar mais com o relatório da Oxfam quando afirma que "empregos dignos, com salários dignos são essenciais para a criação de sociedades mais justas" e que a chave para reduzir a desigualdade é "trabalho decente e bem pago".

- Guy Rider, Diretor-Geral da Organização Internacional do Trabalho (OIT)

ENDOSSOS

Nenhum grupo do mundo fez mais do que a Oxfam para trazer à luz a coexistência da riqueza extrema e da pobreza extrema e as medidas necessárias para mover o mundo para a justiça social com menores desigualdades de renda e riqueza. O mundo inteiro assinou os Objetivos de Desenvolvimento Sustentável, com o ODS 10 chamando todas as nações para que reduzam a desigualdade dentro e entre os países. O novo relatório da Oxfam é leitura obrigatória para se alcançar o ODS 10 e abre novas idéias e abordagens. O relatório certamente vai gerar atenção e controvérsia - como deve ser. Às vezes, os super-ricos chamam a Oxfam e outros por "fazerem guerra de classes", mas a verdade é que em muitas sociedades, incluindo a minha, os Estados Unidos, muitos dos super-ricos declararam guerra aos pobres. A necessidade urgente é reequilibrar as mesas, defender os direitos dos pobres e restabelecer sociedades justas que atendam às necessidades de todos, de acordo com os objetivos acordados globalmente.

- Jeffrey D. Sachs, Professor da Universidade de Columbia, Diretor da Rede de Soluções para o Desenvolvimento Sustentável (UN SDSN, por sua sigla em inglês)

A receita para reduzir a desigualdade para as famílias trabalhadoras e garantir o trabalho decente é simples: um salário mínimo com o qual se possa viver, proteção social e o cumprimento pelas empresas dos direitos humanos e trabalhistas. A liberdade de associação e os direitos de negociação coletiva são facilitadores fundamentais. Os trabalhadores precisam do volume adicional da voz coletiva para se fazerem ouvir. Os governos devem agir. As empresas devem enfrentar suas responsabilidades. A Oxfam está certa - a economia global vai diminuir com muitos bilionários. Uma economia para pessoas trabalhadoras, e não proprietários ricos, acabará com a crise da desigualdade.

- Sharan Burrow, Secretária Geral, Confederação Sindical Internacional (ITUC, por sua sigla em inglês)

Devido à alta e crescente desigualdade dentro dos países, o 1% dos indivíduos mais ricos do mundo capturaram o crescimento duas vezes mais que os 50% mais pobres desde 1980. A riqueza está disparando no topo e ficando entricheirada. A pesquisa da Oxfam, que descreve essas tendências preocupantes, é uma leitura essencial. Agora é hora de recompensar o trabalho, não a riqueza.

- Gabriel Zucman, Universidade da California, Berkeley

Este relatório confirma o que os trabalhadores conhecem há anos: a maioria dos benefícios anunciados da globalização são reservados para uma elite global que se considera intocável. Os mitos do modelo atual de globalização estão entrando em colapso como uma casa de cartas e com ela a credibilidade de seus defensores e a confiança nas instituições políticas. Evasão descarada de impostos corporativos, privatizações, cortes de serviços e décadas de salários estagnados não ocorreram por acidente. É necessária uma ação urgente e radical para financiar serviços públicos universais, trabalho decente e redistribuir riqueza. A alternativa é o aumento contínuo do populismo, do racismo e do medo na extrema direita. Fomos avisados.

- Rosa Pavanelli, Secretária Geral da Internacional de Serviços Públicos (PSI, por sua sigla em inglês)

*"*Recompensem o trabalho, não a riqueza*" mostra que os trabalhadores precisam de sindicatos e do direito à negociação coletiva mais do que nunca. As pessoas precisam de salários com os quais possam viver com dignidade. Mas a ganância descontrolada das empresas está acelerando a desigualdade e a insegurança. A negociação coletiva mais generalizada reequilibraria a economia global para que essa funcione para todos, não apenas para o 1%. É hora de os governos atuarem.*

- Frances O'Grady, Secretário Geral do UK Trades Union Congress (TUC)

Oxfam mudou a forma como o mundo pensa sobre a desigualdade. Agora é a hora de parar de falar em Davos e começar a trabalhar para criar a maior igualdade que tantos milhões demandam.

- Danny Dorling, Universidade de Oxford

A Oxfam continua a oferecer uma excelente pesquisa sobre a crise global da desigualdade. Sua mensagem é clara: temos uma economia que atende os interesses do 1%. Se queremos curar nosso mundo fraturado e instável, precisamos mudar de rumo - e rápido.

- Jason Kickel, Goldsmiths - Universidade de Londres

RESUMO EXECUTIVO

Em 2016, os dividendos anuais das ações da matriz da rede varejista de moda Zara pagos ao quarto homem mais rico do mundo, Amancio Ortega, somaram aproximadamente € 1,3 bilhão.[1] Stefan Persson, cujo pai fundou a H&M[2], foi classificado em 43º lugar na lista Forbes de pessoas mais ricas do mundo e recebeu € 658 milhões de dividendos no ano passado[3].

Anju trabalha em Bangladesh costurando roupas para exportação. Frequentemente, ela trabalha 12 horas por dia, até tarde da noite. Muitas vezes ela pula algumas refeições porque não ganhou dinheiro suficiente. Ela ganha pouco mais de $ 900 dólares por ano[4].

O ano passado registrou o maior aumento no número de bilionários da história: um a mais a cada dois dias. Atualmente, há 2.043 bilionários em todo o mundo. Nove entre dez são homens.[5] A riqueza desses bilionários também aumentou consideravelmente, em um nível que seria suficiente para acabar com a pobreza extrema por mais de sete vezes. De toda a riqueza gerada no ano passado, 82% foram parar nas mãos do 1% que está no topo, enquanto os 50% mais pobres não viram nada.[6]

Salários dignos e trabalho decente para os trabalhadores do mundo são fundamentais para acabar com o estado de desigualdade em que vivemos. Em todo o mundo, nossa economia do 1% é construída nas costas de trabalhadores mal remunerados, frequentemente mulheres, que recebem baixos salários e são privados de direitos básicos. É construída nas costas de trabalhadoras como Fatima, em Bangladesh, que trabalha costurando roupas para exportação. Ela regularmente sofre abusos quando não consegue atingir as metas e fica doente porque não pode usar o banheiro[7]. É construída à custa de trabalhadoras como Dolores, que trabalha em frigoríficos de frangos nos Estados Unidos e desenvolveu uma deficiência permanente que não lhe permite segurar seus filhos pela mão.[8] É construída nas costas de imigrantes que trabalham como faxineiras em hotéis, como Myint na Tailândia[9], que é assediada sexualmente por hóspedes do sexo masculino e não tem alternativa senão aguentar calada para não perder seu emprego.

Este estudo analisa o aumento da riqueza extrema e a situação dos que trabalham, mas vivem na pobreza. Investiga por que isso está acontecendo e faz recomendações para que essa situação possa ser corrigida.

"Quando fiquei grávida, eles me deixaram trabalhar no estoque. Havia muitas caixas cheias de sapatos e meu trabalho era carimbá-las. Os sapatos são muitos bons e caberiam perfeitamente no meu filho. Gostaria que ele tivesse sapatos como aqueles, mas ele não pode. Eu penso que ele gostaria de tê-los e fico triste por isso. Os sapatos são muito bonitos. Você sabe que um par de sapatos que nós fazemos vale mais que todo o mês de salário."

- Lan, trabalhadora de vestuário, Vietnã

MENOS PALAVRAS E MAIS AÇÃO PARA DAR ÀS PESSOAS O QUE ELAS QUEREM: UM MUNDO MAIS IGUAL

Hoje em dia, é difícil encontrar um líder político ou empresarial que não se diga preocupado com as desigualdades. No entanto, são ações – e não palavras – que contam, e nesse aspecto a maioria dos nossos líderes deixa a desejar. Na verdade, muitos promovem ativamente políticas que podem aumentar a desigualdade. O Presidente dos Estados Unidos, Donald Trump, foi eleito com a promessa de ajudar trabalhadores, mas nomeou um ministério de bilionários e está pressionando pela aprovação de grandes reduções de impostos para o 1% mais rico.[10] O presidente Buhari da Nigéria, disse acreditar que a desigualdade está gerando uma onda crescente de raiva e frustração,[11] não obstante existe a suspeita de que bilhões em riqueza de petróleo estejam sendo roubados naquele país, ao mesmo tempo em que a desigualdade continua a aumentar e 10 milhões de crianças ainda estão fora da escola.[12] Oxfam e *Development Finance International* compilaram um índice detalhado de 152 ações governamentais de combate às desigualdades e a maioria dos governos não tem, vergonhosamente, tomado as mínimas medidas necessárias para eliminá-las.[13]

Quadro 1: Por um mundo mais igualitário[14]

Para elaborar este documento, a Oxfam entrevistou mais de 70 mil pessoas em 10 países que representam um quarto da população mundial:

- Mais de três quartos das pessoas concordam ou concordam enfaticamente que a distância entre ricos e pobres em seu país é muito grande, variando de 58% na Holanda a 92% na Nigéria.
- Quase dois terços dos entrevistados nos 10 países acreditam que a distância entre ricos e pobres precisa ser resolvidaurgentemente ou muito urgentemente.
- 60% do total de entrevistados concordam ou concordam enfaticamente que o governo é responsável por reduzir a distância entre ricos e pobres. Na África do Sul são 69%.
- 75% dos entrevistados preferem níveis de desigualdade de renda mais baixos que os registrados no seu país. Na verdade, mais da metade dos entrevistados desejam ter níveis de desigualdade no seu país mais baixos que os registrados em qualquer país no mundo.

REPRIMAM AS DESIGUALDADES, NÃO A DEMOCRACIA

Em todos os países nos quais a Oxfam atua, o espaço para cidadãos levantarem suas vozes está sendo fechado e a liberdade de expressão reprimida. Civicus, uma aliança global dedicada a fortalecer cidadãos, observou que as liberdades civis estão sob séria ameaça em mais de 100 países.[15]

“Para a minha geração, não há volta para o período anterior à revolução. Nossos olhos foram abertos. E, embora oprimidos, estamos nos reestruturando e nos organizando para combater a desigualdade econômica e a injustiça.”

– Ghouson Tawfik, Plataforma de Justiça Social, Egito

Segundo uma famosa declaração do Ministro da Suprema Corte dos Estados Unidos, Louis Brandeis, “podemos ter democracia neste país ou fortunas concentradas nas mãos de poucos, mas não podemos ter ambos”.[16] Nossos líderes sabem disso, mas em vez de agir para reduzir a concentração de riqueza e a desigualdade, estão optando por suprimir a democracia e a liberdade para demandar uma sociedade mais justa.

“Podemos ter democracia neste país ou fortunas concentradas nas mãos de poucos, mas não podemos ter ambos.”

– Louis Brandeis, ex-Ministro da Suprema Corte dos Estados Unidos

Quadro 2: A bonança dos bilionários[17]

Diante dessa inércia, o estado de desigualdades continua a piorar, já que os benefícios do crescimento econômico continuam a se concentrar em poucas mãos.

- O ano passado registrou o maior aumento no número de bilionários da história, com um bilionário a mais a cada dois dias. Atualmente, há 2.043 bilionários (em dólares) em todo o mundo. Nove entre dez deles são homens.[18]
- Em 12 meses, a riqueza desse grupo de elite aumentou US$ 762 bilhões – o suficiente para acabar mais de sete vezes com a pobreza extrema.[19]
- No período entre 2006 e 2015, os trabalhadores viram suas rendas aumentarem em média 2% a cada ano,[20] enquanto a riqueza dos bilionários aumentou próximo de 13% ao ano, quase seis vezes mais rápido.[21]
- Oitenta e dois por cento de todo crescimento na riqueza gerada no último ano foram para o 1% mais rico, enquanto a metade mais pobre da humanidade não viu nenhum aumento.[22]
- Enquanto os bilionários viram suas fortunas aumentarem em US$ 762 bilhões em um ano, as mulheres fornecem, anualmente, US$ 10 trilhões em cuidados não remunerados para sustentar a economia global.[23]
- Novos dados divulgados pelo banco Credit Suisse significam que agora 42 pessoas detêm a mesma riqueza que os 3,7 bilhões de pessoas na base da pirâmide da distribuição de renda e que as estatísticas do ano anterior foram atualizadas de 8 para 61 pessoas que detinham o mesmo nível de riqueza que os 50% mais pobres.[24]
- O 1% mais rico continua a deter mais riqueza que todo o restante da humanidade.[25]

Em países de todo o mundo, esse quadro se repete. Em 2017, pesquisas realizadas pela Oxfam e outras entidades revelaram que:

- Na Nigéria, os juros recebidos pelo homem mais rico sobre sua fortuna em um ano seriam suficientes para retirar duas milhões de pessoas da pobreza extrema. A despeito de quase uma década de crescimento econômico robusto na Nigéria, a pobreza aumentou ao longo do mesmo período no país.[26]
- Na Indonésia,[27] os quatro homens mais ricos concentram mais riqueza que as 100 milhões de pessoas mais pobres.
- As três pessoas mais ricas dos Estados Unidos detêm a mesma riqueza que a metade mais pobre da população do país (cerca de 160 milhões de pessoas).[28]
- No Brasil, uma pessoa que ganha um salário mínimo precisaria trabalhar 19 anos para ganhar o mesmo que uma pessoa do grupo do 0,1% mais rico ganha em um mês.[29]

A riqueza extrema que não vem do trabalho

A justificativa econômica predominante para a desigualdade é que ela oferece incentivos à inovação e ao investimento. Nos é dito que os bilionários são a prova suprema dos benefícios do talento, do trabalho duro e da inovação e que esses elementos beneficiam todos nós.[30]

"A desigualdade aumenta a cada dia. Os trabalhadores estão frustrados, seus salários não correspondem ao custo de vida. Isso se deve à crescente brecha entre ricos e pobres, que restringe quaisquer chances de prosperidade."

– Tariq Mobeen Chaudray, Center for Finance for Development, Indus Consortium, Paquistão

No entanto, há evidências crescentes[31] de que os níveis de desigualdade extrema registrados atualmente excedem em muito o que pode ser justificado por talento, esforço e disposição de assumir riscos. Na verdade, na maioria dos casos são produto de heranças, monopólios ou relações clientelistas com governo.

Aproximadamente um terço das fortunas bilionárias pode ser atribuído a heranças. Nos próximos 20 anos, 500 das pessoas mais ricas do mundo deixarão US$ 2,4 trilhões para os seus herdeiros - uma soma maior do que o PIB da Índia, país com 1,3 bilhão de habitantes.[32]

Os monopólios alimentam retornos excessivos aos proprietários e acionistas à custa do restante da economia. O poder do monopólio para gerar riqueza extrema é demonstrado pela fortuna de Carlos Slim, o sexto homem mais rico do mundo. Sua fortuna deriva de um monopólio quase completo que ele conseguiu estabelecer com serviços de comunicações (fixa, móveis e de banda larga) no México. A Organização para a Cooperação e o Desenvolvimento Econômico (OCDE) descobriu que esse monopólio teve efeitos consideravelmente negativos para os consumidores e para a economia.[33]

O poder monopolístico é acentuado pelo compadrio – a capacidade de interesses privados poderosos de manipular políticas públicas no intuito de consolidar monopólios existentes e criar outros. Acordos de privatizações, recursos naturais concedidos por valores muito abaixo do que seria justo, corrupção nas compras e contratos públicos ou isenções fiscais e brechas jurídicas são todos mecanismos pelos quais interesses privados com relações estreitas com o poder público podem enriquecer à custa do público em geral.

No total, a Oxfam calculou que aproximadamente dois terços das fortunas dos bilionários podem ser atribuídos a heranças, monopólios e compadrio.[34] Pesquisas realizadas pela Oxfam em 10 países revelam que mais da metade dos entrevistados acredita que, ainda que trabalhem duro, é difícil ou impossível para pessoas comuns aumentarem o dinheiro que têm.

As recompensas econômicas estão cada vez mais concentradas nas mãos dos mais ricos. Enquanto milhões de trabalhadores continuam a receber baixos salários, os retornos para acionistas e altos executivos dispararam.[35] Na África do Sul, os 10% mais ricos recebem metade do total de salários pagos, enquanto os 50% da força de trabalho ficam com apenas 12%.[36] Em pouco mais de um dia de trabalho, o diretor executivo de uma empresa americana ganha o mesmo que um trabalhador médio ganha em todo um ano.[37] Os homens são sempre os mais bem pagos.[38] Em média, são necessários somente um pouco mais de quatro dias para o diretor executivo de uma das cinco maiores empresas do setor de vestuário ganhar o mesmo que uma trabalhadora comum de Bangladesh levaria uma vida inteira para ganhar.[39]

Os retornos auferidos por acionistas ricos vêm subindo cada vez e com frequência, aumentando implacavelmente o ônus imposto aos trabalhadores. Seriam necessários US$ 2,2 bilhões por ano para que todos os 2,5 milhões de trabalhadores do setor de vestuário vietnamitas deixassem de ganhar o salário médio pago no país e passassem a receber um salário digno. Isso equivale a um terço do valor distribuído a acionistas pelas cinco maiores empresas do setor de vestuário.[40]

Em muitos casos, as fortunas dos mais ricos são alimentadas pela evasão fiscal – praticada por indivíduos ricos e pelas empresas das quais são titulares ou acionistas. Usando uma rede global de paraísos fiscais, como revelado nos chamados Panamá e Paradise Papers, os super-ricos estão escondendo pelo menos US$ 7,6 trilhões das autoridades fiscais.[41] Uma nova análise do economista Gabriel Zucman para este documento mostrou que isso significa que o 1% mais rico vem sonegando cerca de US$ 200 bilhões em impostos.[42] Os países em desenvolvimento estão perdendo pelo menos US$ 170 bilhões por ano em impostos não pagos por empresas e super-ricos.[43]

Até mesmo bilionários que fizeram suas fortunas em mercados competitivos muitas vezes estão fazendo isso, diminuindo os salários e condições dos trabalhadores, forçando os países a uma corrida suicida para reduzir salários e direitos trabalhistas ao fundo do poço e aumentar isenções fiscais.

Ao mesmo tempo, as crianças mais pobres, especialmente as meninas, são condenadas a morrer pobres, uma vez que as oportunidades vão para crianças de famílias mais ricas.[44]

"Os sonhos nascem lá, e os sonhos morrem lá."

– Mildred Ngesa, da FEMNET: Rede Africana de Mulheres para o Desenvolvimento e a Comunicação, referindo-se à favela de Dandora em Nairóbi, próxima ao local em que foi criada.

A VISTA DESDE BAIXO

Desigualdade e pobreza

Entre 1990 e 2010, o número de pessoas que viviam em situação de pobreza extrema (ou seja, com menos de US$ 1,90 por dia) caiu pela metade, e esse número vem diminuindo desde então.[45] Essa imensa conquista é algo de que o mundo deve se orgulhar. No entanto, se a desigualdade nos países não tivesse aumentado ao longo desse período, outras 200 milhões de pessoas teriam saído da pobreza.[46] Esse número poderia ter aumentado para 700 milhões se os pobres tivessem sido mais beneficiados pelo crescimento econômico do que seus concidadãos ricos.[47] Olhando para o futuro, o Banco Mundial deixou explícito que, a menos que eliminemos a brecha entre ricos e pobres, não conseguiremos alcançar, por uma larga margem, a meta de eliminar a pobreza extrema. Ainda que a meta de redução da pobreza em 3% seja alcançada, teremos cerca de 200 milhões de pessoas ainda vivendo com US$ 1,90 por dia em 2030.[48]

Também existem casos de pessoas que saíram da pobreza extrema mas frequentemente continuam muito pobres, endividadas e lutando intensamente para alimentar suas famílias. Muitas delas podem estar a apenas um passo de caírem na pobreza extrema novamente. Mais da metade da população mundial vive com US$ 2 a US$ 10 por dia.[49]

Essa situação se deve ao fato de que apenas uma proporção reduzida do aumento da renda global ficou nas mãos da metade mais pobre da população nos últimos 25 anos. O recém-publicado "World Inequality Report" (Relatório de Desigualdade Mundial) do banco Credit Suisse mostra que o 1% mais rico capturou 27% do crescimento da renda global entre 1980 e 2016. Enquanto isso, os 50% mais pobres ficaram com a metade disso, ou seja, com 13%.[50] Para alguém enquadrado nos 10% mais pobres, a renda anual média aumentou menos de US$ 3 em um quarto de século. Essa é uma forma profundamente ineficiente de se eliminar a pobreza: destinando somente 13 centavos de cada dólar de aumento da renda global para os 50% mais pobres e 42 centavos para os 10% mais ricos.[51] Em vista dos limites ambientais do nosso planeta, essa abordagem também é absolutamente insustentável: considerando esse nível de desigualdade, a economia global precisaria ser 175 vezes maior apenas para permitir que todos passassem a ganhar mais de US$ 5 por dia, o que seria ambientalmente catastrófico.[52]

Desigualdade econômica e de gênero

A desigualdade econômica e a de gênero estão estreitamente inter-relacionadas. Embora a distância salarial entre os gêneros venha recebendo mais atenção na maioria dos países, a diferença de riqueza entre mulheres e homens é, geralmente, ainda maior. Em todo o mundo, mais homens do que mulheres são proprietários de terras, ações de empresas e outros bens de capital;[53] os homens recebem mais para desempenhar as mesmas funções que as mulheres e estão concentrados em empregos de maior remuneração e *status*. Não é por acaso que as mulheres estão amplamente super-representadas em muitos dos empregos de pior remuneração e menos seguros.[54] Ao redor do mundo, normas sociais, atitudes e crenças desvalorizam o *status* e as habilidades das mulheres, justificam a violência e a discriminação de que são vítimas e determinam os empregos aos quais elas podem – ou não – se candidatar.

A desigualdade de gênero não é um acidente e nem é nova: nossas economias foram construídas por homens ricos e poderosos em benefício próprio. O modelo econômico neoliberal piorou essa situação – redução de serviços públicos, corte de impostos para os mais ricos e a corrida para baixo em matéria de salários e direitos trabalhistas afetaram mais as mulheres do que os homens.

Nossa prosperidade econômica depende também da enorme, embora não reconhecida, contribuição das mulheres por meio dos cuidados não remunerados que prestam. No Peru, por exemplo, estima-se que esses cuidados respondam por 20% do PIB.[55] Mulheres pobres são forçadas a prestar mais cuidados não remunerados do que mulheres mais ricas.[56]

Para combater a desigualdade econômica extrema, precisamos acabar com a desigualdade de gênero. Da mesma forma, para garantir a igualdade entre mulheres e homens, precisamos reduzir radicalmente a desigualdade econômica. Para tanto, não será suficiente integrar mais intensamente as mulheres às estruturas econômicas existentes. Precisamos definir uma visão para uma nova economia humana, conjuntamente criada por mulheres e homens em benefício de todos e não apenas de uns poucos privilegiados.

Trabalhando, mas ainda na pobreza

A renda do trabalho é a fonte mais importante de renda para a maioria das famílias.[57] Portanto, aumentar o acesso ao trabalho decente promove a igualdade.

Para muitos dos mais pobres, essa renda vem da produção de alimentos em pequena escala. Para muitos outros, vem dos salários. Este documento enfoca principalmente nos assalariados do mundo. A Oxfam publicará uma análise complementar dos pequenos produtores de alimentos ainda em 2018.

Quadro 3: Os trabalhadores continuam a enfrentar dificuldades para sobreviver[58]

Em Mianmar, a Oxfam trabalha com jovens operárias do setor de vestuário que confeccionam roupas para marcas globais. Elas ganham US$ 4 por dia, o dobro da linha de pobreza extrema. Para ganhar esse valor, trabalham 11 horas por dia, seis ou sete dias por semana. Em que pesem essas longas jornadas de trabalho, elas ainda enfrentam grandes dificuldades para satisfazer suas necessidades básicas em termos de alimentos e medicamentos e, em muitos casos, se endividam.

Cada vez mais, no entanto, ter um emprego não significa escapar da pobreza. Estimativas recentes da OIT revelam que um entre cada três trabalhadores de países emergentes e em desenvolvimento vive em situação de pobreza, e esse número está aumentando.[59]

A escravidão moderna talvez seja o elemento mais chocante do mercado de trabalho global dos nossos dias. A OIT estimou em 40 milhões o número de pessoas escravizadas em 2016, 25 milhões das quais em situação de trabalho forçado. Segundo a OIT, “trabalhadores forçados produziram alguns dos alimentos que consumimos e das roupas que vestimos e limparam os edifícios nos quais muitos de nós moramos ou trabalhamos".[60]

"Trabalhadores forçados produziram alguns dos alimentos que consumimos e das roupas que vestimos e limparam os edifícios nos quais muitos de nós moramos ou trabalhamos."

– OIT

Quase 43% dos trabalhadores jovens de todo o mundo ainda estão desempregados ou trabalham mas continuam vivendo em situação de pobreza. [61] Mais de 500 milhões de jovens sobrevivem com menos de US$ 2 por dia.[62] Nos países em desenvolvimento, estima-se que 260 milhões de jovens estejam sem emprego, educação ou qualquer tipo de treinamento.[63] Uma em cada três mulheres jovens está na mesma situação.[64] Embora os efeitos da crise financeira tenham variado muito, um fator comum dos seus resultados é que os jovens têm sido os mais afetados.[65]

Quatro milhões de pessoas em situação de trabalho escravo são crianças. De acordo com as estimativas mais recentes, há mais de 150 milhões de crianças de 5 a 17 anos envolvidas em alguma forma de trabalho infantil,[66] quase uma em cada 10.

Isso vem ocorrendo a despeito do significativo crescimento econômico registrado na maioria dos países nas últimas décadas. Embora o valor da sua produção tenha aumentado drasticamente, os trabalhadores não foram beneficiados na mesma proporção em seus salários ou condições de trabalho.Em uma pesquisa realizada em 133 países ricos e em desenvolvimento referente ao período de 1995 a 2014, a OIT constatou que em 91 deles os salários não acompanharam o aumento da produtividade e o crescimento econômico.[67]

Infelizmente, muitos países ainda não adotaram um salário mínimo ou mecanismos de negociação coletiva e, na maioria dos casos, os salários mínimos são significativamente mais baixos do que seria necessário para sobreviver ou do que poderia ser considerado um salário digno.[68] A Oxfam demonstrou que essa é a realidade no mercado de trabalho do Marrocos, do Quênia, da Indonésia e do Vietnã.[69] Quando previstos em lei, os salários mínimos também não vigoram efetivamente e menos ainda para as mulheres.

Inseguro, precário e sem direitos

O trabalho temporário e precário é a norma nos países em desenvolvimento e é uma realidade cada vez mais visível em nações ricas. Os empregados temporários recebem salários mais baixos e têm menos direitos e menor acesso à proteção social. As mulheres e os jovens são os mais propensos a aceitar empregos desse tipo.

Na opinião de muitos, seu trabalho é perigoso e prejudicial à saúde. Segundo a OIT, mais de 2,78 milhões de trabalhadores morrem todos os anos em decorrência de acidentes de trabalho ou doenças ocupacionais - um a cada 11 segundos.[70]

"O assédio sexual é muito comum nesse tipo de trabalho. Pelo menos 90% das mulheres trabalhadoras são assediadas tanto por clientes como pelos donos das empresas. A justiça está do lado das empresas".

– Eulogia Familia, líder sindical, representante dos empregados do setor hoteleiro da República Dominicana[71]

Mulheres trabalhadoras em todo o mundo muitas vezes sofrem lesões graves, ficam expostas a riscos para a sua saúde e à violência sexual no seu local de trabalho. Empregadas de hotéis entrevistadas pela Oxfam na República Dominicana, no Canadá e na Tailândia relataram casos regulares de assédio e violência sexual por parte de hóspedes do sexo masculino.[72] Relataram também problemas de saúde devido ao uso rotineiro de produtos químicos nas suas faxinas. Em Bangladesh, muitas operárias jovens do setor de vestuário sofrem de infecções urinárias recorrentes porque não têm permissão para ir ao banheiro no local de trabalho. Da mesma forma, em um estudo que realizou sobre a situação dos trabalhadores do setor avícola dos Estados Unidos, a Oxfam verificou que eles usavam fraldas porque não tinham permissão para usar o banheiro.[73]

Quadro 4: Sem conseguir segurar as mãos dos filhos[74]

Nos Estados Unidos, a Oxfam está trabalhando com empregados do setor avícola em uma campanha para melhorar suas terríveis condições de trabalho. Eles não têm direito a pausas suficientes para ir ao banheiro, o que força muitos deles a usarem fraldas para poderem trabalhar. Dolores, uma ex-trabalhadora do setor no Arkansas, descreveu a sua situação da seguinte maneira: "Era como não ter nenhum valor... chegávamos às 5 da manhã e trabalhávamos até as 11 ou 12 sem ir ao banheiro... Eu sentia vergonha de dizer a eles que precisava trocar a minha fralda".

O trabalho também é perigoso e marcado por uma das taxas mais altas de lesões entre todos os setores. As lesões por esforço repetitivo podem ser tão graves que após apenas um ano nas linhas de produção alguns trabalhadores não conseguem mais esticar os dedos, segurar uma colher ou mesmo segurar adequadamente as mãos dos filhos.

Trabalhadores organizados constituem um contrapeso ao poder da riqueza e têm desempenhado um papel fundamental na criação de sociedades mais igualitárias e democráticas. Os sindicatos aumentam salários, direitos e proteções não apenas para os seus membros, mas também para todos os trabalhadores de uma sociedade.[75] Infelizmente, o FMI vem observando uma tendência de queda nas taxas de densidade sindical em todo o mundo desde 2000.[76] O FMI associa isso ao aumento da desigualdade.[77] Esse problema vem se agravando em decorrência do uso mais intensivo da terceirização e de contratos temporários de curto prazo para minar direitos trabalhistas.

O número de países marcados pela violência física e ameaças contra trabalhadores aumentou 10% em apenas um ano, de acordo com o Índice Global de Direitos divulgado anualmente pela Confederação Internacional Sindical (CSI).[78] Agressões a sindicalistas foram registradas em 59 países.[79] Mais de três quartos dos países negam o direito de greve a alguns dos seus trabalhadores ou a todos eles. Na Tailândia, trabalhadores migrantes – que constituem uma em cada dez pessoas da força de trabalho – não têm direito de greve.[80]

Os piores empregos predominam no setor informal da economia, largamente não regulamentado, onde mulheres e jovens estão super-representados. Essa situação favorece alguns dos atores mais poderosos de uma economia globalizada. Grandes multinacionais podem reduzir seus custos terceirizando sua produção para empresas menores que empregam trabalhadores informais, pagam salários mais baixos e oferecem condições menos seguras de trabalho, o que lhes permite driblar a legislação trabalhista e de proteção social.

QUAL É A CAUSA DISSO?

Uma "tempestade perfeita" de fatores inter-relacionados está se formando para fortalecer o poder de negociação dos que estão no topo, ao mesmo tempo, reduzir o dos que estão na base.

Na base da pirâmide, direitos trabalhistas estão sendo minados e com eles o poder de negociação dos sindicatos. Empresas estão se consolidando cada vez mais e se encontram sob uma enorme pressão para oferecer retornos cada vez mais altos aos seus acionistas. Esses retornos geralmente são garantidos à custa dos trabalhadores e oferecem um maior incentivo para a evasão fiscal em larga escala. As empresas usam a mobilidade dos seus investimentos para promover uma “corrida para baixo” entre países em termos de tributação e salários. A ameaça de uma automação crescente também garante mais poder nas mãos de ricos donos de empresas e coloca mais pressão sobre os trabalhadores.

Podemos construir uma economia humana para resolver isso

A economia não precisa estar estruturada como está. Podemos criar uma economia mais humana,[81] que priorize os interesses de trabalhadores comuns e de pequenos produtores de alimentos, e não os daqueles com super salários e donos de grandes fortunas. Uma economia desse tipo poderia pôr fim à desigualdade extrema e garantir um futuro promissor para o nosso planeta. Precisamos rejeitar a adesão dogmática à economia neoliberal e a influência inaceitável das elites nos nossos governos. Podemos fazer isso principalmente de duas maneiras: concebendo economias mais igualitárias desde o início e usando a tributação e os gastos públicos para redistribuir e promover uma maior equidade.

Podemos estabelecer uma economia humana principalmente de duas maneiras: concebendo economias mais igualitárias desde o início e usando a tributação e os gastos públicos para redistribuir e promover uma maior equidade.

Regular, reestruturar e redesenhar a nossa economia e a forma como as empresas operam.

A regulação pode ser usada para garantir que os trabalhadores tenham mais poder de negociação; para acabar com os paraísos fiscais; para romper monopólios; e para que o setor financeiro e os avanços tecnológicos beneficiem a maioria. Governos e empresas podem ambos agir no sentido de garantir que salários miseráveis, a escravidão e o trabalho precário e perigoso não sejam vistos como moralmente aceitáveis. Isso exigirá uma cooperação global em uma escala muito maior que a observada atualmente. Será muito difícil lograr esse tipo de cooperação no atual ambiente político. Felizmente, os governos ainda têm muito espaço para promover grandes avanços no nível nacional.

O comércio e os investimentos podem gerar oportunidades, produtos, serviços e prosperidade ampla e irrestritamente. No entanto, decisões são cada vez mais tomadas apenas sob a ótica da maximização de retornos para acionistas ricos. Essa postura acabou se caracterizando como uma espécie de camisa de força que mantém o mundo empresarial em uma dinâmica que conduz à desigualdade.

No entanto, empresas, movimentos sociais e empreendedores têm gerado uma série de conceitos no intuito de se libertarem dessa camisa de força. Esses conceitos incluem cooperativas, modelos de participação acionária de empregados, primazia da missão, negócios centrados na geração de benefícios sociais, empreendimentos sociais e empresas de comércio justo.

Estudos revelam que empresas de propriedade dos funcionários promovem mais empregos e salários mais altos para seus empregados.[82] Por exemplo, a Mondragon é uma cooperativa multinacional espanhola que tem um faturamento US$ 13 bilhões e emprega 74 mil pessoas. Seu processo de tomada de decisões é democrático, a segurança no emprego é promovida e o salário mais alto não é mais do que nove vezes superior ao mais baixo.

Nossas economias poderiam ser construídas sobre essas estruturas progressistas se líderes políticos priorizassem políticas que financiassem, apoiassem e promovessem modelos desse tipo.

Para esse fim, eles devem oferecer educação, saúde e proteção social para todos e pagar por isso assegurando que pessoas físicas e jurídicas ricas paguem sua parcela justa de impostos.

Os governos têm outro papel fundamental a desempenhar na redução da desigualdade usando a tributação e seus gastos para *redistribuir* a renda.

Evidências colhidas em mais de 150 países ricos e pobres, entre 197-2009,[83] indicam que investir na saúde, educação e proteção social reduz a desigualdade.

Serviços públicos universais e de qualidade beneficiam enormemente as mulheres, pois reduzem a necessidade de prestarem cuidados não remunerados e corrigem desigualdades no acesso à educação e à saúde. Esse benefício aumenta se for oferecido juntamente com outras medidas específicas, como a disponibilização gratuita de creches.

Muito mais pode ser feito para que a tributação seja usada no sentido de redistribuir os retornos excessivamente altos desfrutados pelos ricos atualmente. Pessoas físicas e jurídicas ricas devem pagar mais impostos e não devem ter mais a capacidade de sonegar impostos devidos. Precisamos pôr fim aos paraísos fiscais e à rede global de sigilo que permite que empresas e indivíduos ricos deixem de pagar sua parcela justa de impostos. A corrida global para baixo, em termos da tributação, precisa ser revertida. Os governos devem seguir o exemplo do Chile e da África do Sul, que aumentaram a tributação de pessoas físicas e jurídicas ricas.[84]

Um mundo mais igualitário

Precisamos urgentemente reconfigurar nossas economias no sentido de recompensar trabalhadores comuns e pequenos produtores da base da pirâmide de renda e dar um basta à sua exploração. Precisamos parar de recompensar excessivamente os super-ricos. É isso que as pessoas desejam. É isso que nossos líderes prometeram fazer. Juntos, podemos acabar com o estado de desigualdades extremas. Podemos construir uma economia mais humana e um mundo mais igualitário para os nossos filhos e filhas.

RECOMENDAÇÕES

Governos e instituições internacionais devem reconhecer o impacto do atual modelo econômico neoliberal dominante sobre os pobres do mundo. Com base nesse reconhecimento, eles devem trabalhar no sentido de desenvolver economias mais humanas cujo objetivo principal seja o de promover uma maior equidade. As recomendações apresentadas a seguir analisam o que governos, instituições internacionais e empresas devem fazer.

OS GOVERNOS DEVEM

Em relação à desigualdade:

- **Estabelecer metas e planos de ação concretos e com prazos definidos para reduzir a desigualdade.** Os governos devem trabalhar no sentido de que a renda coletiva dos 10% mais ricos não seja mais alta que a dos 40% mais pobres. Os governos devem acordar que usarão essa medida[85] como o indicador atualizado do Objetivo de Desenvolvimento Sustentável (ODS) 10, de redução da desigualdade.[86]
- **Pôr fim à riqueza extrema**. Para acabar com a pobreza extrema, precisamos também acabar com a riqueza extrema. A era dourada dos dias atuais está minando o nosso futuro. Os governos devem usar a regulação e a tributação no sentido de reduzir radicalmente os níveis atuais de riqueza extrema e limitar a influência de indivíduos e grupos ricos na formulação de políticas.
- **Trabalhar em conjunto para promover uma revolução nos dados sobre desigualdade**. Todos os países devem se empenhar em produzir, anualmente, dados sobre a riqueza e a renda de todas as pessoas da sociedade, em especial dos 10% e do 1% mais ricos. Além de financiar mais pesquisas domiciliares, outras fontes de dados devem ser publicadas para lançar luz sobre o tema da renda e da concentração de riqueza no topo.[87]

- **Implementar políticas** concebidas para combater todas as formas de discriminação de gênero, promover normas sociais e atitudes positivas em relação às mulheres e ao seu trabalho e reequilibrar a dinâmica de poder nos níveis domiciliar, local, nacional e internacional.
- **Reconhecer e proteger os direitos dos cidadãos e de suas organizações à liberdade de expressão e de associação.** Reverter todas as leis e ações que tenham fechado espaço para os cidadãos. Apoiar especificamente organizações que defendem os direitos das mulheres e de outros grupos excluídos.

Em relação a conceber uma economia justa desde o início:

- **Incentivar modelos de negócios que priorizem retornos mais justos**, inclusive modelos de cooperativas e de participação de empregados na governança de empresas e nas cadeias de abastecimento.
- **Requerer que todas as multinacionais realizem auditorias obrigatórias** em toda a sua cadeia de abastecimento para garantir que todos os trabalhadores recebam um salário digno, de acordo com os **Princípios Orientadores das Nações Unidas sobre Empresas e Direitos Humanos.**[88]
- **Limitar retornos para acionistas** e promover um coeficiente de remuneração para altos executivos de empresas que seja **no máximo 20 vezes superior ao salário médio de seus empregados,**[89] de preferência até mais baixos.
- **Eliminar diferenças salariais entre homens e mulheres** e garantir que os direitos das mulheres trabalhadoras sejam plenamente usufruídos em toda a economia. Revogar leis que discriminam a igualdade econômica das mulheres e implementar leis e marcos regulatórios que apoiem os direitos das mulheres.
- **Eliminar o trabalho escravo e os salários miseráveis.** Promover uma transição dos níveis de salário mínimo para níveis de "salários dignos" para todos os trabalhadores, com base em evidências sobre o custo de vida e com pleno envolvimento de sindicatos e outros parceiros sociais.
- **Promover a organização dos trabalhadores.** Definir normas legais que protejam os direitos de sindicalização e de greve dos trabalhadores, revogando todas as leis que contrariem esses direitos. Permitir e apoiar acordos de negociação coletiva com ampla cobertura.
- **Eliminar o trabalho precário e garantir que todas as novas formas de emprego respeitem os direitos dos trabalhadores**. **Garantir os direitos de trabalhadores domésticos, trabalhadores migrantes e trabalhadores informais**. Formalizar progressivamente a economia informal e garantir proteção a todos os trabalhadores, garantindo seu envolvimento em processos decisórios.

Em relação a redistribuir para termos uma sociedade mais justa:

Gastos públicos

- **Compromisso público para garantir a oferta de serviços públicos gratuitos universais e um piso universal de proteção social.**[90] Para esse fim, é importante aumentar o financiamento e a prestação de serviços públicos e garantir contribuições dos empregadores para a seguridade social ou o seguro social.
- **Não direcionar recursos públicos para incentivar e subsidiar a prestação de serviços de saúde e educação por empresas do setor privado com fins lucrativos e ampliar a prestação de serviços essenciais pelo setor público**.

Regular rigorosamente instalações privadas para garantir a sua segurança e qualidade e não permitir que elas excluam quem não pode pagar.

Tributação

- **Usar a tributação para reduzir a riqueza extrema.** Priorizar impostos que não são pagos pelos super-ricos na medida justa, como impostos sobre fortunas, imóveis, heranças e ganhos de capital. Aumentar as alíquotas e a tributação de rendas elevadas. Adotar um imposto global sobre fortunas para bilionários para ajudar a financiar a consecução dos ODS.
- **Chamar uma nova geração de reformas fiscais internacionais** para acabar com a guerra fiscal internacional em relação à tributação dos mais ricos. As alíquotas tributárias devem ser definidas em um nível justo e progressivo que contribua para a redução das desigualdades.[91] Quaisquer novas negociações devem ser realizadas sob a responsabilidade de um novo organismo fiscal global que garanta a participação igualitária de todos os países.
- **Erradicar o uso de paraísos fiscais** e promover uma maior transparência nessa área mediante a adoção de uma lista objetiva dos piores paraísos fiscais e a aplicação de sanções robustas e automáticas a empresas, indivíduos e países que usam esses paraísos fiscais.

As empresas devem fazer a sua parte na construção de uma economia mais humana

- **Nada de dividendos se não forem pagos salários dignos:** as multinacionais podem optar por priorizar o bem-estar de trabalhadores de remuneração mais baixa não recompensando acionistas com dividendos ou recompras de ações ou não pagando bônus a executivos e funcionários bem remunerados até que todos os seus funcionários estejam recebendo um salário digno (calculado com base em um padrão independente) e medidas tenham sido tomadas para garantir que estão pagando preços que possam proporcionar uma renda digna a trabalhadores ou produtores das suas cadeias de suprimentos.
- **Representação em conselhos:** as empresas devem garantir a representação de trabalhadores em conselhos de administração e comissões de remuneração e identificar maneiras de levar em consideração as opiniões de outras partes interessadas, como, por exemplo, de trabalhadores das suas cadeias de abastecimento e de comunidades locais, em processos decisórios.
- **Apoiar mudanças transformacionais nas cadeias de abastecimento**: as empresas podem priorizar a contratação de serviços e a compra de insumos de empresas mais equitativamente estruturadas das suas cadeias de abastecimento – por exemplo, empresas de propriedade parcial ou total de trabalhadores ou produtores; que adotam um modelo de governança que prioriza uma missão social; ou que optam por compartilhar, parcial ou totalmente, seus lucros com seus funcionários. Iniciativas como o *Fair Value Club* da Oxfam[92] estão ajudando empresas a fazer exatamente isso.
- **Compartilhar os lucros com trabalhadores mais pobres**: as empresas podem tomar a decisão de compartilhar um percentual dos seus lucros (por exemplo, 50%) com os trabalhadores de remuneração mais baixa das suas cadeias de abastecimento e operações. Por exemplo, a empresa Cafe Direct[93] compartilha 50% dos seus lucros com cafeicultores.
- **Apoiar a igualdade de gênero no local de trabalho**: assumir o compromisso de promover os Princípios de Empoderamento das Mulheres da ONU[94] e as Convenções relevantes da OIT (C100, C111, C156, C183)[95] para confirmar seu compromisso com a igualdade de gênero; implementar uma política de gênero que apoie a apresentação de denúncias relacionadas a contratações, treinamentos, promoções, assédio e controvérsias; e divulgar a diferença salarial

entre homens e mulheres para todos os níveis da empresa, comprometendo-se a eliminá-la.

- **Reduzir diferenças salariais**: divulgar dados sobre a diferença entre os salários pagos pelas empresas aos seus diretores executivos e à média de seus funcionários, assumindo o compromisso de reduzir esse coeficiente a pelo menos 20:1.
- **Apoiar negociações coletivas:** assumir publicamente o compromisso de promover relações significativas e construtivas com sindicatos independentes em bases contínuas e, em parceria com eles, trabalhar no sentido de eliminar barreiras à participação de mulheres trabalhadoras em atividades sindicais, especialmente em funções de liderança, bem como promover outros meios para que mulheres trabalhadoras possam se fazer ouvir com segurança e eficácia.

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3 Calculado usando índice S&P Capital IQ e Financial Times Markets Data.

4 Em uma entrevista para Oxfam Austrália, Anju explicou que ganha em média 6 a 7 mil takas por mês, e que ela trabalha em média três horas a mais por dia. Em dólares, sua renda média mensal é de USD $ 78 (1 BDT = 0.012 USD) e, em média, ela trabalha 286,44 horas por mês (incluindo as horas extras). Isso significa que sua renda anual média é USD $ 78 x 12 = USD $ 936.

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Financial Services and Markets Act 2000

CHAPTER 8

ARRANGEMENT OF SECTIONS

PART I

THE REGULATOR

Conduct of investigations

Offences

Part XII

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Financial Services and Markets Act 2000

2000 CHAPTER 8

An Act to make provision about the regulation of financial services and markets; to provide for the transfer of certain statutory functions relating to building societies, friendly societies, industrial and provident societies and certain other mutual societies; and for connected purposes. [00th June 2000]

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

PART I

THE REGULATOR

The Financial Services Authority.

1.—(1) The body corporate known as the Financial Services Authority ("the Authority") is to have the functions conferred on it by or under this Act.

(2) The Authority must comply with the requirements as to its constitution set out in Schedule 1.

(3) Schedule 1 also makes provision about the status of the Authority and the exercise of certain of its functions.

The Authority's general duties

The Authority's general duties.

2.—(1) In discharging its general functions the Authority must, so far as is reasonably possible, act in a way—

(a) which is compatible with the regulatory objectives; and

(b) which the Authority considers most appropriate for the purpose of meeting those objectives.

(2) The regulatory objectives are—

(a) market confidence;

(b) public awareness;

(c) the protection of consumers; and

(d) the reduction of financial crime.

(3) In discharging its general functions the Authority must have regard to—

(a) the need to use its resources in the most efficient and economic way;

(b) the responsibilities of those who manage the affairs of authorised persons;

(c) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;

(d) the desirability of facilitating innovation in connection with regulated activities;

(e) the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom;

(f) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions;

(g) the desirability of facilitating competition between those who are subject to any form of regulation by the Authority.

(4) The Authority's general functions are—

(a) its function of making rules under this Act (considered as a whole);

(b) its function of preparing and issuing codes under this Act (considered as a whole);

(c) its functions in relation to the giving of general guidance (considered as a whole); and

(d) its function of determining the general policy and principles by reference to which it performs particular functions.

(5) "General guidance" has the meaning given in section 158(5).

The regulatory objectives

Market confidence.

3.—(1) The market confidence objective is: maintaining confidence in the financial system.

(2) "The financial system" means the financial system operating in the United Kingdom and includes—

(a) financial markets and exchanges;

(b) regulated activities; and

(c) other activities connected with financial markets and exchanges.

4.—(1) The public awareness objective is: promoting public understanding of the financial system. Public awareness.

(2) It includes, in particular—

(a) promoting awareness of the benefits and risks associated with different kinds of investment or other financial dealing; and

(b) the provision of appropriate information and advice.

(3) "The financial system" has the same meaning as in section 3.

5.—(1) The protection of consumers objective is: securing the appropriate degree of protection for consumers. The protection of consumers.

(2) In considering what degree of protection may be appropriate, the Authority must have regard to—

(a) the differing degrees of risk involved in different kinds of investment or other transaction;

(b) the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity;

(c) the needs that consumers may have for advice and accurate information; and

(d) the general principle that consumers should take responsibility for their decisions.

(3) "Consumers" means persons—

(a) who are consumers for the purposes of section 138; or

(b) who, in relation to regulated activities carried on otherwise than by authorised persons, would be consumers for those purposes if the activities were carried on by authorised persons.

6.—(1) The reduction of financial crime objective is: reducing the extent to which it is possible for a business carried on— The reduction of financial crime.

(a) by a regulated person, or

(b) in contravention of the general prohibition,

to be used for a purpose connected with financial crime.

(2) In considering that objective the Authority must, in particular, have regard to the desirability of—

(a) regulated persons being aware of the risk of their businesses being used in connection with the commission of financial crime;

(b) regulated persons taking appropriate measures (in relation to their administration and employment practices, the conduct of transactions by them and otherwise) to prevent financial crime, facilitate its detection and monitor its incidence;

(c) regulated persons devoting adequate resources to the matters mentioned in paragraph (b).

(3) "Financial crime" includes any offence involving—

(a) fraud or dishonesty;

(b) misconduct in, or misuse of information relating to, a financial market; or

(c) handling the proceeds of crime.

(4) "Offence" includes an act or omission which would be an offence if it had taken place in the United Kingdom.

(5) "Regulated person" means an authorised person, a recognised investment exchange or a recognised clearing house.

Corporate governance

Duty of Authority to follow principles of good governance.

7. In managing its affairs, the Authority must have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it.

Arrangements for consulting practitioners and consumers

The Authority's general duty to consult.

8. The Authority must make and maintain effective arrangements for consulting practitioners and consumers on the extent to which its general policies and practices are consistent with its general duties under section 2.

The Practitioner Panel.

9.—(1) Arrangements under section 8 must include the establishment and maintenance of a panel of persons (to be known as "the Practitioner Panel") to represent the interests of practitioners.

(2) The Authority must appoint one of the members of the Practitioner Panel to be its chairman.

(3) The Treasury's approval is required for the appointment or dismissal of the chairman.

(4) The Authority must have regard to any representations made to it by the Practitioner Panel.

(5) The Authority must appoint to the Practitioner Panel such—

(a) individuals who are authorised persons,

(b) persons representing authorised persons,

(c) persons representing recognised investment exchanges, and

(d) persons representing recognised clearing houses,

as it considers appropriate.

The Consumer Panel.

10.—(1) Arrangements under section 8 must include the establishment and maintenance of a panel of persons (to be known as "the Consumer Panel") to represent the interests of consumers.

(2) The Authority must appoint one of the members of the Consumer Panel to be its chairman.

(3) The Treasury's approval is required for the appointment or dismissal of the chairman.

(4) The Authority must have regard to any representations made to it by the Consumer Panel.

(5) The Authority must appoint to the Consumer Panel such consumers, or persons representing the interests of consumers, as it considers appropriate.

(6) The Authority must secure that the membership of the Consumer Panel is such as to give a fair degree of representation to those who are using, or are or may be contemplating using, services otherwise than in connection with businesses carried on by them.

(7) "Consumers" means persons, other than authorised persons—

(a) who are consumers for the purposes of section 138; or

(b) who, in relation to regulated activities carried on otherwise than by authorised persons, would be consumers for those purposes if the activities were carried on by authorised persons.

Duty to consider representations by the Panels.

11.—(1) This section applies to a representation made, in accordance with arrangements made under section 8, by the Practitioner Panel or by the Consumer Panel.

(2) The Authority must consider the representation.

(3) If the Authority disagrees with a view expressed, or proposal made, in the representation, it must give the Panel a statement in writing of its reasons for disagreeing.

Reviews

Reviews.

12.—(1) The Treasury may appoint an independent person to conduct a review of the economy, efficiency and effectiveness with which the Authority has used its resources in discharging its functions.

(2) A review may be limited by the Treasury to such functions of the Authority (however described) as the Treasury may specify in appointing the person to conduct it.

(3) A review is not to be concerned with the merits of the Authority's general policy or principles in pursuing regulatory objectives or in exercising functions under Part VI.

(4) On completion of a review, the person conducting it must make a written report to the Treasury—

(a) setting out the result of the review; and

(b) making such recommendations (if any) as he considers appropriate.

(5) A copy of the report must be—

(a) laid before each House of Parliament; and

(b) published in such manner as the Treasury consider appropriate.

(6) Any expenses reasonably incurred in the conduct of a review are to be met by the Treasury out of money provided by Parliament.

(7) "Independent" means appearing to the Treasury to be independent of the Authority.

Right to obtain documents and information.

13.—(1) A person conducting a review under section 12—

(a) has a right of access at any reasonable time to all such documents as he may reasonably require for purposes of the review; and

(b) may require any person holding or accountable for any such document to provide such information and explanation as are reasonably necessary for that purpose.

(2) Subsection (1) applies only to documents in the custody or under the control of the Authority.

(3) An obligation imposed on a person as a result of the exercise of powers conferred by subsection (1) is enforceable by injunction or, in Scotland, by an order for specific performance under section 45 of the Court of Session Act 1988.

1988 c. 36.

Inquiries

Cases in which the Treasury may arrange independent inquiries.

14.—(1) This section applies in two cases.

(2) The first is where it appears to the Treasury that—

(a) events have occurred in relation to—

(i) a collective investment scheme, or

(ii) a person who is, or was at the time of the events, carrying on a regulated activity (whether or not as an authorised person),

which posed or could have posed a grave risk to the financial system or caused or risked causing significant damage to the interests of consumers; and

(b) those events might not have occurred, or the risk or damage might have been reduced, but for a serious failure in—

(i) the system established by this Act for the regulation of such schemes or of such persons and their activities; or

(ii) the operation of that system.

(3) The second is where it appears to the Treasury that—

(a) events have occurred in relation to listed securities or an issuer of listed securities which caused or could have caused significant damage to holders of listed securities; and

(b) those events might not have occurred but for a serious failure in the regulatory system established by Part VI or in its operation.

(4) If the Treasury consider that it is in the public interest that there should be an independent inquiry into the events and the circumstances surrounding them, they may arrange for an inquiry to be held under section 15.

(5) "Consumers" means persons—

(a) who are consumers for the purposes of section 138; or

(b) who, in relation to regulated activities carried on otherwise than by authorised persons, would be consumers for those purposes if the activities were carried on by authorised persons.

(6) "The financial system" has the same meaning as in section 3.

(7) "Listed securities" means anything which has been admitted to the official list under Part VI.

Power to appoint person to hold an inquiry.

15.—(1) If the Treasury decide to arrange for an inquiry to be held under this section, they may appoint such person as they consider appropriate to hold the inquiry.

(2) The Treasury may, by a direction to the appointed person, control—

(a) the scope of the inquiry;

(b) the period during which the inquiry is to be held;

(c) the conduct of the inquiry; and

(d) the making of reports.

(3) A direction may, in particular—

(a) confine the inquiry to particular matters;

(b) extend the inquiry to additional matters;

(c) require the appointed person to discontinue the inquiry or to take only such steps as are specified in the direction;

(d) require the appointed person to make such interim reports as are so specified.

Powers of appointed person and procedure.

16.—(1) The person appointed to hold an inquiry under section 15 may—

(a) obtain such information from such persons and in such manner as he thinks fit;

(b) make such inquiries as he thinks fit; and

(c) determine the procedure to be followed in connection with the inquiry.

(2) The appointed person may require any person who, in his opinion, is able to provide any information, or produce any document, which is relevant to the inquiry to provide any such information or produce any such document.

(3) For the purposes of an inquiry, the appointed person has the same powers as the court in respect of the attendance and examination of witnesses (including the examination of witnesses abroad) and in respect of the production of documents.

(4) "Court" means—

(a) the High Court; or

(b) in Scotland, the Court of Session.

Conclusion of inquiry.

17.—(1) On completion of an inquiry under section 15, the person holding the inquiry must make a written report to the Treasury—

(a) setting out the result of the inquiry; and

(b) making such recommendations (if any) as he considers appropriate.

(2) The Treasury may publish the whole, or any part, of the report and may do so in such manner as they consider appropriate.

(3) Subsection (4) applies if the Treasury propose to publish a report but consider that it contains material—

(a) which relates to the affairs of a particular person whose interests would, in the opinion of the Treasury, be seriously prejudiced by publication of the material; or

(b) the disclosure of which would be incompatible with an international obligation of the United Kingdom.

(4) The Treasury must ensure that the material is removed before publication.

(5) The Treasury must lay before each House of Parliament a copy of any report or part of a report published under subsection (2).

(6) Any expenses reasonably incurred in holding an inquiry are to be met by the Treasury out of money provided by Parliament.

Obstruction and contempt.

18.—(1) If a person ("A")—

(a) fails to comply with a requirement imposed on him by a person holding an inquiry under section 15, or

(b) otherwise obstructs such an inquiry,

the person holding the inquiry may certify the matter to the High Court (or, in Scotland, the Court of Session).

(2) The court may enquire into the matter.

(3) If, after hearing—

(a) any witnesses who may be produced against or on behalf of A, and

(b) any statement made by or on behalf of A,

the court is satisfied that A would have been in contempt of court if the inquiry had been proceedings before the court, it may deal with him as if he were in contempt.

Part II

Regulated And Prohibited Activities

The general prohibition

The general prohibition.

19.—(1) No person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is—

(a) an authorised person; or

(b) an exempt person.

(2) The prohibition is referred to in this Act as the general prohibition.

Requirement for permission

Authorised persons acting without permission.

20.—(1) If an authorised person carries on a regulated activity in the United Kingdom, or purports to do so, otherwise than in accordance with permission—

(a) given to him by the Authority under Part IV, or

(b) resulting from any other provision of this Act,

he is to be taken to have contravened a requirement imposed on him by the Authority under this Act.

(2) The contravention does not—

(a) make a person guilty of an offence;

(b) make any transaction void or unenforceable; or

(c) (subject to subsection (3)) give rise to any right of action for breach of statutory duty.

(3) In prescribed cases the contravention is actionable at the suit of a person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

Financial promotion

Restrictions on financial promotion.

21.—(1) A person ("A") must not, in the course of business, communicate an invitation or inducement to engage in investment activity.

(2) But subsection (1) does not apply if—

(a) A is an authorised person; or

(b) the content of the communication is approved for the purposes of this section by an authorised person.

(3) In the case of a communication originating outside the United Kingdom, subsection (1) applies only if the communication is capable of having an effect in the United Kingdom.

(4) The Treasury may by order specify circumstances in which a person is to be regarded for the purposes of subsection (1) as—

(a) acting in the course of business;

(b) not acting in the course of business.

(5) The Treasury may by order specify circumstances (which may include compliance with financial promotion rules) in which subsection (1) does not apply.

(6) An order under subsection (5) may, in particular, provide that subsection (1) does not apply in relation to communications—

(a) of a specified description;

(b) originating in a specified country or territory outside the United Kingdom;

(c) originating in a country or territory which falls within a specified description of country or territory outside the United Kingdom; or

(d) originating outside the United Kingdom.

(7) The Treasury may by order repeal subsection (3).

(8) "Engaging in investment activity" means—

(a) entering or offering to enter into an agreement the making or performance of which by either party constitutes a controlled activity; or

(b) exercising any rights conferred by a controlled investment to acquire, dispose of, underwrite or convert a controlled investment.

(9) An activity is a controlled activity if—

(a) it is an activity of a specified kind or one which falls within a specified class of activity; and

(b) it relates to an investment of a specified kind, or to one which falls within a specified class of investment.

(10) An investment is a controlled investment if it is an investment of a specified kind or one which falls within a specified class of investment.

(11) Schedule 2 (except paragraph 26) applies for the purposes of subsections (9) and (10) with references to section 22 being read as references to each of those subsections.

(12) Nothing in Schedule 2, as applied by subsection (11), limits the powers conferred by subsection (9) or (10).

(13) "Communicate" includes causing a communication to be made.

(14) "Investment" includes any asset, right or interest.

(15) "Specified" means specified in an order made by the Treasury.

Regulated activities

The classes of activity and categories of investment.

22.—(1) An activity is a regulated activity for the purposes of this Act if it is an activity of a specified kind which is carried on by way of business and—

(a) relates to an investment of a specified kind; or

(b) in the case of an activity of a kind which is also specified for the purposes of this paragraph, is carried on in relation to property of any kind.

(2) Schedule 2 makes provision supplementing this section.

(3) Nothing in Schedule 2 limits the powers conferred by subsection (1).

(4) "Investment" includes any asset, right or interest.

(5) "Specified" means specified in an order made by the Treasury.

Offences

Contravention of the general prohibition.

23.—(1) A person who contravenes the general prohibition is guilty of an offence and liable—

(a) on summary conviction, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

(2) In this Act "an authorisation offence" means an offence under this section.

(3) In proceedings for an authorisation offence it is a defence for the accused to show that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.

False claims to be authorised or exempt.

24.—(1) A person who is neither an authorised person nor, in relation to the regulated activity in question, an exempt person is guilty of an offence if he—

(a) describes himself (in whatever terms) as an authorised person;

(b) describes himself (in whatever terms) as an exempt person in relation to the regulated activity; or

(c) behaves, or otherwise holds himself out, in a manner which indicates (or which is reasonably likely to be understood as indicating) that he is—

(i) an authorised person; or

(ii) an exempt person in relation to the regulated activity.

(2) In proceedings for an offence under this section it is a defence for the accused to show that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.

(3) A person guilty of an offence under this section is liable on summary conviction to imprisonment for a term not exceeding six months or a fine not exceeding level 5 on the standard scale, or both.

(4) But where the conduct constituting the offence involved or included the public display of any material, the maximum fine for the offence is level 5 on the standard scale multiplied by the number of days for which the display continued.

Contravention of section 21.

25.—(1) A person who contravenes section 21(1) is guilty of an offence and liable—

(a) on summary conviction, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

(2) In proceedings for an offence under this section it is a defence for the accused to show—

(a) that he believed on reasonable grounds that the content of the communication was prepared, or approved for the purposes of section 21, by an authorised person; or

(b) that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.

Enforceability of agreements

Agreements made by unauthorised persons.

26.—(1) An agreement made by a person in the course of carrying on a regulated activity in contravention of the general prohibition is unenforceable against the other party.

(2) The other party is entitled to recover—

(a) any money or other property paid or transferred by him under the agreement; and

(b) compensation for any loss sustained by him as a result of having parted with it.

(3) "Agreement" means an agreement—

(a) made after this section comes into force; and

(b) the making or performance of which constitutes, or is part of, the regulated activity in question.

(4) This section does not apply if the regulated activity is accepting deposits.

Agreements made through unauthorised persons.

27.—(1) An agreement made by an authorised person ("the provider")—

(a) in the course of carrying on a regulated activity (not in contravention of the general prohibition), but

(b) in consequence of something said or done by another person ("the third party") in the course of a regulated activity carried on by the third party in contravention of the general prohibition,

is unenforceable against the other party.

(2) The other party is entitled to recover—

(a) any money or other property paid or transferred by him under the agreement; and

(b) compensation for any loss sustained by him as a result of having parted with it.

(3) "Agreement" means an agreement—

(a) made after this section comes into force; and

(b) the making or performance of which constitutes, or is part of, the regulated activity in question carried on by the provider.

(4) This section does not apply if the regulated activity is accepting deposits.

Agreements made unenforceable by section 26 or 27.

28.—(1) This section applies to an agreement which is unenforceable because of section 26 or 27.

(2) The amount of compensation recoverable as a result of that section is—

(a) the amount agreed by the parties; or

(b) on the application of either party, the amount determined by the court.

(3) If the court is satisfied that it is just and equitable in the circumstances of the case, it may allow—

(a) the agreement to be enforced; or

(b) money and property paid or transferred under the agreement to be retained.

(4) In considering whether to allow the agreement to be enforced or (as the case may be) the money or property paid or transferred under the agreement to be retained the court must—

(a) if the case arises as a result of section 26, have regard to the issue mentioned in subsection (5); or

(b) if the case arises as a result of section 27, have regard to the issue mentioned in subsection (6).

(5) The issue is whether the person carrying on the regulated activity concerned reasonably believed that he was not contravening the general prohibition by making the agreement.

(6) The issue is whether the provider knew that the third party was (in carrying on the regulated activity) contravening the general prohibition.

(7) If the person against whom the agreement is unenforceable—

(a) elects not to perform the agreement, or

(b) as a result of this section, recovers money paid or other property transferred by him under the agreement,

he must repay any money and return any other property received by him under the agreement.

(8) If property transferred under the agreement has passed to a third party, a reference in section 26 or 27 or this section to that property is to be read as a reference to its value at the time of its transfer under the agreement.

(9) The commission of an authorisation offence does not make the agreement concerned illegal or invalid to any greater extent than is provided by section 26 or 27.

Accepting deposits in breach of general prohibition.

29.—(1) This section applies to an agreement between a person ("the depositor") and another person ("the deposit-taker") made in the course of the carrying on by the deposit-taker of accepting deposits in contravention of the general prohibition.

(2) If the depositor is not entitled under the agreement to recover without delay any money deposited by him, he may apply to the court for an order directing the deposit-taker to return the money to him.

(3) The court need not make such an order if it is satisfied that it would not be just and equitable for the money deposited to be returned, having regard to the issue mentioned in subsection (4).

(4) The issue is whether the deposit-taker reasonably believed that he was not contravening the general prohibition by making the agreement.

(5) "Agreement" means an agreement—

(a) made after this section comes into force; and

(b) the making or performance of which constitutes, or is part of, accepting deposits.

Enforceability of agreements resulting from unlawful communications.

30.—(1) In this section—

"unlawful communication" means a communication in relation to which there has been a contravention of section 21(1);

"controlled agreement" means an agreement the making or performance of which by either party constitutes a controlled activity for the purposes of that section; and

"controlled investment" has the same meaning as in section 21.

(2) If in consequence of an unlawful communication a person enters as a customer into a controlled agreement, it is unenforceable against him and he is entitled to recover—

(a) any money or other property paid or transferred by him under the agreement; and

(b) compensation for any loss sustained by him as a result of having parted with it.

(3) If in consequence of an unlawful communication a person exercises any rights conferred by a controlled investment, no obligation to which he is subject as a result of exercising them is enforceable against him and he is entitled to recover—

(a) any money or other property paid or transferred by him under the obligation; and

(b) compensation for any loss sustained by him as a result of having parted with it.

(4) But the court may allow—

(a) the agreement or obligation to be enforced, or

(b) money or property paid or transferred under the agreement or obligation to be retained,

if it is satisfied that it is just and equitable in the circumstances of the case.

(5) In considering whether to allow the agreement or obligation to be enforced or (as the case may be) the money or property paid or transferred under the agreement to be retained the court must have regard to the issues mentioned in subsections (6) and (7).

(6) If the applicant made the unlawful communication, the issue is whether he reasonably believed that he was not making such a communication.

(7) If the applicant did not make the unlawful communication, the issue is whether he knew that the agreement was entered into in consequence of such a communication.

(8) "Applicant" means the person seeking to enforce the agreement or obligation or retain the money or property paid or transferred.

(9) Any reference to making a communication includes causing a communication to be made.

(10) The amount of compensation recoverable as a result of subsection (2) or (3) is—

(a) the amount agreed between the parties; or

(b) on the application of either party, the amount determined by the court.

(11) If a person elects not to perform an agreement or an obligation which (by virtue of subsection (2) or (3)) is unenforceable against him, he must repay any money and return any other property received by him under the agreement.

(12) If (by virtue of subsection (2) or (3)) a person recovers money paid or property transferred by him under an agreement or obligation, he must repay any money and return any other property received by him as a result of exercising the rights in question.

(13) If any property required to be returned under this section has passed to a third party, references to that property are to be read as references to its value at the time of its receipt by the person required to return it.

Part III

Authorisation and Exemption

Authorisation

Authorised persons.

31.—(1) The following persons are authorised for the purposes of this Act—

(a) a person who has a Part IV permission to carry on one or more regulated activities;

(b) an EEA firm qualifying for authorisation under Schedule 3;

(c) a Treaty firm qualifying for authorisation under Schedule 4;

(d) a person who is otherwise authorised by a provision of, or made under, this Act.

(2) In this Act "authorised person" means a person who is authorised for the purposes of this Act.

Partnerships and unincorporated associations.

32.—(1) If a firm is authorised—

(a) it is authorised to carry on the regulated activities concerned in the name of the firm; and

(b) its authorisation is not affected by any change in its membership.

(2) If an authorised firm is dissolved, its authorisation continues to have effect in relation to any firm which succeeds to the business of the dissolved firm.

(3) For the purposes of this section, a firm is to be regarded as succeeding to the business of another firm only if—

(a) the members of the resulting firm are substantially the same as those of the former firm; and

(b) succession is to the whole or substantially the whole of the business of the former firm.

(4) "Firm" means—

(a) a partnership; or

(b) an unincorporated association of persons.

(5) "Partnership" does not include a partnership which is constituted under the law of any place outside the United Kingdom and is a body corporate.

Ending of authorisation

Withdrawal of authorisation by the Authority.

33.—(1) This section applies if—

(a) an authorised person's Part IV permission is cancelled; and

(b) as a result, there is no regulated activity for which he has permission.

(2) The Authority must give a direction withdrawing that person's status as an authorised person.

EEA firms.

34.—(1) An EEA firm ceases to qualify for authorisation under Part II of Schedule 3 if it ceases to be an EEA firm as a result of—

(a) having its EEA authorisation withdrawn; or

(b) ceasing to have an EEA right in circumstances in which EEA authorisation is not required.

(2) At the request of an EEA firm, the Authority may give a direction cancelling its authorisation under Part II of Schedule 3.

(3) If an EEA firm has a Part IV permission, it does not cease to be an authorised person merely because it ceases to qualify for authorisation under Part II of Schedule 3.

Treaty firms.

35.—(1) A Treaty firm ceases to qualify for authorisation under Schedule 4 if its home State authorisation is withdrawn.

(2) At the request of a Treaty firm, the Authority may give a direction cancelling its Schedule 4 authorisation.

(3) If a Treaty firm has a Part IV permission, it does not cease to be an authorised person merely because it ceases to qualify for authorisation under Schedule 4.

Persons authorised as a result of paragraph 1(1) of Schedule 5.

36.—(1) At the request of a person authorised as a result of paragraph 1(1) of Schedule 5, the Authority may give a direction cancelling his authorisation as such a person.

(2) If a person authorised as a result of paragraph 1(1) of Schedule 5 has a Part IV permission, he does not cease to be an authorised person merely because he ceases to be a person so authorised.

Exercise of EEA rights by UK firms

Exercise of EEA rights by UK firms.

37. Part III of Schedule 3 makes provision in relation to the exercise outside the United Kingdom of EEA rights by UK firms.

Exemption

Exemption orders.

38.—(1) The Treasury may by order ("an exemption order") provide for—

(a) specified persons, or

(b) persons falling within a specified class,

to be exempt from the general prohibition.

(2) But a person cannot be an exempt person as a result of an exemption order if he has a Part IV permission.

(3) An exemption order may provide for an exemption to have effect—

(a) in respect of all regulated activities;

(b) in respect of one or more specified regulated activities;

(c) only in specified circumstances;

(d) only in relation to specified functions;

(e) subject to conditions.

(4) "Specified" means specified by the exemption order.

Exemption of appointed representatives.

39.—(1) If a person (other than an authorised person)—

(a) is a party to a contract with an authorised person ("his principal") which—

(i) permits or requires him to carry on business of a prescribed description, and

(ii) complies with such requirements as may be prescribed, and

(b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing,

he is exempt from the general prohibition in relation to any regulated activity comprised in the carrying on of that business for which his principal has accepted responsibility.

(2) A person who is exempt as a result of subsection (1) is referred to in this Act as an appointed representative.

(3) The principal of an appointed representative is responsible, to the same extent as if he had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which he has accepted responsibility.

(4) In determining whether an authorised person has complied with a provision contained in or made under this Act, anything which a relevant person has done or omitted as respects business for which the authorised person has accepted responsibility is to be treated as having been done or omitted by the authorised person.

(5) "Relevant person" means a person who at the material time is or was an appointed representative by virtue of being a party to a contract with the authorised person.

(6) Nothing in subsection (4) is to cause the knowledge or intentions of an appointed representative to be attributed to his principal for the purpose of determining whether the principal has committed an offence, unless in all the circumstances it is reasonable for them to be attributed to him.

PART IV

PERMISSION TO CARRY ON REGULATED ACTIVITIES

Application for permission

40.—(1) An application for permission to carry on one or more regulated activities may be made to the Authority by— Application for permission.

(a) an individual;

(b) a body corporate;

(c) a partnership; or

(d) an unincorporated association.

(2) An authorised person may not apply for permission under this section if he has a permission—

(a) given to him by the Authority under this Part, or

(b) having effect as if so given,

which is in force.

(3) An EEA firm may not apply for permission under this section to carry on a regulated activity which it is, or would be, entitled to carry on in exercise of an EEA right, whether through a United Kingdom branch or by providing services in the United Kingdom.

(4) A permission given by the Authority under this Part or having effect as if so given is referred to in this Act as "a Part IV permission".

The threshold conditions.

41.—(1) "The threshold conditions", in relation to a regulated activity, means the conditions set out in Schedule 6.

(2) In giving or varying permission, or imposing or varying any requirement, under this Part the Authority must ensure that the person concerned will satisfy, and continue to satisfy, the threshold conditions in relation to all of the regulated activities for which he has or will have permission.

(3) But the duty imposed by subsection (2) does not prevent the Authority, having due regard to that duty, from taking such steps as it considers are necessary, in relation to a particular authorised person, in order to secure its regulatory objective of the protection of consumers.

Permission

Giving permission.

42.—(1) "The applicant" means an applicant for permission under section 40.

(2) The Authority may give permission for the applicant to carry on the regulated activity or activities to which his application relates or such of them as may be specified in the permission.

(3) If the applicant—

(a) in relation to a particular regulated activity, is exempt from the general prohibition as a result of section 39(1) or an order made under section 38(1), but

(b) has applied for permission in relation to another regulated activity,

the application is to be treated as relating to all the regulated activities which, if permission is given, he will carry on.

(4) If the applicant—

(a) in relation to a particular regulated activity, is exempt from the general prohibition as a result of section 285(2) or (3), but

(b) has applied for permission in relation to another regulated activity,

the application is to be treated as relating only to that other regulated activity.

(5) If the applicant—

(a) is a person to whom, in relation to a particular regulated activity, the general prohibition does not apply as a result of Part XIX, but

(b) has applied for permission in relation to another regulated activity,

the application is to be treated as relating only to that other regulated activity.

(6) If it gives permission, the Authority must specify the permitted regulated activity or activities, described in such manner as the Authority considers appropriate.

(7) The Authority may—

(a) incorporate in the description of a regulated activity such limitations (for example as to circumstances in which the activity may, or may not, be carried on) as it considers appropriate;

(b) specify a narrower or wider description of regulated activity than that to which the application relates;

(c) give permission for the carrying on of a regulated activity which is not included among those to which the application relates.

Imposition of requirements.

43.—(1) A Part IV permission may include such requirements as the Authority considers appropriate.

(2) A requirement may, in particular, be imposed—

(a) so as to require the person concerned to take specified action; or

(b) so as to require him to refrain from taking specified action.

(3) A requirement may extend to activities which are not regulated activities.

(4) A requirement may be imposed by reference to the person's relationship with—

(a) his group; or

(b) other members of his group.

(5) A requirement expires at the end of such period as the Authority may specify in the permission.

(6) But subsection (5) does not affect the Authority's powers under section 44 or 45.

Variation and cancellation of Part IV permission

Variation etc. at request of authorised person.

44.—(1) The Authority may, on the application of an authorised person with a Part IV permission, vary the permission by—

(a) adding a regulated activity to those for which it gives permission;

(b) removing a regulated activity from those for which it gives permission;

(c) varying the description of a regulated activity for which it gives permission;

(d) cancelling a requirement imposed under section 43; or

(e) varying such a requirement.

(2) The Authority may, on the application of an authorised person with a Part IV permission, cancel the permission.

(3) The Authority may refuse an application under this section if it appears to it—

(a) that the interests of consumers, or potential consumers, would be adversely affected if the application were to be granted; and

(b) that it is desirable in the interests of consumers, or potential consumers, for the application to be refused.

(4) If, as a result of a variation of a Part IV permission under this section, there are no longer any regulated activities for which the authorised person concerned has permission, the Authority must, once it is satisfied that it is no longer necessary to keep the permission in force, cancel it.

(5) The Authority's power to vary a Part IV permission under this section extends to including any provision in the permission as varied that could be included if a fresh permission were being given in response to an application under section 40.

Variation etc. on the Authority's own initiative.

45.—(1) The Authority may exercise its power under this section in relation to an authorised person if it appears to it that—

(a) he is failing, or is likely to fail, to satisfy the threshold conditions;

(b) he has failed, during a period of at least 12 months, to carry on a regulated activity for which he has a Part IV permission; or

(c) it is desirable to exercise that power in order to protect the interests of consumers or potential consumers.

(2) The Authority's power under this section is the power to vary a Part IV permission in any of the ways mentioned in section 44(1) or to cancel it.

(3) If, as a result of a variation of a Part IV permission under this section, there are no longer any regulated activities for which the authorised person concerned has permission, the Authority must, once it is satisfied that it is no longer necessary to keep the permission in force, cancel it.

(4) The Authority's power to vary a Part IV permission under this section extends to including any provision in the permission as varied that could be included if a fresh permission were being given in response to an application under section 40.

(5) The Authority's power under this section is referred to in this Part as its own-initiative power.

Variation of permission on acquisition of control.

46.—(1) This section applies if it appears to the Authority that—

(a) a person has acquired control over a UK authorised person who has a Part IV permission; but

(b) there are no grounds for exercising its own-initiative power.

(2) If it appears to the Authority that the likely effect of the acquisition of control on the authorised person, or on any of its activities, is uncertain the Authority may vary the authorised person's permission by—

(a) imposing a requirement of a kind that could be imposed under section 43 on giving permission; or

(b) varying a requirement included in the authorised person's permission under that section.

(3) Any reference to a person having acquired control is to be read in accordance with Part XII.

Exercise of power in support of overseas regulator.

47.—(1) The Authority's own-initiative power may be exercised in respect of an authorised person at the request of, or for the purpose of assisting, a regulator who is—

(a) outside the United Kingdom; and

(b) of a prescribed kind.

(2) Subsection (1) applies whether or not the Authority has powers which are exercisable in relation to the authorised person by virtue of any provision of Part XIII.

(3) If a request to the Authority for the exercise of its own-initiative power has been made by a regulator who is—

(a) outside the United Kingdom,

(b) of a prescribed kind, and

(c) acting in pursuance of provisions of a prescribed kind,

the Authority must, in deciding whether or not to exercise that power in response to the request, consider whether it is necessary to do so in order to comply with a Community obligation.

(4) In deciding in any case in which the Authority does not consider that the exercise of its own-initiative power is necessary in order to comply with a Community obligation, it may take into account in particular—

(a) whether in the country or territory of the regulator concerned, corresponding assistance would be given to a United Kingdom regulatory authority;

(b) whether the case concerns the breach of a law, or other requirement, which has no close parallel in the United Kingdom or involves the assertion of a jurisdiction not recognised by the United Kingdom;

(c) the seriousness of the case and its importance to persons in the United Kingdom;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

(5) The Authority may decide not to exercise its own-initiative power, in response to a request, unless the regulator concerned undertakes to make such contribution towards the cost of its exercise as the Authority considers appropriate.

(6) Subsection (5) does not apply if the Authority decides that it is necessary for it to exercise its own-initiative power in order to comply with a Community obligation.

(7) In subsections (4) and (5) "request" means a request of a kind mentioned in subsection (1).

Prohibitions and restrictions.

48.—(1) This section applies if the Authority—

(a) on giving a person a Part IV permission, imposes an assets requirement on him; or

(b) varies an authorised person's Part IV permission so as to alter an assets requirement imposed on him or impose such a requirement on him.

(2) A person on whom an assets requirement is imposed is referred to in this section as "A".

(3) "Assets requirement" means a requirement under section 43—

(a) prohibiting the disposal of, or other dealing with, any of A's assets (whether in the United Kingdom or elsewhere) or restricting such disposals or dealings; or

(b) that all or any of A's assets, or all or any assets belonging to consumers but held by A or to his order, must be transferred to and held by a trustee approved by the Authority.

(4) If the Authority—

(a) imposes a requirement of the kind mentioned in subsection (3)(a), and

(b) gives notice of the requirement to any institution with whom A keeps an account,

the notice has the effects mentioned in subsection (5).

(5) Those effects are that—

(a) the institution does not act in breach of any contract with A if, having been instructed by A (or on his behalf) to transfer any sum or otherwise make any payment out of A's account, it refuses to do so in the reasonably held belief that complying with the instruction would be incompatible with the requirement; and

(b) if the institution complies with such an instruction, it is liable to pay to the Authority an amount equal to the amount transferred from, or otherwise paid out of, A's account in contravention of the requirement.

(6) If the Authority imposes a requirement of the kind mentioned in subsection (3)(b), no assets held by a person as trustee in accordance with the requirement may, while the requirement is in force, be released or dealt with except with the consent of the Authority.

(7) If, while a requirement of the kind mentioned in subsection (3)(b) is in force, A creates a charge over any assets of his held in accordance with the requirement, the charge is (to the extent that it confers security over the assets) void against the liquidator and any of A's creditors.

(8) Assets held by a person as trustee ("T") are to be taken to be held by T in accordance with a requirement mentioned in subsection (3)(b) only if—

(a) A has given T written notice that those assets are to be held by T in accordance with the requirement; or

(b) they are assets into which assets to which paragraph (a) applies have been transposed by T on the instructions of A.

(9) A person who contravenes subsection (6) is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.

(10) "Charge" includes a mortgage (or in Scotland a security over property).

(11) Subsections (6) and (8) do not affect any equitable interest or remedy in favour of a person who is a beneficiary of a trust as a result of a requirement of the kind mentioned in subsection (3)(b).

Connected persons

Persons connected with an applicant.

49.—(1) In considering—

(a) an application for a Part IV permission, or

(b) whether to vary or cancel a Part IV permission,

the Authority may have regard to any person appearing to it to be, or likely to be, in a relationship with the applicant or person given permission which is relevant.

(2) Before—

(a) giving permission in response to an application made by a person who is connected with an EEA firm, or

(b) cancelling or varying any permission given by the Authority to such a person,

the Authority must consult the firm's home state regulator.

(3) A person ("A") is connected with an EEA firm if—

(a) A is a subsidiary undertaking of the firm; or

(b) A is a subsidiary undertaking of a parent undertaking of the firm.

Additional permissions

Authority's duty to consider other permissions etc.

50.—(1) "Additional Part IV permission" means a Part IV permission which is in force in relation to an EEA firm, a Treaty firm or a person authorised as a result of paragraph 1(1) of Schedule 5.

(2) If the Authority is considering whether, and if so how, to exercise its own-initiative power under this Part in relation to an additional Part IV permission, it must take into account—

(a) the home State authorisation of the authorised person concerned;

(b) any relevant directive; and

(c) relevant provisions of the Treaty.

Procedure

Applications under this Part.

51.—(1) An application for a Part IV permission must—

(a) contain a statement of the regulated activity or regulated activities which the applicant proposes to carry on and for which he wishes to have permission; and

(b) give the address of a place in the United Kingdom for service on the applicant of any notice or other document which is required or authorised to be served on him under this Act.

(2) An application for the variation of a Part IV permission must contain a statement—

(a) of the desired variation; and

(b) of the regulated activity or regulated activities which the applicant proposes to carry on if his permission is varied.

(3) Any application under this Part must—

(a) be made in such manner as the Authority may direct; and

(b) contain, or be accompanied by, such other information as the Authority may reasonably require.

(4) At any time after receiving an application and before determining it, the Authority may require the applicant to provide it with such further information as it reasonably considers necessary to enable it to determine the application.

(5) Different directions may be given, and different requirements imposed, in relation to different applications or categories of application.

(6) The Authority may require an applicant to provide information which he is required to provide under this section in such form, or to verify it in such a way, as the Authority may direct.

Determination of applications.

52.—(1) An application under this Part must be determined by the Authority before the end of the period of six months beginning with the date on which it received the completed application.

(2) The Authority may determine an incomplete application if it considers it appropriate to do so; and it must in any event determine such an application within twelve months beginning with the date on which it received the application.

(3) The applicant may withdraw his application, by giving the Authority written notice, at any time before the Authority determines it.

(4) If the Authority grants an application for, or for variation of, a Part IV permission, it must give the applicant written notice.

(5) The notice must state the date from which the permission, or the variation, has effect.

(6) If the Authority proposes—

(a) to give a Part IV permission but to exercise its power under section 42(7)(a) or (b) or 43(1), or

(b) to vary a Part IV permission on the application of an authorised person but to exercise its power under any of those provisions (as a result of section 44(5)),

it must give the applicant a warning notice.

(7) If the Authority proposes to refuse an application made under this Part, it must (unless subsection (8) applies) give the applicant a warning notice.

(8) This subsection applies if it appears to the Authority that—

(a) the applicant is an EEA firm; and

(b) the application is made with a view to carrying on a regulated activity in a manner in which the applicant is, or would be, entitled to carry on that activity in the exercise of an EEA right whether through a United Kingdom branch or by providing services in the United Kingdom.

(9) If the Authority decides—

(a) to give a Part IV permission but to exercise its power under section 42(7)(a) or (b) or 43(1),

(b) to vary a Part IV permission on the application of an authorised person but to exercise its power under any of those provisions (as a result of section 44(5)), or

(c) to refuse an application under this Part,

it must give the applicant a decision notice.

Exercise of own-initiative power: procedure.

53.—(1) This section applies to an exercise of the Authority's own-initiative power to vary an authorised person's Part IV permission.

(2) A variation takes effect—

(a) immediately, if the notice given under subsection (4) states that that is the case;

(b) on such date as may be specified in the notice; or

(c) if no date is specified in the notice, when the matter to which the notice relates is no longer open to review.

(3) A variation may be expressed to take effect immediately (or on a specified date) only if the Authority, having regard to the ground on which it is exercising its own-initiative power, reasonably considers that it is necessary for the variation to take effect immediately (or on that date).

(4) If the Authority proposes to vary the Part IV permission, or varies it with immediate effect, it must give the authorised person written notice.

(5) The notice must—

(a) give details of the variation;

(b) state the Authority's reasons for the variation and for its determination as to when the variation takes effect;

(c) inform the authorised person that he may make representations to the Authority within such period as may be specified in the notice (whether or not he has referred the matter to the Tribunal);

(d) inform him of when the variation takes effect; and

(e) inform him of his right to refer the matter to the Tribunal.

(6) The Authority may extend the period allowed under the notice for making representations.

(7) If, having considered any representations made by the authorised person, the Authority decides—

(a) to vary the permission in the way proposed, or

(b) if the permission has been varied, not to rescind the variation,

it must give him written notice.

(8) If, having considered any representations made by the authorised person, the Authority decides—

(a) not to vary the permission in the way proposed,

(b) to vary the permission in a different way, or

(c) to rescind a variation which has effect,

it must give him written notice.

(9) A notice given under subsection (7) must inform the authorised person of his right to refer the matter to the Tribunal.

(10) A notice under subsection (8)(b) must comply with subsection (5).

(11) If a notice informs a person of his right to refer a matter to the Tribunal, it must give an indication of the procedure on such a reference.

(12) For the purposes of subsection (2)(c), whether a matter is open to review is to be determined in accordance with section 391(8).

Cancellation of Part IV permission: procedure.

54.—(1) If the Authority proposes to cancel an authorised person's Part IV permission otherwise than at his request, it must give him a warning notice.

(2) If the Authority decides to cancel an authorised person's Part IV permission otherwise than at his request, it must give him a decision notice.

References to the Tribunal

Right to refer matters to the Tribunal.

55.—(1) An applicant who is aggrieved by the determination of an application made under this Part may refer the matter to the Tribunal.

(2) An authorised person who is aggrieved by the exercise of the Authority's own-initiative power may refer the matter to the Tribunal.

PART V

PERFORMANCE OF REGULATED ACTIVITIES

Prohibition orders

Prohibition orders.

56.—(1) Subsection (2) applies if it appears to the Authority that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person.

(2) The Authority may make an order ("a prohibition order") prohibiting the individual from performing a specified function, any function falling within a specified description or any function.

(3) A prohibition order may relate to—

(a) a specified regulated activity, any regulated activity falling within a specified description or all regulated activities;

(b) authorised persons generally or any person within a specified class of authorised person.

(4) An individual who performs or agrees to perform a function in breach of a prohibition order is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.

(5) In proceedings for an offence under subsection (4) it is a defence for the accused to show that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.

(6) An authorised person must take reasonable care to ensure that no function of his, in relation to the carrying on of a regulated activity, is performed by a person who is prohibited from performing that function by a prohibition order.

(7) The Authority may, on the application of the individual named in a prohibition order, vary or revoke it.

(8) This section applies to the performance of functions in relation to a regulated activity carried on by—

(a) a person who is an exempt person in relation to that activity, and

(b) a person to whom, as a result of Part XX, the general prohibition does not apply in relation to that activity,

as it applies to the performance of functions in relation to a regulated activity carried on by an authorised person.

(9) "Specified" means specified in the prohibition order.

Prohibition orders: procedure and right to refer to Tribunal.

57.—(1) If the Authority proposes to make a prohibition order it must give the individual concerned a warning notice.

(2) The warning notice must set out the terms of the prohibition.

(3) If the Authority decides to make a prohibition order it must give the individual concerned a decision notice.

(4) The decision notice must—

(a) name the individual to whom the prohibition order applies;

(b) set out the terms of the order; and

(c) be given to the individual named in the order.

(5) A person against whom a decision to make a prohibition order is made may refer the matter to the Tribunal.

Applications relating to prohibitions: procedure and right to refer to Tribunal.

58.—(1) This section applies to an application for the variation or revocation of a prohibition order.

(2) If the Authority decides to grant the application, it must give the applicant written notice of its decision.

(3) If the Authority proposes to refuse the application, it must give the applicant a warning notice.

(4) If the Authority decides to refuse the application, it must give the applicant a decision notice.

(5) If the Authority gives the applicant a decision notice, he may refer the matter to the Tribunal.

Approval

Approval for particular arrangements.

59.—(1) An authorised person ("A") must take reasonable care to ensure that no person performs a controlled function under an arrangement entered into by A in relation to the carrying on by A of a regulated activity, unless the Authority approves the performance by that person of the controlled function to which the arrangement relates.

(2) An authorised person ("A") must take reasonable care to ensure that no person performs a controlled function under an arrangement entered into by a contractor of A in relation to the carrying on by A of a regulated activity, unless the Authority approves the performance by that person of the controlled function to which the arrangement relates.

(3) "Controlled function" means a function of a description specified in rules.

(4) The Authority may specify a description of function under subsection (3) only if, in relation to the carrying on of a regulated activity by an authorised person, it is satisfied that the first, second or third condition is met.

(5) The first condition is that the function is likely to enable the person responsible for its performance to exercise a significant influence on the conduct of the authorised person's affairs, so far as relating to the regulated activity.

(6) The second condition is that the function will involve the person performing it in dealing with customers of the authorised person in a manner substantially connected with the carrying on of the regulated activity.

(7) The third condition is that the function will involve the person performing it in dealing with property of customers of the authorised person in a manner substantially connected with the carrying on of the regulated activity.

(8) Neither subsection (1) nor subsection (2) applies to an arrangement which allows a person to perform a function if the question of whether he is a fit and proper person to perform the function is reserved under any of the single market directives to an authority in a country or territory outside the United Kingdom.

(9) In determining whether the first condition is met, the Authority may take into account the likely consequences of a failure to discharge that function properly.

(10) "Arrangement"—

(a) means any kind of arrangement for the performance of a function of A which is entered into by A or any contractor of his with another person; and

(b) includes, in particular, that other person's appointment to an office, his becoming a partner or his employment (whether under a contract of service or otherwise).

(11) "Customer", in relation to an authorised person, means a person who is using, or who is or may be contemplating using, any of the services provided by the authorised person.

Applications for approval.

60.—(1) An application for the Authority's approval under section 59 may be made by the authorised person concerned.

(2) The application must—

(a) be made in such manner as the Authority may direct; and

(b) contain, or be accompanied by, such information as the Authority may reasonably require.

(3) At any time after receiving the application and before determining it, the Authority may require the applicant to provide it with such further information as it reasonably considers necessary to enable it to determine the application.

(4) The Authority may require an applicant to present information which he is required to give under this section in such form, or to verify it in such a way, as the Authority may direct.

(5) Different directions may be given, and different requirements imposed, in relation to different applications or categories of application.

(6) "The authorised person concerned" includes a person who has applied for permission under Part IV and will be the authorised person concerned if permission is given.

Determination of applications.

61.—(1) The Authority may grant an application made under section 60 only if it is satisfied that the person in respect of whom the application is made ("the candidate") is a fit and proper person to perform the function to which the application relates.

(2) In deciding that question, the Authority may have regard (among other things) to whether the candidate, or any person who may perform a function on his behalf—

(a) has obtained a qualification,

(b) has undergone, or is undergoing, training, or

(c) possesses a level of competence,

required by general rules in relation to persons performing functions of the kind to which the application relates.

(3) The Authority must, before the end of the period of three months beginning with the date on which it receives an application made under section 60 ("the period for consideration"), determine whether—

(a) to grant the application; or

(b) to give a warning notice under section 62(2).

(4) If the Authority imposes a requirement under section 60(3), the period for consideration stops running on the day on which the requirement is imposed but starts running again—

(a) on the day on which the required information is received by the Authority; or

(b) if the information is not provided on a single day, on the last of the days on which it is received by the Authority.

(5) A person who makes an application under section 60 may withdraw his application by giving written notice to the Authority at any time before the Authority determines it, but only with the consent of—

(a) the candidate; and

(b) the person by whom the candidate is to be retained to perform the function concerned, if not the applicant.

Applications for approval: procedure and right to refer to Tribunal.

62.—(1) If the Authority decides to grant an application made under section 60 ("an application"), it must give written notice of its decision to each of the interested parties.

(2) If the Authority proposes to refuse an application, it must give a warning notice to each of the interested parties.

(3) If the Authority decides to refuse an application, it must give a decision notice to each of the interested parties.

(4) If the Authority decides to refuse an application, each of the interested parties may refer the matter to the Tribunal.

(5) "The interested parties", in relation to an application, are—

(a) the applicant;

(b) the person in respect of whom the application is made ("A"); and

(c) the person by whom A's services are to be retained, if not the applicant.

Withdrawal of approval.

63.—(1) The Authority may withdraw an approval given under section 59 if it considers that the person in respect of whom it was given is not a fit and proper person to perform the function to which the approval relates.

(2) When considering whether to withdraw its approval, the Authority may take into account any matter which it could take into account if it were considering an application made under section 60 in respect of the performance of the function to which the approval relates.

(3) If the Authority proposes to withdraw its approval, it must give each of the interested parties a warning notice.

(4) If the Authority decides to withdraw its approval, it must give each of the interested parties a decision notice.

(5) If the Authority decides to withdraw its approval, each of the interested parties may refer the matter to the Tribunal.

(6) "The interested parties", in relation to an approval, are—

(a) the person on whose application it was given ("A");

(b) the person in respect of whom it was given ("B"); and

(c) the person by whom B's services are retained, if not A.

Conduct

Conduct: statements and codes.

64.—(1) The Authority may issue statements of principle with respect to the conduct expected of approved persons.

(2) If the Authority issues a statement of principle under subsection (1), it must also issue a code of practice for the purpose of helping to determine whether or not a person's conduct complies with the statement of principle.

(3) A code issued under subsection (2) may specify—

(a) descriptions of conduct which, in the opinion of the Authority, comply with a statement of principle;

(b) descriptions of conduct which, in the opinion of the Authority, do not comply with a statement of principle;

(c) factors which, in the opinion of the Authority, are to be taken into account in determining whether or not a person's conduct complies with a statement of principle.

(4) The Authority may at any time alter or replace a statement or code issued under this section.

(5) If a statement or code is altered or replaced, the altered or replacement statement or code must be issued by the Authority.

(6) A statement or code issued under this section must be published by the Authority in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(7) A code published under this section and in force at the time when any particular conduct takes place may be relied on so far as it tends to establish whether or not that conduct complies with a statement of principle.

(8) Failure to comply with a statement of principle under this section does not of itself give rise to any right of action by persons affected or affect the validity of any transaction.

(9) A person is not to be taken to have failed to comply with a statement of principle if he shows that, at the time of the alleged failure, it or its associated code of practice had not been published.

(10) The Authority must, without delay, give the Treasury a copy of any statement or code which it publishes under this section.

(11) The power under this section to issue statements of principle and codes of practice—

(a) includes power to make different provision in relation to persons, cases or circumstances of different descriptions; and

(b) is to be treated for the purposes of section 2(4)(a) as part of the Authority's rule-making functions.

(12) The Authority may charge a reasonable fee for providing a person with a copy of a statement or code published under this section.

(13) "Approved person" means a person in relation to whom the Authority has given its approval under section 59.

Statements and codes: procedure.

65.—(1) Before issuing a statement or code under section 64, the Authority must publish a draft of it in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(2) The draft must be accompanied by —

(a) a cost benefit analysis; and

(b) notice that representations about the proposal may be made to the Authority within a specified time.

(3) Before issuing the proposed statement or code, the Authority must have regard to any representations made to it in accordance with subsection (2)(b).

(4) If the Authority issues the proposed statement or code it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2)(b); and

(b) its response to them.

(5) If the statement or code differs from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant—

(a) the Authority must (in addition to complying with subsection (4)) publish details of the difference; and

(b) those details must be accompanied by a cost benefit analysis.

(6) Neither subsection (2)(a) nor subsection (5)(b) applies if the Authority considers—

(a) that, making the appropriate comparison, there will be no increase in costs; or

(b) that, making that comparison, there will be an increase in costs but the increase will be of minimal significance.

(7) Subsections (1) to (6) do not apply if the Authority considers that the delay involved in complying with them would prejudice the interests of consumers.

(8) A statement or code must state that it is issued under section 64.

(9) The Authority may charge a reasonable fee for providing a copy of a draft published under subsection (1).

(10) This section also applies to a proposal to alter or replace a statement or code.

(11) "Cost benefit analysis" means an estimate of the costs together with an analysis of the benefits that will arise—

(a) if the proposed statement or code is issued; or

(b) if subsection (5)(b) applies, from the statement or code that has been issued.

(12) "The appropriate comparison" means—

(a) in relation to subsection (2)(a), a comparison between the overall position if the statement or code is issued and the overall position if it is not issued;

(b) in relation to subsection (5)(b), a comparison between the overall position after the issuing of the statement or code and the overall position before it was issued.

Disciplinary powers.

66.—(1) The Authority may take action against a person under this section if—

(a) it appears to the Authority that he is guilty of misconduct; and

(b) the Authority is satisfied that it is appropriate in all the circumstances to take action against him.

(2) A person is guilty of misconduct if, while an approved person—

(a) he has failed to comply with a statement of principle issued under section 64; or

(b) he has been knowingly concerned in a contravention by the relevant authorised person of a requirement imposed on that authorised person by or under this Act.

(3) If the Authority is entitled to take action under this section against a person, it may—

(a) impose a penalty on him of such amount as it considers appropriate; or

(b) publish a statement of his misconduct.

(4) The Authority may not take action under this section after the end of the period of two years beginning with the first day on which the Authority knew of the misconduct, unless proceedings in respect of it against the person concerned were begun before the end of that period.

(5) For the purposes of subsection (4)—

(a) the Authority is to be treated as knowing of misconduct if it has information from which the misconduct can reasonably be inferred; and

(b) proceedings against a person in respect of misconduct are to be treated as begun when a warning notice is given to him under section 67(1).

(6) "Approved person" has the same meaning as in section 64.

(7) "Relevant authorised person", in relation to an approved person, means the person on whose application approval under section 59 was given.

Disciplinary measures: procedure and right to refer to Tribunal.

67.—(1) If the Authority proposes to take action against a person under section 66, it must give him a warning notice.

(2) A warning notice about a proposal to impose a penalty must state the amount of the penalty.

(3) A warning notice about a proposal to publish a statement must set out the terms of the statement.

(4) If the Authority decides to take action against a person under section 66, it must give him a decision notice.

(5) A decision notice about the imposition of a penalty must state the amount of the penalty.

(6) A decision notice about the publication of a statement must set out the terms of the statement.

(7) If the Authority decides to take action against a person under section 66, he may refer the matter to the Tribunal.

Publication.

68. After a statement under section 66 is published, the Authority must send a copy of it to the person concerned and to any person to whom a copy of the decision notice was given.

Statement of policy.

69.—(1) The Authority must prepare and issue a statement of its policy with respect to—

(a) the imposition of penalties under section 66; and

(b) the amount of penalties under that section.

(2) The Authority's policy in determining what the amount of a penalty should be must include having regard to—

(a) the seriousness of the misconduct in question in relation to the nature of the principle or requirement concerned;

(b) the extent to which that misconduct was deliberate or reckless; and

(c) whether the person on whom the penalty is to be imposed is an individual.

(3) The Authority may at any time alter or replace a statement issued under this section.

(4) If a statement issued under this section is altered or replaced, the Authority must issue the altered or replacement statement.

(5) The Authority must, without delay, give the Treasury a copy of any statement which it publishes under this section.

(6) A statement issued under this section must be published by the Authority in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(7) The Authority may charge a reasonable fee for providing a person with a copy of the statement.

(8) In exercising, or deciding whether to exercise, its power under section 66 in the case of any particular misconduct, the Authority must have regard to any statement of policy published under this section and in force at the time when the misconduct in question occurred.

Statements of policy: procedure.

70.—(1) Before issuing a statement under section 69, the Authority must publish a draft of the proposed statement in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(2) The draft must be accompanied by notice that representations about the proposal may be made to the Authority within a specified time.

(3) Before issuing the proposed statement, the Authority must have regard to any representations made to it in accordance with subsection (2).

(4) If the Authority issues the proposed statement it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2); and

(b) its response to them.

(5) If the statement differs from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant, the Authority must (in addition to complying with subsection (4)) publish details of the difference.

(6) The Authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

(7) This section also applies to a proposal to alter or replace a statement.

Breach of statutory duty

Actions for damages.

71.—(1) A contravention of section 56(6) or 59(1) or (2) is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

(2) In prescribed cases, a contravention of that kind which would be actionable at the suit of a private person is actionable at the suit of a person who is not a private person, subject to the defences and other incidents applying to actions for breach of statutory duty.

(3) "Private person" has such meaning as may be prescribed.

Part VI

Official Listing

The competent authority

The competent authority.

72.—(1) On the coming into force of this section, the functions conferred on the competent authority by this Part are to be exercised by the Authority.

(2) Schedule 7 modifies this Act in its application to the Authority when it acts as the competent authority.

(3) But provision is made by Schedule 8 allowing some or all of those functions to be transferred by the Treasury so as to be exercisable by another person.

General duty of the competent authority.

73.—(1) In discharging its general functions the competent authority must have regard to—

(a) the need to use its resources in the most efficient and economic way;

(b) the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits, considered in general terms, which are expected to arise from the imposition of that burden or restriction;

(c) the desirability of facilitating innovation in respect of listed securities;

(d) the international character of capital markets and the desirability of maintaining the competitive position of the United Kingdom;

(e) the need to minimise the adverse effects on competition of anything done in the discharge of those functions;

(f) the desirability of facilitating competition in relation to listed securities.

(2) The competent authority's general functions are—

(a) its function of making rules under this Part (considered as a whole);

(b) its functions in relation to the giving of general guidance in relation to this Part (considered as a whole);

(c) its function of determining the general policy and principles by reference to which it performs particular functions under this Part.

The official list

The official list.

74.—(1) The competent authority must maintain the official list.

(2) The competent authority may admit to the official list such securities and other things as it considers appropriate.

(3) But—

(a) nothing may be admitted to the official list except in accordance with this Part; and

(b) the Treasury may by order provide that anything which falls within a description or category specified in the order may not be admitted to the official list.

(4) The competent authority may make rules ("listing rules") for the purposes of this Part.

(5) In the following provisions of this Part—

"security" means anything which has been, or may be, admitted to the official list; and

"listing" means being included in the official list in accordance with this Part.

Listing

Applications for listing.

75.—(1) Admission to the official list may be granted only on an application made to the competent authority in such manner as may be required by listing rules.

(2) No application for listing may be entertained by the competent authority unless it is made by, or with the consent of, the issuer of the securities concerned.

(3) No application for listing may be entertained by the competent authority in respect of securities which are to be issued by a body of a prescribed kind.

(4) The competent authority may not grant an application for listing unless it is satisfied that—

(a) the requirements of listing rules (so far as they apply to the application), and

(b) any other requirements imposed by the authority in relation to the application,

are complied with.

(5) An application for listing may be refused if, for a reason relating to the issuer, the competent authority considers that granting it would be detrimental to the interests of investors.

(6) An application for listing securities which are already officially listed in another EEA State may be refused if the issuer has failed to comply with any obligations to which he is subject as a result of that listing.

Decision on application.

76.—(1) The competent authority must notify the applicant of its decision on an application for listing—

(a) before the end of the period of six months beginning with the date on which the application is received; or

(b) if within that period the authority has required the applicant to provide further information in connection with the application, before the end of the period of six months beginning with the date on which that information is provided.

(2) If the competent authority fails to comply with subsection (1), it is to be taken to have decided to refuse the application.

(3) If the competent authority decides to grant an application for listing, it must give the applicant written notice.

(4) If the competent authority proposes to refuse an application for listing, it must give the applicant a warning notice.

(5) If the competent authority decides to refuse an application for listing, it must give the applicant a decision notice.

(6) If the competent authority decides to refuse an application for listing, the applicant may refer the matter to the Tribunal.

(7) If securities are admitted to the official list, their admission may not be called in question on the ground that any requirement or condition for their admission has not been complied with.

Discontinuance and suspension of listing.

77.—(1) The competent authority may, in accordance with listing rules, discontinue the listing of any securities if satisfied that there are special circumstances which preclude normal regular dealings in them.

(2) The competent authority may, in accordance with listing rules, suspend the listing of any securities.

(3) If securities are suspended under subsection (2) they are to be treated, for the purposes of sections 96 and 99, as still being listed.

(4) This section applies to securities whenever they were admitted to the official list.

(5) If the competent authority discontinues or suspends the listing of any securities, the issuer may refer the matter to the Tribunal.

Discontinuance or suspension: procedure.

78.—(1) A discontinuance or suspension takes effect—

(a) immediately, if the notice under subsection (2) states that that is the case;

(b) in any other case, on such date as may be specified in that notice.

(2) If the competent authority—

(a) proposes to discontinue or suspend the listing of securities, or

(b) discontinues or suspends the listing of securities with immediate effect,

it must give the issuer of the securities written notice.

(3) The notice must—

(a) give details of the discontinuance or suspension;

(b) state the competent authority's reasons for the discontinuance or suspension and for choosing the date on which it took effect or takes effect;

(c) inform the issuer of the securities that he may make representations to the competent authority within such period as may be specified in the notice (whether or not he has referred the matter to the Tribunal);

(d) inform him of the date on which the discontinuance or suspension took effect or will take effect; and

(e) inform him of his right to refer the matter to the Tribunal.

(4) The competent authority may extend the period within which representations may be made to it.

(5) If, having considered any representations made by the issuer of the securities, the competent authority decides—

(a) to discontinue or suspend the listing of the securities, or

(b) if the discontinuance or suspension has taken effect, not to cancel it,

the competent authority must give the issuer of the securities written notice.

(6) A notice given under subsection (5) must inform the issuer of the securities of his right to refer the matter to the Tribunal.

(7) If a notice informs a person of his right to refer a matter to the Tribunal, it must give an indication of the procedure on such a reference.

(8) If the competent authority decides—

(a) not to discontinue or suspend the listing of the securities, or

(b) if the discontinuance or suspension has taken effect, to cancel it,

the competent authority must give the issuer of the securities written notice.

(9) The effect of cancelling a discontinuance is that the securities concerned are to be readmitted, without more, to the official list.

(10) If the competent authority has suspended the listing of securities and proposes to refuse an application by the issuer of the securities for the cancellation of the suspension, it must give him a warning notice.

(11) The competent authority must, having considered any representations made in response to the warning notice—

(a) if it decides to refuse the application, give the issuer of the securities a decision notice;

(b) if it grants the application, give him written notice of its decision.

(12) If the competent authority decides to refuse an application for the cancellation of the suspension of listed securities, the applicant may refer the matter to the Tribunal.

(13) "Discontinuance" means a discontinuance of listing under section 77(1).

(14) "Suspension" means a suspension of listing under section 77(2).

Listing particulars

Listing particulars and other documents.

79.—(1) Listing rules may provide that securities (other than new securities) of a kind specified in the rules may not be admitted to the official list unless—

(a) listing particulars have been submitted to, and approved by, the competent authority and published; or

(b) in such cases as may be specified by listing rules, such document (other than listing particulars or a prospectus of a kind required by listing rules) as may be so specified has been published.

(2) "Listing particulars" means a document in such form and containing such information as may be specified in listing rules.

(3) For the purposes of this Part, the persons responsible for listing particulars are to be determined in accordance with regulations made by the Treasury.

(4) Nothing in this section affects the competent authority's general power to make listing rules.

General duty of disclosure in listing particulars.

80.—(1) Listing particulars submitted to the competent authority under section 79 must contain all such information as investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of—

(a) the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities; and

(b) the rights attaching to the securities.

(2) That information is required in addition to any information required by—

(a) listing rules, or

(b) the competent authority,

as a condition of the admission of the securities to the official list.

(3) Subsection (1) applies only to information—

(a) within the knowledge of any person responsible for the listing particulars; or

(b) which it would be reasonable for him to obtain by making enquiries.

(4) In determining what information subsection (1) requires to be included in listing particulars, regard must be had (in particular) to—

(a) the nature of the securities and their issuer;

(b) the nature of the persons likely to consider acquiring them;

(c) the fact that certain matters may reasonably be expected to be within the knowledge of professional advisers of a kind which persons likely to acquire the securities may reasonably be expected to consult; and

(d) any information available to investors or their professional advisers as a result of requirements imposed on the issuer of the securities by a recognised investment exchange, by listing rules or by or under any other enactment.

Supplementary listing particulars.

81.—(1) If at any time after the preparation of listing particulars which have been submitted to the competent authority under section 79 and before the commencement of dealings in the securities concerned following their admission to the official list—

(a) there is a significant change affecting any matter contained in those particulars the inclusion of which was required by—

(i) section 80,

(ii) listing rules, or

(iii) the competent authority, or

(b) a significant new matter arises, the inclusion of information in respect of which would have been so required if it had arisen when the particulars were prepared,

the issuer must, in accordance with listing rules, submit supplementary listing particulars of the change or new matter to the competent authority, for its approval and, if they are approved, publish them.

(2) "Significant" means significant for the purpose of making an informed assessment of the kind mentioned in section 80(1).

(3) If the issuer of the securities is not aware of the change or new matter in question, he is not under a duty to comply with subsection (1) unless he is notified of the change or new matter by a person responsible for the listing particulars.

(4) But it is the duty of any person responsible for those particulars who is aware of such a change or new matter to give notice of it to the issuer.

(5) Subsection (1) applies also as respects matters contained in any supplementary listing particulars previously published under this section in respect of the securities in question.

Exemptions from disclosure.

82.—(1) The competent authority may authorise the omission from listing particulars of any information, the inclusion of which would otherwise be required by section 80 or 81, on the ground—

(a) that its disclosure would be contrary to the public interest;

(b) that its disclosure would be seriously detrimental to the issuer; or

(c) in the case of securities of a kind specified in listing rules, that its disclosure is unnecessary for persons of the kind who may be expected normally to buy or deal in securities of that kind.

(2) But—

(a) no authority may be granted under subsection (1)(b) in respect of essential information; and

(b) no authority granted under subsection (1)(b) extends to any such information.

(3) The Secretary of State or the Treasury may issue a certificate to the effect that the disclosure of any information (including information that would otherwise have to be included in listing particulars for which they are themselves responsible) would be contrary to the public interest.

(4) The competent authority is entitled to act on any such certificate in exercising its powers under subsection (1)(a).

(5) This section does not affect any powers of the competent authority under listing rules made as a result of section 101(2).

(6) "Essential information" means information which a person considering acquiring securities of the kind in question would be likely to need in order not to be misled about any facts which it is essential for him to know in order to make an informed assessment.

(7) "Listing particulars" includes supplementary listing particulars.

Registration of listing particulars.

83.—(1) On or before the date on which listing particulars are published as required by listing rules, a copy of the particulars must be delivered for registration to the registrar of companies.

(2) A statement that a copy has been delivered to the registrar must be included in the listing particulars when they are published.

(3) If there has been a failure to comply with subsection (1) in relation to listing particulars which have been published—

(a) the issuer of the securities in question, and

(b) any person who is a party to the publication and aware of the failure,

is guilty of an offence.

(4) A person guilty of an offence under subsection (3) is liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to a fine.

(5) "Listing particulars" includes supplementary listing particulars.

(6) "The registrar of companies" means—

(a) if the securities are, or are to be, issued by a company incorporated in Great Britain whose registered office is in England and Wales, the registrar of companies in England and Wales;

(b) if the securities are, or are to be, issued by a company incorporated in Great Britain whose registered office is in Scotland, the registrar of companies in Scotland;

(c) if the securities are, or are to be, issued by a company incorporated in Northern Ireland, the registrar of companies for Northern Ireland; and

(d) in any other case, any of those registrars.

Prospectuses

Prospectuses.

84.—(1) Listing rules must provide that no new securities for which an application for listing has been made may be admitted to the official list unless a prospectus has been submitted to, and approved by, the competent authority and published.

(2) "New securities" means securities which are to be offered to the public in the United Kingdom for the first time before admission to the official list.

(3) "Prospectus" means a prospectus in such form and containing such information as may be specified in listing rules.

(4) Nothing in this section affects the competent authority's general power to make listing rules.

Publication of prospectus.

85.—(1) If listing rules made under section 84 require a prospectus to be published before particular new securities are admitted to the official list, it is unlawful for any of those securities to be offered to the public in the United Kingdom before the required prospectus is published.

(2) A person who contravenes subsection (1) is guilty of an offence and liable—

(a) on summary conviction, to imprisonment for a term not exceeding three months or a fine not exceeding level 5 on the standard scale;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

(3) A person is not to be regarded as contravening subsection (1) merely because a prospectus does not fully comply with the requirements of listing rules as to its form or content.

(4) But subsection (3) does not affect the question whether any person is liable to pay compensation under section 90.

(5) Any contravention of subsection (1) is actionable, at the suit of a person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

Application of this Part to prospectuses.

86.—(1) The provisions of this Part apply in relation to a prospectus required by listing rules as they apply in relation to listing particulars.

(2) In this Part—

(a) any reference to listing particulars is to be read as including a reference to a prospectus; and

(b) any reference to supplementary listing particulars is to be read as including a reference to a supplementary prospectus.

Approval of prospectus where no application for listing.

87.—(1) Listing rules may provide for a prospectus to be submitted to and approved by the competent authority if—

(a) securities are to be offered to the public in the United Kingdom for the first time;

(b) no application for listing of the securities has been made under this Part; and

(c) the prospectus is submitted by, or with the consent of, the issuer of the securities.

(2) "Non-listing prospectus" means a prospectus submitted to the competent authority as a result of any listing rules made under subsection (1).

(3) Listing rules made under subsection (1) may make provision—

(a) as to the information to be contained in, and the form of, a non-listing prospectus; and

(b) as to the timing and manner of publication of a non-listing prospectus.

(4) The power conferred by subsection (3)(b) is subject to such provision made by or under any other enactment as the Treasury may by order specify.

(5) Schedule 9 modifies provisions of this Part as they apply in relation to non-listing prospectuses.

Sponsors

Sponsors.

88.—(1) Listing rules may require a person to make arrangements with a sponsor for the performance by the sponsor of such services in relation to him as may be specified in the rules.

(2) "Sponsor" means a person approved by the competent authority for the purposes of the rules.

(3) Listing rules made by virtue of subsection (1) may—

(a) provide for the competent authority to maintain a list of sponsors;

(b) specify services which must be performed by a sponsor;

(c) impose requirements on a sponsor in relation to the provision of services or specified services;

(d) specify the circumstances in which a person is qualified for being approved as a sponsor.

(4) If the competent authority proposes—

(a) to refuse a person's application for approval as a sponsor, or

(b) to cancel a person's approval as a sponsor,

it must give him a warning notice.

(5) If, after considering any representations made in response to the warning notice, the competent authority decides—

(a) to grant the application for approval, or

(b) not to cancel the approval,

it must give the person concerned, and any person to whom a copy of the warning notice was given, written notice of its decision.

(6) If, after considering any representations made in response to the warning notice, the competent authority decides—

(a) to refuse to grant the application for approval, or

(b) to cancel the approval,

it must give the person concerned a decision notice.

(7) A person to whom a decision notice is given under this section may refer the matter to the Tribunal.

Public censure of sponsor.

89.—(1) Listing rules may make provision for the competent authority, if it considers that a sponsor has contravened a requirement imposed on him by rules made as a result of section 88(3)(c), to publish a statement to that effect.

(2) If the competent authority proposes to publish a statement it must give the sponsor a warning notice setting out the terms of the proposed statement.

(3) If, after considering any representations made in response to the warning notice, the competent authority decides to make the proposed statement, it must give the sponsor a decision notice setting out the terms of the statement.

(4) A sponsor to whom a decision notice is given under this section may refer the matter to the Tribunal.

Compensation

Compensation for false or misleading particulars.

90.—(1) Any person responsible for listing particulars is liable to pay compensation to a person who has—

(a) acquired securities to which the particulars apply; and

(b) suffered loss in respect of them as a result of—

(i) any untrue or misleading statement in the particulars; or

(ii) the omission from the particulars of any matter required to be included by section 80 or 81.

(2) Subsection (1) is subject to exemptions provided by Schedule 10.

(3) If listing particulars are required to include information about the absence of a particular matter, the omission from the particulars of that information is to be treated as a statement in the listing particulars that there is no such matter.

(4) Any person who fails to comply with section 81 is liable to pay compensation to any person who has—

(a) acquired securities of the kind in question; and

(b) suffered loss in respect of them as a result of the failure.

(5) Subsection (4) is subject to exemptions provided by Schedule 10.

(6) This section does not affect any liability which may be incurred apart from this section.

(7) References in this section to the acquisition by a person of securities include references to his contracting to acquire them or any interest in them.

(8) No person shall, by reason of being a promoter of a company or otherwise, incur any liability for failing to disclose information which he would not be required to disclose in listing particulars in respect of a company's securities—

(a) if he were responsible for those particulars; or

(b) if he is responsible for them, which he is entitled to omit by virtue of section 82.

(9) The reference in subsection (8) to a person incurring liability includes a reference to any other person being entitled as against that person to be granted any civil remedy or to rescind or repudiate an agreement.

(10) "Listing particulars", in subsection (1) and Schedule 10, includes supplementary listing particulars.

Penalties

Penalties for breach of listing rules.

91.—(1) If the competent authority considers that—

(a) an issuer of listed securities, or

(b) an applicant for listing,

has contravened any provision of listing rules, it may impose on him a penalty of such amount as it considers appropriate.

(2) If, in such a case, the competent authority considers that a person who was at the material time a director of the issuer or applicant was knowingly concerned in the contravention, it may impose on him a penalty of such amount as it considers appropriate.

(3) If the competent authority is entitled to impose a penalty on a person under this section in respect of a particular matter it may, instead of imposing a penalty on him in respect of that matter, publish a statement censuring him.

(4) Nothing in this section prevents the competent authority from taking any other steps which it has power to take under this Part.

(5) A penalty under this section is payable to the competent authority.

(6) The competent authority may not take action against a person under this section after the end of the period of two years beginning with the first day on which it knew of the contravention unless proceedings against that person, in respect of the contravention, were begun before the end of that period.

(7) For the purposes of subsection (6)—

(a) the competent authority is to be treated as knowing of a contravention if it has information from which the contravention can reasonably be inferred; and

(b) proceedings against a person in respect of a contravention are to be treated as begun when a warning notice is given to him under section 92.

Procedure.

92.—(1) If the competent authority proposes to take action against a person under section 91, it must give him a warning notice.

(2) A warning notice about a proposal to impose a penalty must state the amount of the proposed penalty.

(3) A warning notice about a proposal to publish a statement must set out the terms of the proposed statement.

(4) If the competent authority decides to take action against a person under section 91, it must give him a decision notice.

(5) A decision notice about the imposition of a penalty must state the amount of the penalty.

(6) A decision notice about the publication of a statement must set out the terms of the statement.

(7) If the competent authority decides to take action against a person under section 91, he may refer the matter to the Tribunal.

Statement of policy.

93.—(1) The competent authority must prepare and issue a statement ("its policy statement") of its policy with respect to—

(a) the imposition of penalties under section 91; and

(b) the amount of penalties under that section.

(2) The competent authority's policy in determining what the amount of a penalty should be must include having regard to—

(a) the seriousness of the contravention in question in relation to the nature of the requirement contravened;

(b) the extent to which that contravention was deliberate or reckless; and

(c) whether the person on whom the penalty is to be imposed is an individual.

(3) The competent authority may at any time alter or replace its policy statement.

(4) If its policy statement is altered or replaced, the competent authority must issue the altered or replacement statement.

(5) In exercising, or deciding whether to exercise, its power under section 91 in the case of any particular contravention, the competent authority must have regard to any policy statement published under this section and in force at the time when the contravention in question occurred.

(6) The competent authority must publish a statement issued under this section in the way appearing to the competent authority to be best calculated to bring it to the attention of the public.

(7) The competent authority may charge a reasonable fee for providing a person with a copy of the statement.

(8) The competent authority must, without delay, give the Treasury a copy of any policy statement which it publishes under this section.

Statements of policy: procedure.

94.—(1) Before issuing a statement under section 93, the competent authority must publish a draft of the proposed statement in the way appearing to the competent authority to be best calculated to bring it to the attention of the public.

(2) The draft must be accompanied by notice that representations about the proposal may be made to the competent authority within a specified time.

(3) Before issuing the proposed statement, the competent authority must have regard to any representations made to it in accordance with subsection (2).

(4) If the competent authority issues the proposed statement it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2); and

(b) its response to them.

(5) If the statement differs from the draft published under subsection (1) in a way which is, in the opinion of the competent authority, significant, the competent authority must (in addition to complying with subsection (4)) publish details of the difference.

(6) The competent authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

(7) This section also applies to a proposal to alter or replace a statement.

Competition

Competition scrutiny.

95.—(1) The Treasury may by order provide for—

(a) regulating provisions, and

(b) the practices of the competent authority in exercising its functions under this Part ("practices"),

to be kept under review.

(2) Provision made as a result of subsection (1) must require the person responsible for keeping regulating provisions and practices under review to consider—

(a) whether any regulating provision or practice has a significantly adverse effect on competition; or

(b) whether two or more regulating provisions or practices taken together have, or a particular combination of regulating provisions and practices has, such an effect.

(3) An order under this section may include provision corresponding to that made by any provision of Chapter III of Part X.

(4) Subsection (3) is not to be read as in any way restricting the power conferred by subsection (1).

(5) Subsections (6) to (8) apply for the purposes of provision made by or under this section.

(6) Regulating provisions or practices have a significantly adverse effect on competition if—

(a) they have, or are intended or likely to have, that effect; or

(b) the effect that they have, or are intended or likely to have, is to require or encourage behaviour which has, or is intended or likely to have, a significantly adverse effect on competition.

(7) If regulating provisions or practices have, or are intended or likely to have, the effect of requiring or encouraging exploitation of the strength of a market position they are to be taken to have, or be intended or be likely to have, an adverse effect on competition.

(8) In determining whether any of the regulating provisions or practices have, or are intended or likely to have, a particular effect, it may be assumed that the persons to whom the provisions concerned are addressed will act in accordance with them.

(9) "Regulating provisions" means—

(a) listing rules,

(b) general guidance given by the competent authority in connection with its functions under this Part.

Miscellaneous

Obligations of issuers of listed securities.

96.—(1) Listing rules may—

(a) specify requirements to be complied with by issuers of listed securities; and

(b) make provision with respect to the action that may be taken by the competent authority in the event of non-compliance.

(2) If the rules require an issuer to publish information, they may include provision authorising the competent authority to publish it in the event of his failure to do so.

(3) This section applies whenever the listed securities were admitted to the official list.

Appointment by competent authority of persons to carry out investigations.

97.—(1) Subsection (2) applies if it appears to the competent authority that there are circumstances suggesting that—

(a) there may have been a breach of listing rules;

(b) a person who was at the material time a director of an issuer of listed securities has been knowingly concerned in a breach of listing rules by that issuer;

(c) a person who was at the material time a director of a person applying for the admission of securities to the official list has been knowingly concerned in a breach of listing rules by that applicant;

(d) there may have been a contravention of section 83, 85 or 98.

(2) The competent authority may appoint one or more competent persons to conduct an investigation on its behalf.

(3) Part XI applies to an investigation under subsection (2) as if—

(a) the investigator were appointed under section 167(1);

(b) references to the investigating authority in relation to him were to the competent authority;

(c) references to the offences mentioned in section 168 were to those mentioned in subsection (1)(d);

(d) references to an authorised person were references to the person under investigation.

Advertisements etc. in connection with listing applications.

98.—(1) If listing particulars are, or are to be, published in connection with an application for listing, no advertisement or other information of a kind specified by listing rules may be issued in the United Kingdom unless the contents of the advertisement or other information have been submitted to the competent authority and that authority has—

(a) approved those contents; or

(b) authorised the issue of the advertisement or information without such approval.

(2) A person who contravenes subsection (1) is guilty of an offence and liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

(3) A person who issues an advertisement or other information to the order of another person is not guilty of an offence under subsection (2) if he shows that he believed on reasonable grounds that the advertisement or information had been approved, or its issue authorised, by the competent authority.

(4) If information has been approved, or its issue has been authorised, under this section, neither the person issuing it nor any person responsible for, or for any part of, the listing particulars incurs any civil liability by reason of any statement in or omission from the information if that information and the listing particulars, taken together, would not be likely to mislead persons of the kind likely to consider acquiring the securities in question.

(5) The reference in subsection (4) to a person incurring civil liability includes a reference to any other person being entitled as against that person to be granted any civil remedy or to rescind or repudiate an agreement.

Fees.

99.—(1) Listing rules may require the payment of fees to the competent authority in respect of—

(a) applications for listing;

(b) the continued inclusion of securities in the official list;

(c) applications under section 88 for approval as a sponsor; and

(d) continued inclusion of sponsors in the list of sponsors.

(2) In exercising its powers under subsection (1), the competent authority may set such fees as it considers will (taking account of the income it expects as the competent authority) enable it—

(a) to meet expenses incurred in carrying out its functions under this Part or for any incidental purpose;

(b) to maintain adequate reserves; and

(c) in the case of the Authority, to repay the principal of, and pay any interest on, any money which it has borrowed and which has been used for the purpose of meeting expenses incurred in relation to—

(i) its assumption of functions from the London Stock Exchange Limited in relation to the official list; and

(ii) its assumption of functions under this Part.

(3) In fixing the amount of any fee which is to be payable to the competent authority, no account is to be taken of any sums which it receives, or expects to receive, by way of penalties imposed by it under this Part.

(4) Subsection (2)(c) applies whether expenses were incurred before or after the coming into force of this Part.

(5) Any fee which is owed to the competent authority under any provision made by or under this Part may be recovered as a debt due to it.

100.—(1) In determining its policy with respect to the amount of penalties to be imposed by it under this Part, the competent authority must take no account of the expenses which it incurs, or expects to incur, in discharging its functions under this Part. Penalties.

(2) The competent authority must prepare and operate a scheme for ensuring that the amounts paid to it by way of penalties imposed under this Part are applied for the benefit of issuers of securities admitted to the official list.

(3) The scheme may, in particular, make different provision with respect to different classes of issuer.

(4) Up to date details of the scheme must be set out in a document ("the scheme details").

(5) The scheme details must be published by the competent authority in the way appearing to it to be best calculated to bring them to the attention of the public.

(6) Before making the scheme, the competent authority must publish a draft of the proposed scheme in the way appearing to it to be best calculated to bring it to the attention of the public.

(7) The draft must be accompanied by notice that representations about the proposals may be made to the competent authority within a specified time.

(8) Before making the scheme, the competent authority must have regard to any representations made to it under subsection (7).

(9) If the competent authority makes the proposed scheme, it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (7); and

(b) its response to them.

(10) If the scheme differs from the draft published under subsection (6) in a way which is, in the opinion of the competent authority, significant the competent authority must (in addition to complying with subsection (9)) publish details of the difference.

(11) The competent authority must, without delay, give the Treasury a copy of any scheme details published by it.

(12) The competent authority may charge a reasonable fee for providing a person with a copy of—

(a) a draft published under subsection (6);

(b) scheme details.

(13) Subsections (6) to (10) and (12) apply also to a proposal to alter or replace the scheme.

Listing rules: general provisions.

101.—(1) Listing rules may make different provision for different cases.

(2) Listing rules may authorise the competent authority to dispense with or modify the application of the rules in particular cases and by reference to any circumstances.

(3) Listing rules must be made by an instrument in writing.

(4) Immediately after an instrument containing listing rules is made, it must be printed and made available to the public with or without payment.

(5) A person is not to be taken to have contravened any listing rule if he shows that at the time of the alleged contravention the instrument containing the rule had not been made available as required by subsection (4).

(6) The production of a printed copy of an instrument purporting to be made by the competent authority on which is endorsed a certificate signed by an officer of the authority authorised by it for that purpose and stating—

(a) that the instrument was made by the authority,

(b) that the copy is a true copy of the instrument, and

(c) that on a specified date the instrument was made available to the public as required by subsection (4),

is evidence (or in Scotland sufficient evidence) of the facts stated in the certificate.

(7) A certificate purporting to be signed as mentioned in subsection (6) is to be treated as having been properly signed unless the contrary is shown.

(8) A person who wishes in any legal proceedings to rely on a rule-making instrument may require the Authority to endorse a copy of the instrument with a certificate of the kind mentioned in subsection (6).

Exemption from liability in damages.

102.—(1) Neither the competent authority nor any person who is, or is acting as, a member, officer or member of staff of the competent authority is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of the authority's functions.

(2) Subsection (1) does not apply—

(a) if the act or omission is shown to have been in bad faith; or

(b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998.

1998 c. 42.

Interpretation of this Part.

103.—(1) In this Part—

"application" means an application made under section 75;

"issuer", in relation to anything which is or may be admitted to the official list, has such meaning as may be prescribed by the Treasury;

"listing" has the meaning given in section 74(5);

"listing particulars" has the meaning given in section 79(2);

"listing rules" has the meaning given in section 74(4);

"new securities" has the meaning given in section 84(2);

"the official list" means the list maintained as the official list by the Authority immediately before the coming into force of section 74, as that list has effect for the time being;

"security" (except in section 74(2)) has the meaning given in section 74(5).

(2) In relation to any function conferred on the competent authority by this Part, any reference in this Part to the competent authority is to be read as a reference to the person by whom that function is for the time being exercisable.

(3) If, as a result of an order under Schedule 8, different functions conferred on the competent authority by this Part are exercisable by different persons, the powers conferred by section 91 are exercisable by such person as may be determined in accordance with the provisions of the order.

(4) For the purposes of this Part, a person offers securities if, and only if, as principal—

(a) he makes an offer which, if accepted, would give rise to a contract for their issue or sale by him or by another person with whom he has made arrangements for their issue or sale; or

(b) he invites a person to make such an offer.

(5) "Offer" and "offeror" are to be read accordingly.

(6) For the purposes of this Part, the question whether a person offers securities to the public in the United Kingdom is to be determined in accordance with Schedule 11.

(7) For the purposes of subsection (4) "sale" includes any disposal for valuable consideration.

PART VII

CONTROL OF BUSINESS TRANSFERS

Control of business transfers.

104. No insurance business transfer scheme or banking business transfer scheme is to have effect unless an order has been made in relation to it under section 111(1).

Insurance business transfer schemes.

105.—(1) A scheme is an insurance business transfer scheme if it—

(a) satisfies one of the conditions set out in subsection (2);

(b) results in the business transferred being carried on from an establishment of the transferee in an EEA State; and

(c) is not an excluded scheme.

(2) The conditions are that—

(a) the whole or part of the business carried on in one or more member States by a UK authorised person who has permission to effect or carry out contracts of insurance ("the authorised person concerned") is to be transferred to another body ("the transferee");

(b) the whole or part of the business, so far as it consists of reinsurance, carried on in the United Kingdom through an establishment there by an EEA firm qualifying for authorisation under Schedule 3 which has permission to effect or carry out contracts of insurance ("the authorised person concerned") is to be transferred to another body ("the transferee");

(c) the whole or part of the business carried on in the United Kingdom by an authorised person who is neither a UK authorised person nor an EEA firm but who has permission to effect or carry out contracts of insurance ("the authorised person concerned") is to be transferred to another body ("the transferee").

(3) A scheme is an excluded scheme for the purposes of this section if it falls within any of the following cases:

Case 1

Where the authorised person concerned is a friendly society.

Case 2

Where—

(a) the authorised person concerned is a UK authorised person;

(b) the business to be transferred under the scheme is business which consists of the effecting or carrying out of contracts of reinsurance in one or more EEA States other than the United Kingdom; and

(c) the scheme has been approved by a court in an EEA State other than the United Kingdom or by the host state regulator.

Case 3

Where—

(a) the authorised person concerned is a UK authorised person;

(b) the business to be transferred under the scheme is carried on in one or more countries or territories (none of which is an EEA State) and does not include policies of insurance (other than reinsurance) against risks arising in an EEA State; and

(c) the scheme has been approved by a court in a country or territory other than an EEA State or by the authority responsible for the supervision of that business in a country or territory in which it is carried on.

Case 4

Where the business to be transferred under the scheme is the whole of the business of the authorised person concerned and—

(a) consists solely of the effecting or carrying out of contracts of reinsurance, or

(b) all the policyholders are controllers of the firm or of firms within the same group as the firm which is the transferee,

and, in either case, all of the policyholders who will be affected by the transfer have consented to it.

(4) The parties to a scheme which falls within Case 2, 3 or 4 may apply to the court for an order sanctioning the scheme as if it were an insurance business transfer scheme.

(5) Subsection (6) applies if the scheme involves a compromise or arrangement falling within section 427A of the Companies Act 1985 (or Article 420A of the Companies (Northern Ireland) Order 1986).

1985 c. 6.
S.I. 1986/1032 (N.I. 6).

(6) Sections 425 to 427 of that Act (or Articles 418 to 420 of that Order) have effect as modified by section 427A of that Act (or Article 420A of that Order) in relation to that compromise or arrangement.

(7) But subsection (6) does not affect the operation of this Part in relation to the scheme.

(8) "UK authorised person" means a body which is an authorised person and which—

(a) is incorporated in the United Kingdom; or

(b) is an unincorporated association formed under the law of any part of the United Kingdom.

(9) "Establishment" means, in relation to a person, his head office or a branch of his.

Banking business transfer schemes.

106.—(1) A scheme is a banking business transfer scheme if it—

(a) satisfies one of the conditions set out in subsection (2);

(b) is one under which the whole or part of the business to be transferred includes the accepting of deposits; and

(c) is not an excluded scheme.

(2) The conditions are that—

(a) the whole or part of the business carried on by a UK authorised person who has permission to accept deposits ("the authorised person concerned") is to be transferred to another body ("the transferee");

(b) the whole or part of the business carried on in the United Kingdom by an authorised person who is not a UK authorised person but who has permission to accept deposits ("the authorised person concerned") is to be transferred to another body which will carry it on in the United Kingdom ("the transferee").

(3) A scheme is an excluded scheme for the purposes of this section if—

(a) the authorised person concerned is a building society or a credit union; or

1985 c. 6.
S.I. 1986/1032 (N.I. 6).

(b) the scheme is a compromise or arrangement to which section 427A(1) of the Companies Act 1985 or Article 420A of the Companies (Northern Ireland) Order 1986 (mergers and divisions of public companies) applies.

(4) For the purposes of subsection (2)(a) it is immaterial whether or not the business to be transferred is carried on in the United Kingdom.

(5) "UK authorised person" has the same meaning as in section 105.

1986 c. 53.

(6) "Building society" has the meaning given in the Building Societies Act 1986.

(7) "Credit union" means a credit union within the meaning of—

1979 c. 34.

(a) the Credit Unions Act 1979;

S.I. 1985/1205 (N.I. 12).

(b) the Credit Unions (Northern Ireland) Order 1985.

Application for order sanctioning transfer scheme.

107.—(1) An application may be made to the court for an order sanctioning an insurance business transfer scheme or a banking business transfer scheme.

(2) An application may be made by—

(a) the authorised person concerned;

(b) the transferee; or

(c) both.

(3) The application must be made—

(a) if the authorised person concerned and the transferee are registered or have their head offices in the same jurisdiction, to the court in that jurisdiction;

(b) if the authorised person concerned and the transferee are registered or have their head offices in different jurisdictions, to the court in either jurisdiction;

(c) if the transferee is not registered in the United Kingdom and does not have his head office there, to the court which has jurisdiction in relation to the authorised person concerned.

(4) "Court" means—

(a) the High Court; or

(b) in Scotland, the Court of Session.

Requirements on applicants.

108.—(1) The Treasury may by regulations impose requirements on applicants under section 107.

(2) The court may not determine an application under that section if the applicant has failed to comply with a prescribed requirement.

(3) The regulations may, in particular, include provision—

(a) as to the persons to whom, and periods within which, notice of an application must be given;

(b) enabling the court to waive a requirement of the regulations in prescribed circumstances.

Scheme reports.

109.—(1) An application under section 107 in respect of an insurance business transfer scheme must be accompanied by a report on the terms of the scheme ("a scheme report").

(2) A scheme report may be made only by a person—

(a) appearing to the Authority to have the skills necessary to enable him to make a proper report; and

(b) nominated or approved for the purpose by the Authority.

(3) A scheme report must be made in a form approved by the Authority.

Right to participate in proceedings.

110. On an application under section 107, the following are also entitled to be heard—

(a) the Authority, and

(b) any person (including an employee of the authorised person concerned or of the transferee) who alleges that he would be adversely affected by the carrying out of the scheme.

Sanction of the court for business transfer schemes.

111.—(1) This section sets out the conditions which must be satisfied before the court may make an order under this section sanctioning an insurance business transfer scheme or a banking business transfer scheme.

(2) The court must be satisfied that—

(a) the appropriate certificates have been obtained (as to which see Parts I and II of Schedule 12);

(b) the transferee has the authorisation required (if any) to enable the business, or part, which is to be transferred to be carried on in the place to which it is to be transferred (or will have it before the scheme takes effect).

(3) The court must consider that, in all the circumstances of the case, it is appropriate to sanction the scheme.

Effect of order sanctioning business transfer scheme.

112.—(1) If the court makes an order under section 111(1), it may by that or any subsequent order make such provision (if any) as it thinks fit—

(a) for the transfer to the transferee of the whole or any part of the undertaking concerned and of any property or liabilities of the authorised person concerned;

(b) for the allotment or appropriation by the transferee of any shares, debentures, policies or other similar interests in the transferee which under the scheme are to be allotted or appropriated to or for any other person;

(c) for the continuation by (or against) the transferee of any pending legal proceedings by (or against) the authorised person concerned;

(d) with respect to such incidental, consequential and supplementary matters as are, in its opinion, necessary to secure that the scheme is fully and effectively carried out.

(2) An order under subsection (1)(a) may—

(a) transfer property or liabilities whether or not the authorised person concerned otherwise has the capacity to effect the transfer in question;

(b) make provision in relation to property which was held by the authorised person concerned as trustee;

(c) make provision as to future or contingent rights or liabilities of the authorised person concerned, including provision as to the construction of instruments (including wills) under which such rights or liabilities may arise;

(d) make provision as to the consequences of the transfer in relation to any retirement benefits scheme (within the meaning of section 611 of the Income and Corporation Taxes Act 1988) operated by or on behalf of the authorised person concerned.

1988 c. 1.

(3) If an order under subsection (1) makes provision for the transfer of property or liabilities—

(a) the property is transferred to and vests in, and

(b) the liabilities are transferred to and become liabilities of,

the transferee as a result of the order.

(4) But if any property or liability included in the order is governed by the law of any country or territory outside the United Kingdom, the order may require the authorised person concerned, if the transferee so requires, to take all necessary steps for securing that the transfer to the transferee of the property or liability is fully effective under the law of that country or territory.

(5) Property transferred as the result of an order under subsection (1) may, if the court so directs, vest in the transferee free from any charge which is (as a result of the scheme) to cease to have effect.

(6) An order under subsection (1) which makes provision for the transfer of property is to be treated as an instrument of transfer for the purposes of the provisions mentioned in subsection (7) and any other enactment requiring the delivery of an instrument of transfer for the registration of property.

(7) The provisions are—

1985 c. 6.

(a) section 183(1) of the Companies Act 1985;

S.I. 1986/1032 (N.I. 6).

(b) Article 193(1) and (2) of the Companies (Northern Ireland) Order 1986.

(8) If the court makes an order under section 111(1) in relation to an insurance business transfer scheme, it may by that or any subsequent order make such provision (if any) as it thinks fit—

(a) for dealing with the interests of any person who, within such time and in such manner as the court may direct, objects to the scheme;

(b) for the dissolution, without winding up, of the authorised person concerned;

(c) for the reduction, on such terms and subject to such conditions (if any) as it thinks fit, of the benefits payable under—

(i) any description of policy, or

(ii) policies generally,

entered into by the authorised person concerned and transferred as a result of the scheme.

(9) If, in the case of an insurance business transfer scheme, the authorised person concerned is not an EEA firm, it is immaterial for the purposes of subsection (1)(a), (c) or (d) or subsection (2), (3) or (4) that the law applicable to any of the contracts of insurance included in the transfer is the law of an EEA State other than the United Kingdom.

(10) The transferee must, if an insurance or banking business transfer scheme is sanctioned by the court, deposit two office copies of the order made under subsection (1) with the Authority within 10 days of the making of the order.

(11) But the Authority may extend that period.

(12) "Property" includes property, rights and powers of any description.

(13) "Liabilities" includes duties.

(14) "Shares" and "debentures" have the same meaning as in—

(a) the Companies Act 1985; or 1985 c. 6.

(b) in Northern Ireland, the Companies (Northern Ireland) Order 1986. S.I. 1986/1032 (N.I. 6).

(15) "Charge" includes a mortgage (or, in Scotland, a security over property).

Appointment of actuary in relation to reduction of benefits.

113.—(1) This section applies if an order has been made under section 111(1).

(2) The court making the order may, on the application of the Authority, appoint an independent actuary—

(a) to investigate the business transferred under the scheme; and

(b) to report to the Authority on any reduction in the benefits payable under policies entered into by the authorised person concerned that, in the opinion of the actuary, ought to be made.

Rights of certain policyholders.

114.—(1) This section applies in relation to an insurance business transfer scheme if—

(a) the authorised person concerned is an authorised person other than an EEA firm qualifying for authorisation under Schedule 3;

(b) the court has made an order under section 111 in relation to the scheme; and

(c) an EEA State other than the United Kingdom is, as regards any policy included in the transfer which evidences a contract of insurance, the State of the commitment or the EEA State in which the risk is situated ("the EEA State concerned").

(2) The court must direct that notice of the making of the order, or the execution of any instrument, giving effect to the transfer must be published by the transferee in the EEA State concerned.

(3) A notice under subsection (2) must specify such period as the court may direct as the period during which the policyholder may exercise any right which he has to cancel the policy.

(4) The order or instrument mentioned in subsection (2) does not bind the policyholder if—

(a) the notice required under that subsection is not published; or

(b) the policyholder cancels the policy during the period specified in the notice given under that subsection.

(5) The law of the EEA State concerned governs—

(a) whether the policyholder has a right to cancel the policy; and

(b) the conditions, if any, subject to which any such right may be exercised.

(6) Paragraph 6 of Schedule 12 applies for the purposes of this section as it applies for the purposes of that Schedule.

Business transfers outside the United Kingdom

Certificates for purposes of insurance business transfers overseas.

115. Part III of Schedule 12 makes provision about certificates which the Authority may issue in relation to insurance business transfers taking place outside the United Kingdom.

Effect of insurance business transfers authorised in other EEA States.

116.—(1) This section applies if, as a result of an authorised transfer, an EEA firm falling within paragraph 5(d) of Schedule 3 transfers to another body all its rights and obligations under any UK policies.

(2) This section also applies if, as a result of an authorised transfer, a company authorised in an EEA State other than the United Kingdom under Article 27 of the first life insurance directive, or Article 23 of the first non-life insurance directive, transfers to another body all its rights and obligations under any UK policies.

(3) If appropriate notice of the execution of an instrument giving effect to the transfer is published, the instrument has the effect in law—

(a) of transferring to the transferee all the transferor's rights and obligations under the UK policies to which the instrument applies, and

(b) if the instrument so provides, of securing the continuation by or against the transferee of any legal proceedings by or against the transferor which relate to those rights and obligations.

(4) No agreement or consent is required before subsection (3) has the effects mentioned.

(5) "Authorised transfer" means—

(a) in subsection (1), a transfer authorised in the home State of the EEA firm in accordance with—

(i) Article 11 of the third life directive; or

(ii) Article 12 of the third non-life directive; and

(b) in subsection (2), a transfer authorised in an EEA State other than the United Kingdom in accordance with—

(i) Article 31a of the first life directive; or

(ii) Article 28a of the first non-life directive.

(6) "UK policy" means a policy evidencing a contract of insurance (other than a contract of reinsurance) to which the applicable law is the law of any part of the United Kingdom.

(7) "Appropriate notice" means—

(a) if the UK policy evidences a contract of insurance in relation to which an EEA State other than the United Kingdom is the State of the commitment, notice given in accordance with the law of that State;

(b) if the UK policy evidences a contract of insurance where the risk is situated in an EEA State other than the United Kingdom, notice given in accordance with the law of that EEA State;

(c) in any other case, notice given in accordance with the applicable law.

(8) Paragraph 6 of Schedule 12 applies for the purposes of this section as it applies for the purposes of that Schedule.

Modifications

117. The Treasury may by regulations— Power to modify this Part.

(a) provide for prescribed provisions of this Part to have effect in relation to prescribed cases with such modifications as may be prescribed;

(b) make such amendments to any provision of this Part as they consider appropriate for the more effective operation of that or any other provision of this Part.

Part VIII

Penalties for Market Abuse

Market abuse

118.—(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert)— Market abuse.

(a) which occurs in relation to qualifying investments traded on a market to which this section applies;

(b) which satisfies any one or more of the conditions set out in subsection (2); and

(c) which is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.

(2) The conditions are that—

(a) the behaviour is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected;

(b) the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question;

(c) a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question.

(3) The Treasury may by order prescribe (whether by name or by description)—

(a) the markets to which this section applies; and

(b) the investments which are qualifying investments in relation to those markets.

(4) The order may prescribe different investments or descriptions of investment in relation to different markets or descriptions of market.

(5) Behaviour is to be disregarded for the purposes of subsection (1) unless it occurs—

(a) in the United Kingdom; or

(b) in relation to qualifying investments traded on a market to which this section applies which is situated in the United Kingdom or which is accessible electronically in the United Kingdom.

(6) For the purposes of this section, the behaviour which is to be regarded as occurring in relation to qualifying investments includes behaviour which—

(a) occurs in relation to anything which is the subject matter, or whose price or value is expressed by reference to the price or value, of those qualifying investments; or

(b) occurs in relation to investments (whether qualifying or not) whose subject matter is those qualifying investments.

(7) Information which can be obtained by research or analysis conducted by, or on behalf of, users of a market is to be regarded for the purposes of this section as being generally available to them.

(8) Behaviour does not amount to market abuse if it conforms with a rule which includes a provision to the effect that behaviour conforming with the rule does not amount to market abuse.

(9) Any reference in this Act to a person engaged in market abuse is a reference to a person engaged in market abuse whether alone or with one or more other persons.

(10) In this section—

"behaviour" includes action or inaction;

"investment" is to be read with section 22 and Schedule 2;

"regular user", in relation to a particular market, means a reasonable person who regularly deals on that market in investments of the kind in question.

The code

The code.

119.—(1) The Authority must prepare and issue a code containing such provisions as the Authority considers will give appropriate guidance to those determining whether or not behaviour amounts to market abuse.

(2) The code may among other things specify—

(a) descriptions of behaviour that, in the opinion of the Authority, amount to market abuse;

(b) descriptions of behaviour that, in the opinion of the Authority, do not amount to market abuse;

(c) factors that, in the opinion of the Authority, are to be taken into account in determining whether or not behaviour amounts to market abuse.

(3) The code may make different provision in relation to persons, cases or circumstances of different descriptions.

(4) The Authority may at any time alter or replace the code.

(5) If the code is altered or replaced, the altered or replacement code must be issued by the Authority.

(6) A code issued under this section must be published by the Authority in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(7) The Authority must, without delay, give the Treasury a copy of any code published under this section.

(8) The Authority may charge a reasonable fee for providing a person with a copy of the code.

Provisions included in the Authority's code by reference to the City Code.

120.—(1) The Authority may include in a code issued by it under section 119 ("the Authority's code") provision to the effect that in its opinion behaviour conforming with the City Code—

(a) does not amount to market abuse;

(b) does not amount to market abuse in specified circumstances; or

(c) does not amount to market abuse if engaged in by a specified description of person.

(2) But the Treasury's approval is required before any such provision may be included in the Authority's code.

(3) If the Authority's code includes provision of a kind authorised by subsection (1), the Authority must keep itself informed of the way in which the Panel on Takeovers and Mergers interprets and administers the relevant provisions of the City Code.

(4) "City Code" means the City Code on Takeovers and Mergers issued by the Panel as it has effect at the time when the behaviour occurs.

(5) "Specified" means specified in the Authority's code.

Codes: procedure.

121.—(1) Before issuing a code under section 119, the Authority must publish a draft of the proposed code in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(2) The draft must be accompanied by—

(a) a cost benefit analysis; and

(b) notice that representations about the proposal may be made to the Authority within a specified time.

(3) Before issuing the proposed code, the Authority must have regard to any representations made to it in accordance with subsection (2)(b).

(4) If the Authority issues the proposed code it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2)(b); and

(b) its response to them.

(5) If the code differs from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant—

(a) the Authority must (in addition to complying with subsection (4)) publish details of the difference; and

(b) those details must be accompanied by a cost benefit analysis.

(6) Subsections (1) to (5) do not apply if the Authority considers that there is an urgent need to publish the code.

(7) Neither subsection (2)(a) nor subsection (5)(b) applies if the Authority considers—

(a) that, making the appropriate comparison, there will be no increase in costs; or

(b) that, making that comparison, there will be an increase in costs but the increase will be of minimal significance.

(8) The Authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

(9) This section also applies to a proposal to alter or replace a code.

(10) "Cost benefit analysis" means an estimate of the costs together with an analysis of the benefits that will arise—

(a) if the proposed code is issued; or

(b) if subsection (5)(b) applies, from the code that has been issued.

(11) "The appropriate comparison" means—

(a) in relation to subsection (2)(a), a comparison between the overall position if the code is issued and the overall position if it is not issued;

(b) in relation to subsection (5)(b), a comparison between the overall position after the issuing of the code and the overall position before it was issued.

Effect of the code.

122.—(1) If a person behaves in a way which is described (in the code in force under section 119 at the time of the behaviour) as behaviour that, in the Authority's opinion, does not amount to market abuse that behaviour of his is to be taken, for the purposes of this Act, as not amounting to market abuse.

(2) Otherwise, the code in force under section 119 at the time when particular behaviour occurs may be relied on so far as it indicates whether or not that behaviour should be taken to amount to market abuse.

Power to impose penalties

Power to impose penalties in cases of market abuse.

123.—(1) If the Authority is satisfied that a person ("A")—

(a) is or has engaged in market abuse, or

(b) by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse,

it may impose on him a penalty of such amount as it considers appropriate.

(2) But the Authority may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that—

(a) he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1), or

(b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.

(3) If the Authority is entitled to impose a penalty on a person under this section it may, instead of imposing a penalty on him, publish a statement to the effect that he has engaged in market abuse.

Statement of policy

Statement of policy.

124.—(1) The Authority must prepare and issue a statement of its policy with respect to—

(a) the imposition of penalties under section 123; and

(b) the amount of penalties under that section.

(2) The Authority's policy in determining what the amount of a penalty should be must include having regard to—

(a) whether the behaviour in respect of which the penalty is to be imposed had an adverse effect on the market in question and, if it did, how serious that effect was;

(b) the extent to which that behaviour was deliberate or reckless; and

(c) whether the person on whom the penalty is to be imposed is an individual.

(3) A statement issued under this section must include an indication of the circumstances in which the Authority is to be expected to regard a person as—

(a) having a reasonable belief that his behaviour did not amount to market abuse; or

(b) having taken reasonable precautions and exercised due diligence to avoid engaging in market abuse.

(4) The Authority may at any time alter or replace a statement issued under this section.

(5) If a statement issued under this section is altered or replaced, the Authority must issue the altered or replacement statement.

(6) In exercising, or deciding whether to exercise, its power under section 123 in the case of any particular behaviour, the Authority must have regard to any statement published under this section and in force at the time when the behaviour concerned occurred.

(7) A statement issued under this section must be published by the Authority in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(8) The Authority may charge a reasonable fee for providing a person with a copy of a statement published under this section.

(9) The Authority must, without delay, give the Treasury a copy of any statement which it publishes under this section.

Statement of policy: procedure.

125.—(1) Before issuing a statement of policy under section 124, the Authority must publish a draft of the proposed statement in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(2) The draft must be accompanied by notice that representations about the proposal may be made to the Authority within a specified time.

(3) Before issuing the proposed statement, the Authority must have regard to any representations made to it in accordance with subsection (2).

(4) If the Authority issues the proposed statement it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2); and

(b) its response to them.

(5) If the statement differs from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant, the Authority must (in addition to complying with subsection (4)) publish details of the difference.

(6) The Authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

(7) This section also applies to a proposal to alter or replace a statement.

Procedure

Warning notices.

126.—(1) If the Authority proposes to take action against a person under section 123, it must give him a warning notice.

(2) A warning notice about a proposal to impose a penalty must state the amount of the proposed penalty.

(3) A warning notice about a proposal to publish a statement must set out the terms of the proposed statement.

Decision notices and right to refer to Tribunal.

127.—(1) If the Authority decides to take action against a person under section 123, it must give him a decision notice.

(2) A decision notice about the imposition of a penalty must state the amount of the penalty.

(3) A decision notice about the publication of a statement must set out the terms of the statement.

(4) If the Authority decides to take action against a person under section 123, that person may refer the matter to the Tribunal.

Miscellaneous

Suspension of investigations.

128.—(1) If the Authority considers it desirable or expedient because of the exercise or possible exercise of a power relating to market abuse, it may direct a recognised investment exchange or recognised clearing house—

(a) to terminate, suspend or limit the scope of any inquiry which the exchange or clearing house is conducting under its rules; or

(b) not to conduct an inquiry which the exchange or clearing house proposes to conduct under its rules.

(2) A direction under this section—

(a) must be given to the exchange or clearing house concerned by notice in writing; and

(b) is enforceable, on the application of the Authority, by injunction or, in Scotland, by an order under section 45 of the Court of Session Act 1988. 1988 c. 36.

(3) The Authority's powers relating to market abuse are its powers—

(a) to impose penalties under section 123; or

(b) to appoint a person to conduct an investigation under section 168 in a case falling within subsection (2)(d) of that section.

Power of court to impose penalty in cases of market abuse.

129.—(1) The Authority may on an application to the court under section 381 or 383 request the court to consider whether the circumstances are such that a penalty should be imposed on the person to whom the application relates.

(2) The court may, if it considers it appropriate, make an order requiring the person concerned to pay to the Authority a penalty of such amount as it considers appropriate.

Guidance.

130.—(1) The Treasury may from time to time issue written guidance for the purpose of helping relevant authorities to determine the action to be taken in cases where behaviour occurs which is behaviour—

(a) with respect to which the power in section 123 appears to be exercisable; and

(b) which appears to involve the commission of an offence under section 397 of this Act or Part V of the Criminal Justice Act 1993 (insider dealing). 1993 c. 36.

(2) The Treasury must obtain the consent of the Attorney General and the Secretary of State before issuing any guidance under this section.

(3) In this section "relevant authorities"—

(a) in relation to England and Wales, means the Secretary of State, the Authority, the Director of the Serious Fraud Office and the Director of Public Prosecutions;

(b) in relation to Northern Ireland, means the Secretary of State, the Authority, the Director of the Serious Fraud Office and the Director of Public Prosecutions for Northern Ireland.

(4) Subsections (1) to (3) do not apply to Scotland.

(5) In relation to Scotland, the Lord Advocate may from time to time, after consultation with the Treasury, issue written guidance for the purpose of helping the Authority to determine the action to be taken in cases where behaviour mentioned in subsection (1) occurs.

Effect on transactions.

131. The imposition of a penalty under this Part does not make any transaction void or unenforceable.

Part IX

Hearings and Appeals

The Financial Services and Markets Tribunal.

132.—(1) For the purposes of this Act, there is to be a tribunal known as the Financial Services and Markets Tribunal (but referred to in this Act as "the Tribunal").

(2) The Tribunal is to have the functions conferred on it by or under this Act.

(3) The Lord Chancellor may by rules make such provision as appears to him to be necessary or expedient in respect of the conduct of proceedings before the Tribunal.

(4) Schedule 13 is to have effect as respects the Tribunal and its proceedings (but does not limit the Lord Chancellor's powers under this section).

Proceedings: general provision.

133.—(1) A reference to the Tribunal under this Act must be made before the end of—

(a) the period of 28 days beginning with the date on which the decision notice or supervisory notice in question is given; or

(b) such other period as may be specified in rules made under section 132.

(2) Subject to rules made under section 132, the Tribunal may allow a reference to be made after the end of that period.

(3) On a reference the Tribunal may consider any evidence relating to the subject-matter of the reference, whether or not it was available to the Authority at the material time.

(4) On a reference the Tribunal must determine what (if any) is the appropriate action for the Authority to take in relation to the matter referred to it.

(5) On determining a reference, the Tribunal must remit the matter to the Authority with such directions (if any) as the Tribunal considers appropriate for giving effect to its determination.

(6) In determining a reference made as a result of a decision notice, the Tribunal may not direct the Authority to take action which the Authority would not, as a result of section 388(2), have had power to take when giving the decision notice.

(7) In determining a reference made as a result of a supervisory notice, the Tribunal may not direct the Authority to take action which would have otherwise required the giving of a decision notice.

(8) The Tribunal may, on determining a reference, make recommendations as to the Authority's regulating provisions or its procedures.

(9) The Authority must not take the action specified in a decision notice—

(a) during the period within which the matter to which the decision notice relates may be referred to the Tribunal; and

(b) if the matter is so referred, until the reference, and any appeal against the Tribunal's determination, has been finally disposed of.

(10) The Authority must act in accordance with the determination of, and any direction given by, the Tribunal.

(11) An order of the Tribunal may be enforced—

(a) as if it were an order of a county court; or

(b) in Scotland, as if it were an order of the Court of Session.

(12) "Supervisory notice" has the same meaning as in section 395.

Legal assistance before the Tribunal

Legal assistance scheme.

134.—(1) The Lord Chancellor may by regulations establish a scheme governing the provision of legal assistance in connection with proceedings before the Tribunal.

(2) If the Lord Chancellor establishes a scheme under subsection (1), it must provide that a person is eligible for assistance only if—

(a) he falls within subsection (3); and

(b) he fulfils such other criteria (if any) as may be prescribed as a result of section 135(1)(d).

(3) A person falls within this subsection if he is an individual who has referred a matter to the Tribunal under section 127(4).

(4) In this Part of this Act "the legal assistance scheme" means any scheme in force under subsection (1).

Provisions of the legal assistance scheme.

135.—(1) The legal assistance scheme may, in particular, make provision as to—

(a) the kinds of legal assistance that may be provided;

(b) the persons by whom legal assistance may be provided;

(c) the manner in which applications for legal assistance are to be made;

(d) the criteria on which eligibility for legal assistance is to be determined;

(e) the persons or bodies by whom applications are to be determined;

(f) appeals against refusals of applications;

(g) the revocation or variation of decisions;

(h) its administration and the enforcement of its provisions.

(2) Legal assistance under the legal assistance scheme may be provided subject to conditions or restrictions, including conditions as to the making of contributions by the person to whom it is provided.

Funding of the legal assistance scheme.

136.—(1) The Authority must pay to the Lord Chancellor such sums at such times as he may, from time to time, determine in respect of the anticipated or actual cost of legal assistance provided in connection with proceedings before the Tribunal under the legal assistance scheme.

(2) In order to enable it to pay any sum which it is obliged to pay under subsection (1), the Authority must make rules requiring the payment to it by authorised persons or any class of authorised person of specified amounts or amounts calculated in a specified way.

(3) Sums received by the Lord Chancellor under subsection (1) must be paid into the Consolidated Fund.

(4) The Lord Chancellor must, out of money provided by Parliament fund the cost of legal assistance provided in connection with proceedings before the Tribunal under the legal assistance scheme.

(5) Subsection (6) applies if, as respects a period determined by the Lord Chancellor, the amount paid to him under subsection (1) as respects that period exceeds the amount he has expended in that period under subsection (4).

(6) The Lord Chancellor must—

(a) repay, out of money provided by Parliament, the excess to the Authority; or

(b) take the excess into account on the next occasion on which he makes a determination under subsection (1).

(7) The Authority must make provision for any sum repaid to it under subsection (6)(a)—

(a) to be distributed among—

(i) the authorised persons on whom a levy was imposed in the period in question as a result of rules made under subsection (2); or

(ii) such of those persons as it may determine;

(b) to be applied in order to reduce any amounts which those persons, or such of them as it may determine, are or will be liable to pay to the Authority, whether under rules made under subsection (2) or otherwise; or

(c) to be partly so distributed and partly so applied.

(8) If the Authority considers that it is not practicable to deal with any part of a sum repaid to it under subsection (6)(a) in accordance with provision made by it as a result of subsection (7), it may, with the consent the Lord Chancellor, apply or dispose of that part of that sum in such manner as it considers appropriate.

(9) "Specified" means specified in the rules.

Appeals

Appeal on a point of law.

137.—(1) A party to a reference to the Tribunal may with permission appeal—

(a) to the Court of Appeal, or

(b) in Scotland, to the Court of Session,

on a point of law arising from a decision of the Tribunal disposing of the reference.

(2) "Permission" means permission given by the Tribunal or by the Court of Appeal or (in Scotland) the Court of Session.

(3) If, on an appeal under subsection (1), the court considers that the decision of the Tribunal was wrong in law, it may—

(a) remit the matter to the Tribunal for rehearing and determination by it; or

(b) itself make a determination.

(4) An appeal may not be brought from a decision of the Court of Appeal under subsection (3) except with the leave of—

(a) the Court of Appeal; or

(b) the House of Lords.

(5) An appeal lies, with the leave of the Court of Session or the House of Lords, from any decision of the Court of Session under this section, and such leave may be given on such terms as to costs, expenses or otherwise as the Court of Session or the House of Lords may determine.

(6) Rules made under section 132 may make provision for regulating or prescribing any matters incidental to or consequential on an appeal under this section.

PART X

RULES AND GUIDANCE

CHAPTER I

RULE-MAKING POWERS

General rule-making power.

138.—(1) The Authority may make such rules applying to authorised persons—

(a) with respect to the carrying on by them of regulated activities, or

(b) with respect to the carrying on by them of activities which are not regulated activities,

as appear to it to be necessary or expedient for the purpose of protecting the interests of consumers.

(2) Rules made under this section are referred to in this Act as the Authority's general rules.

(3) The Authority's power to make general rules is not limited by any other power which it has to make regulating provisions.

(4) The Authority's general rules may make provision applying to authorised persons even though there is no relationship between the authorised persons to whom the rules will apply and the persons whose interests will be protected by the rules.

(5) General rules may contain requirements which take into account, in the case of an authorised person who is a member of a group, any activity of another member of the group.

(6) General rules may not—

(a) make provision prohibiting an EEA firm from carrying on, or holding itself out as carrying on, any activity which it has permission conferred by Part II of Schedule 3 to carry on in the United Kingdom;

(b) make provision, as respects an EEA firm, about any matter responsibility for which is, under any of the single market directives, reserved to the firm's home state regulator.

(7) "Consumers" means persons—

(a) who use, have used, or are or may be contemplating using, any of the services provided by—

(i) authorised persons in carrying on regulated activities; or

(ii) persons acting as appointed representatives;

(b) who have rights or interests which are derived from, or are otherwise attributable to, the use of any such services by other persons; or

(c) who have rights or interests which may be adversely affected by the use of any such services by persons acting on their behalf or in a fiduciary capacity in relation to them.

(8) If an authorised person is carrying on a regulated activity in his capacity as a trustee, the persons who are, have been or may be beneficiaries of the trust are to be treated as persons who use, have used or are or may be contemplating using services provided by the authorised person in his carrying on of that activity.

(9) For the purposes of subsection (7) a person who deals with an authorised person in the course of the authorised person's carrying on of a regulated activity is to be treated as using services provided by the authorised person in carrying on those activities.

Miscellaneous ancillary matters.

139.—(1) Rules relating to the handling of money held by an authorised person in specified circumstances ("clients' money") may—

(a) make provision which results in that clients' money being held on trust in accordance with the rules;

(b) treat two or more accounts as a single account for specified purposes (which may include the distribution of money held in the accounts);

(c) authorise the retention by the authorised person of interest accruing on the clients' money; and

(d) make provision as to the distribution of such interest which is not to be retained by him.

(2) An institution with which an account is kept in pursuance of rules relating to the handling of clients' money does not incur any liability as constructive trustee if money is wrongfully paid from the account, unless the institution permits the payment—

(a) with knowledge that it is wrongful; or

(b) having deliberately failed to make enquiries in circumstances in which a reasonable and honest person would have done so.

(3) In the application of subsection (1) to Scotland, the reference to money being held on trust is to be read as a reference to its being held as agent for the person who is entitled to call for it to be paid over to him or to be paid on his direction or to have it otherwise credited to him.

(4) Rules may—

(a) confer rights on persons to rescind agreements with, or withdraw offers to, authorised persons within a specified period; and

(b) make provision, in respect of authorised persons and persons exercising those rights, for the restitution of property and the making or recovery of payments where those rights are exercised.

(5) "Rules" means general rules.

(6) "Specified" means specified in the rules.

Restriction on managers of authorised unit trust schemes.

140.—(1) The Authority may make rules prohibiting an authorised person who has permission to act as the manager of an authorised unit trust scheme from carrying on a specified activity.

(2) Such rules may specify an activity which is not a regulated activity.

Insurance business rules.

141.—(1) The Authority may make rules prohibiting an authorised person who has permission to effect or carry out contracts of insurance from carrying on a specified activity.

(2) Such rules may specify an activity which is not a regulated activity.

(3) The Authority may make rules in relation to contracts entered into by an authorised person in the course of carrying on business which consists of the effecting or carrying out of contracts of long-term insurance.

(4) Such rules may, in particular—

(a) restrict the descriptions of property or indices of the value of property by reference to which the benefits under such contracts may be determined;

(b) make provision, in the interests of the protection of policyholders, for the substitution of one description of property, or index of value, by reference to which the benefits under a contract are to be determined for another such description of property or index.

(5) Rules made under this section are referred to in this Act as insurance business rules.

Insurance business: regulations supplementing Authority's rules.

142.—(1) The Treasury may make regulations for the purpose of preventing a person who is not an authorised person but who—

(a) is a parent undertaking of an authorised person who has permission to effect or carry out contracts of insurance, and

(b) falls within a prescribed class,

from doing anything to lessen the effectiveness of asset identification rules.

(2) "Asset identification rules" means rules made by the Authority which require an authorised person who has permission to effect or carry out contracts of insurance to identify assets which belong to him and which are maintained in respect of a particular aspect of his business.

(3) The regulations may, in particular, include provision—

(a) prohibiting the payment of dividends;

(b) prohibiting the creation of charges;

(c) making charges created in contravention of the regulations void.

(4) The Treasury may by regulations provide that, in prescribed circumstances, charges created in contravention of asset identification rules are void.

(5) A person who contravenes regulations under subsection (1) is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.

(6) "Charges" includes mortgages (or in Scotland securities over property).

Endorsement of codes etc.

143.—(1) The Authority may make rules ("endorsing rules")—

(a) endorsing the City Code on Takeovers and Mergers issued by the Panel on Takeovers and Mergers;

(b) endorsing the Rules Governing Substantial Acquisitions of Shares issued by the Panel.

(2) Endorsement may be—

(a) as respects all authorised persons; or

(b) only as respects a specified kind of authorised person.

(3) At any time when endorsing rules are in force, and if asked to do so by the Panel, the Authority may exercise its powers under Part IV or section 66 as if failure to comply with an endorsed provision was a ground entitling the Authority to exercise those powers.

(4) At any time when endorsing rules are in force and if asked to do so by the Panel, the Authority may exercise its powers under Part XIII, XIV or XXV as if the endorsed provisions were rules applying to the persons in respect of whom they are endorsed.

(5) For the purposes of subsections (3) and (4), a failure to comply with a requirement imposed, or ruling given, under an endorsed provision is to be treated as a failure to comply with the endorsed provision under which that requirement was imposed or ruling was given.

(6) If endorsed provisions are altered, subsections (3) and (4) apply to them as altered, but only if before the alteration the Authority has notified the Panel (and has not withdrawn its notification) that it is satisfied with the Panel's consultation procedures.

(7) "Consultation procedures" means procedures designed to provide an opportunity for persons likely to be affected by alterations to those provisions to make representations about proposed alterations to any of those provisions.

(8) Subsections (1), (2)(d), (4), (5), (6)(a) and (12) of section 155 apply (with the necessary modifications) to a proposal to give notification of the kind mentioned in subsection (6) as they apply to a proposal to make endorsing rules.

(9) This section applies in relation to particular provisions of the code or rules mentioned in subsection (1) as it applies to the code or the rules.

Specific rules

Price stabilising rules.

144.—(1) The Authority may make rules ("price stabilising rules") as to—

(a) the circumstances and manner in which,

(b) the conditions subject to which, and

(c) the time when or the period during which,

action may be taken for the purpose of stabilising the price of investments of specified kinds.

(2) Price stabilising rules—

(a) are to be made so as to apply only to authorised persons;

(b) may make different provision in relation to different kinds of investment.

(3) The Authority may make rules which, for the purposes of section 397(5)(b), treat a person who acts or engages in conduct—

(a) for the purpose of stabilising the price of investments, and

(b) in conformity with such provisions corresponding to price stabilising rules and made by a body or authority outside the United Kingdom as may be specified in the rules under this subsection,

as acting, or engaging in that conduct, for that purpose and in conformity with price stabilising rules.

(4) The Treasury may by order impose limitations on the power to make rules under this section.

(5) Such an order may, in particular—

(a) specify the kinds of investment in relation to which price stabilising rules may make provision;

(b) specify the kinds of investment in relation to which rules made under subsection (3) may make provision;

(c) provide for price stabilising rules to make provision for action to be taken for the purpose of stabilising the price of investments only in such circumstances as the order may specify;

(d) provide for price stabilising rules to make provision for action to be taken for that purpose only at such times or during such periods as the order may specify.

(6) If provisions specified in rules made under subsection (3) are altered, the rules continue to apply to those provisions as altered, but only if before the alteration the Authority has notified the body or authority concerned (and has not withdrawn its notification) that it is satisfied with its consultation procedures.

(7) "Consultation procedures" has the same meaning as in section 143.

Financial promotion rules.

145.—(1) The Authority may make rules applying to authorised persons about the communication by them, or their approval of the communication by others, of invitations or inducements—

(a) to engage in investment activity; or

(b) to participate in a collective investment scheme.

(2) Rules under this section may, in particular, make provision about the form and content of communications.

(3) Subsection (1) applies only to communications which—

(a) if made by a person other than an authorised person, without the approval of an authorised person, would contravene section 21(1);

(b) may be made by an authorised person without contravening section 238(1).

(4) "Engage in investment activity" has the same meaning as in section 21.

(5) The Treasury may by order impose limitations on the power to make rules under this section.

Money laundering rules.

146. The Authority may make rules in relation to the prevention and detection of money laundering in connection with the carrying on of regulated activities by authorised persons.

Control of information rules.

147.—(1) The Authority may make rules ("control of information rules") about the disclosure and use of information held by an authorised person ("A").

(2) Control of information rules may—

(a) require the withholding of information which A would otherwise have to disclose to a person ("B") for or with whom A does business in the course of carrying on any regulated or other activity;

(b) specify circumstances in which A may withhold information which he would otherwise have to disclose to B;

(c) require A not to use for the benefit of B information A holds which A would otherwise have to use in that way;

(d) specify circumstances in which A may decide not to use for the benefit of B information A holds which A would otherwise have to use in that way.

Modification or waiver

Modification or waiver of rules.

148.—(1) This section applies in relation to the following—

(a) auditors and actuaries rules;

(b) control of information rules;

(c) financial promotion rules;

(d) general rules;

(e) insurance business rules;

(f) money laundering rules; and

(g) price stabilising rules.

(2) The Authority may, on the application or with the consent of an authorised person, direct that all or any of the rules to which this section applies—

(a) are not to apply to the authorised person; or

(b) are to apply to him with such modifications as may be specified in the direction.

(3) An application must be made in such manner as the Authority may direct.

(4) The Authority may not give a direction unless it is satisfied that—

(a) compliance by the authorised person with the rules, or with the rules as unmodified, would be unduly burdensome or would not achieve the purpose for which the rules were made; and

(b) the direction would not result in undue risk to persons whose interests the rules are intended to protect.

(5) A direction may be given subject to conditions.

(6) Unless it is satisfied that it is inappropriate or unnecessary to do so, a direction must be published by the Authority in such a way as it thinks most suitable for bringing the direction to the attention of—

(a) those likely to be affected by it; and

(b) others who may be likely to make an application for a similar direction.

(7) In deciding whether it is satisfied as mentioned in subsection (6), the Authority must—

(a) take into account whether the direction relates to a rule contravention of which is actionable in accordance with section 150;

(b) consider whether its publication would prejudice, to an unreasonable degree, the commercial interests of the authorised person concerned or any other member of his immediate group; and

(c) consider whether its publication would be contrary to an international obligation of the United Kingdom.

(8) For the purposes of paragraphs (b) and (c) of subsection (7), the Authority must consider whether it would be possible to publish the direction without either of the consequences mentioned in those paragraphs by publishing it without disclosing the identity of the authorised person concerned.

(9) The Authority may—

(a) revoke a direction; or

(b) vary it on the application, or with the consent, of the authorised person to whom it relates.

(10) "Direction" means a direction under subsection (2).

(11) "Immediate group", in relation to an authorised person ("A"), means—

(a) A;

(b) a parent undertaking of A;

(c) a subsidiary undertaking of A;

(d) a subsidiary undertaking of a parent undertaking of A;

(e) a parent undertaking of a subsidiary undertaking of A.

Contravention of rules

149.—(1) If a particular rule so provides, contravention of the rule does not give rise to any of the consequences provided for by other provisions of this Act. Evidential provisions.

(2) A rule which so provides must also provide—

(a) that contravention may be relied on as tending to establish contravention of such other rule as may be specified; or

(b) that compliance may be relied on as tending to establish compliance with such other rule as may be specified.

(3) A rule may include the provision mentioned in subsection (1) only if the Authority considers that it is appropriate for it also to include the provision required by subsection (2).

Actions for damages.

150.—(1) A contravention by an authorised person of a rule is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

(2) If rules so provide, subsection (1) does not apply to contravention of a specified provision of those rules.

(3) In prescribed cases, a contravention of a rule which would be actionable at the suit of a private person is actionable at the suit of a person who is not a private person, subject to the defences and other incidents applying to actions for breach of statutory duty.

(4) In subsections (1) and (3) "rule" does not include—

(a) listing rules; or

(b) a rule requiring an authorised person to have or maintain financial resources.

(5) "Private person" has such meaning as may be prescribed.

Limits on effect of contravening rules.

151.—(1) A person is not guilty of an offence by reason of a contravention of a rule made by the Authority.

(2) No such contravention makes any transaction void or unenforceable.

Procedural provisions

Notification of rules to the Treasury.

152.—(1) If the Authority makes any rules, it must give a copy to the Treasury without delay.

(2) If the Authority alters or revokes any rules, it must give written notice to the Treasury without delay.

(3) Notice of an alteration must include details of the alteration.

Rule-making instruments.

153.—(1) Any power conferred on the Authority to make rules is exercisable in writing.

(2) An instrument by which rules are made by the Authority ("a rule-making instrument") must specify the provision under which the rules are made.

(3) To the extent to which a rule-making instrument does not comply with subsection (2), it is void.

(4) A rule-making instrument must be published by the Authority in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(5) The Authority may charge a reasonable fee for providing a person with a copy of a rule-making instrument.

(6) A person is not to be taken to have contravened any rule made by the Authority if he shows that at the time of the alleged contravention the rule-making instrument concerned had not been made available in accordance with this section.

Verification of rules.

154.—(1) The production of a printed copy of a rule-making instrument purporting to be made by the Authority—

(a) on which is endorsed a certificate signed by a member of the Authority's staff authorised by it for that purpose, and

(b) which contains the required statements,

is evidence (or in Scotland sufficient evidence) of the facts stated in the certificate.

(2) The required statements are—

(a) that the instrument was made by the Authority;

(b) that the copy is a true copy of the instrument; and

(c) that on a specified date the instrument was made available to the public in accordance with section 153(4).

(3) A certificate purporting to be signed as mentioned in subsection (1) is to be taken to have been properly signed unless the contrary is shown.

(4) A person who wishes in any legal proceedings to rely on a rule-making instrument may require the Authority to endorse a copy of the instrument with a certificate of the kind mentioned in subsection (1).

Consultation.

155.—(1) If the Authority proposes to make any rules, it must publish a draft of the proposed rules in the way appearing to it to be best calculated to bring them to the attention of the public.

(2) The draft must be accompanied by—

(a) a cost benefit analysis;

(b) an explanation of the purpose of the proposed rules;

(c) an explanation of the Authority's reasons for believing that making the proposed rules is compatible with its general duties under section 2; and

(d) notice that representations about the proposals may be made to the Authority within a specified time.

(3) In the case of a proposal to make rules under a provision mentioned in subsection (9), the draft must also be accompanied by details of the expected expenditure by reference to which the proposal is made.

(4) Before making the proposed rules, the Authority must have regard to any representations made to it in accordance with subsection (2)(d).

(5) If the Authority makes the proposed rules, it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2)(d); and

(b) its response to them.

(6) If the rules differ from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant—

(a) the Authority must (in addition to complying with subsection (5)) publish details of the difference; and

(b) those details must be accompanied by a cost benefit analysis.

(7) Subsections (1) to (6) do not apply if the Authority considers that the delay involved in complying with them would be prejudicial to the interests of consumers.

(8) Neither subsection (2)(a) nor subsection (6)(b) applies if the Authority considers—

(a) that, making the appropriate comparison, there will be no increase in costs; or

(b) that, making that comparison, there will be an increase in costs but the increase will be of minimal significance.

(9) Neither subsection (2)(a) nor subsection (6)(b) requires a cost benefit analysis to be carried out in relation to rules made under—

(a) section 136(2);

(b) subsection (1) of section 213 as a result of subsection (4) of that section;

(c) section 234;

(d) paragraph 17 of Schedule 1.

(10) "Cost benefit analysis" means an estimate of the costs together with an analysis of the benefits that will arise—

(a) if the proposed rules are made; or

(b) if subsection (6) applies, from the rules that have been made.

(11) "The appropriate comparison" means—

(a) in relation to subsection (2)(a), a comparison between the overall position if the rules are made and the overall position if they are not made;

(b) in relation to subsection (6)(b), a comparison between the overall position after the making of the rules and the overall position before they were made.

(12) The Authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

General supplementary powers.

156.—(1) Rules made by the Authority may make different provision for different cases and may, in particular, make different provision in respect of different descriptions of authorised person, activity or investment.

(2) Rules made by the Authority may contain such incidental, supplemental, consequential and transitional provision as the Authority considers appropriate.

CHAPTER II

GUIDANCE

Guidance.

157.—(1) The Authority may give guidance consisting of such information and advice as it considers appropriate—

(a) with respect to the operation of this Act and of any rules made under it;

(b) with respect to any matters relating to functions of the Authority;

(c) for the purpose of meeting the regulatory objectives;

(d) with respect to any other matters about which it appears to the Authority to be desirable to give information or advice.

(2) The Authority may give financial or other assistance to persons giving information or advice of a kind which the Authority could give under this section.

(3) If the Authority proposes to give guidance to regulated persons generally, or to a class of regulated person, in relation to rules to which those persons are subject, subsections (1), (2) and (4) to (10) of section 155 apply to the proposed guidance as they apply to proposed rules.

(4) The Authority may—

(a) publish its guidance;

(b) offer copies of its published guidance for sale at a reasonable price; and

(c) if it gives guidance in response to a request made by any person, make a reasonable charge for that guidance.

(5) In this Chapter, references to guidance given by the Authority include references to any recommendation made by the Authority to persons generally, to regulated persons generally or to any class of regulated person.

(6) "Regulated person" means any—

(a) authorised person;

(b) person who is otherwise subject to rules made by the Authority.

Notification of guidance to the Treasury.

158.—(1) On giving any general guidance, the Authority must give the Treasury a copy of the guidance without delay.

(2) If the Authority alters any of its general guidance, it must give written notice to the Treasury without delay.

(3) The notice must include details of the alteration.

(4) If the Authority revokes any of its general guidance, it must give written notice to the Treasury without delay.

(5) "General guidance" means guidance given by the Authority under section 157 which is—

(a) given to persons generally, to regulated persons generally or to a class of regulated person;

(b) intended to have continuing effect; and

(c) given in writing or other legible form.

(6) "Regulated person" has the same meaning as in section 157.

CHAPTER III

COMPETITION SCRUTINY

Interpretation.

159.—(1) In this Chapter—

"Director" means the Director General of Fair Trading;

"practices", in relation to the Authority, means practices adopted by the Authority in the exercise of functions under this Act;

"regulating provisions" means any—

(a) rules;

(b) general guidance (as defined by section 158(5));

(c) statement issued by the Authority under section 64;

(d) code issued by the Authority under section 64 or 119.

(2) For the purposes of this Chapter, regulating provisions or practices have a significantly adverse effect on competition if—

(a) they have, or are intended or likely to have, that effect; or

(b) the effect that they have, or are intended or likely to have, is to require or encourage behaviour which has, or is intended or likely to have, a significantly adverse effect on competition.

(3) If regulating provisions or practices have, or are intended or likely to have, the effect of requiring or encouraging exploitation of the strength of a market position they are to be taken, for the purposes of this Chapter, to have an adverse effect on competition.

(4) In determining under this Chapter whether any of the regulating provisions have, or are likely to have, a particular effect, it may be assumed that the persons to whom the provisions concerned are addressed will act in accordance with them.

Reports by Director General of Fair Trading.

160.—(1) The Director must keep the regulating provisions and the Authority's practices under review.

(2) If at any time the Director considers that—

(a) a regulating provision or practice has a significantly adverse effect on competition, or

(b) two or more regulating provisions or practices taken together, or a particular combination of regulating provisions and practices, have such an effect,

he must make a report to that effect.

(3) If at any time the Director considers that—

(a) a regulating provision or practice does not have a significantly adverse effect on competition, or

(b) two or more regulating provisions or practices taken together, or a particular combination of regulating provisions and practices, do not have any such effect,

he may make a report to that effect.

(4) A report under subsection (2) must include details of the adverse effect on competition.

(5) If the Director makes a report under subsection (2) he must—

(a) send a copy of it to the Treasury, the Competition Commission and the Authority; and

(b) publish it in the way appearing to him to be best calculated to bring it to the attention of the public.

(6) If the Director makes a report under subsection (3)—

(a) he must send a copy of it to the Treasury, the Competition Commission and the Authority; and

(b) he may publish it.

(7) Before publishing a report under this section the Director must, so far as practicable, exclude any matter which relates to the private affairs of a particular individual the publication of which, in the opinion of the Director, would or might seriously and prejudicially affect his interests.

(8) Before publishing such a report the Director must, so far as practicable, exclude any matter which relates to the affairs of a particular body the publication of which, in the opinion of the Director, would or might seriously and prejudicially affect its interests.

(9) Subsections (7) and (8) do not apply in relation to copies of a report which the Director is required to send under subsection (5)(a) or (6)(a).

(10) For the purposes of the law of defamation, absolute privilege attaches to any report of the Director under this section.

Power of Director to request information.

161.—(1) For the purpose of investigating any matter with a view to its consideration under section 160, the Director may exercise the powers conferred on him by this section.

(2) The Director may by notice in writing require any person to produce to him or to a person appointed by him for the purpose, at a time and place specified in the notice, any document which—

(a) is specified or described in the notice; and

(b) is a document in that person's custody or under his control.

(3) The Director may by notice in writing—

(a) require any person carrying on any business to provide him with such information as may be specified or described in the notice; and

(b) specify the time within which, and the manner and form in which, any such information is to be provided.

(4) A requirement may be imposed under subsection (2) or (3)(a) only in respect of documents or information which relate to any matter relevant to the investigation.

(5) If a person ("the defaulter") refuses, or otherwise fails, to comply with a notice under this section, the Director may certify that fact in writing to the court and the court may enquire into the case.

(6) If, after hearing any witness who may be produced against or on behalf of the defaulter and any statement which may be offered in defence, the court is satisfied that the defaulter did not have a reasonable excuse for refusing or otherwise failing to comply with the notice, the court may deal with the defaulter as if he were in contempt.

(7) "Court" means—

(a) the High Court; or

(b) in relation to Scotland, the Court of Session.

Consideration by Competition Commission.

162.—(1) If the Director—

(a) makes a report under section 160(2), or

(b) asks the Commission to consider a report that he has made under section 160(3),

the Commission must investigate the matter.

(2) The Commission must then make its own report on the matter unless it considers that, as a result of a change of circumstances, no useful purpose would be served by a report.

(3) If the Commission decides in accordance with subsection (2) not to make a report, it must make a statement setting out the change of circumstances which resulted in that decision.

(4) A report made under this section must state the Commission's conclusion as to whether—

(a) the regulating provision or practice which is the subject of the report has a significantly adverse effect on competition; or

(b) the regulating provisions or practices, or combination of regulating provisions and practices, which are the subject of the report have such an effect.

(5) A report under this section stating the Commission's conclusion that there is a significantly adverse effect on competition must also—

(a) state whether the Commission considers that that effect is justified; and

(b) if it states that the Commission considers that it is not justified, state its conclusion as to what action, if any, ought to be taken by the Authority.

(6) Subsection (7) applies whenever the Commission is considering, for the purposes of this section, whether a particular adverse effect on competition is justified.

(7) The Commission must ensure, so far as that is reasonably possible, that the conclusion it reaches is compatible with the functions conferred, and obligations imposed, on the Authority by or under this Act.

(8) A report under this section must contain such an account of the Commission's reasons for its conclusions as is expedient, in the opinion of the Commission, for facilitating proper understanding of them.

(9) Schedule 14 supplements this section.

(10) If the Commission makes a report under this section it must send a copy to the Treasury, the Authority and the Director.

Role of the Treasury.

163.—(1) This section applies if the Competition Commission makes a report under section 162(2) which states its conclusion that there is a significantly adverse effect on competition.

(2) If the Commission's conclusion, as stated in the report, is that the adverse effect on competition is not justified, the Treasury must give a direction to the Authority requiring it to take such action as may be specified in the direction.

(3) But subsection (2) does not apply if the Treasury consider—

(a) that, as a result of action taken by the Authority in response to the Commission's report, it is unnecessary for them to give a direction; or

(b) that the exceptional circumstances of the case make it inappropriate or unnecessary for them to do so.

(4) In considering the action to be specified in a direction under subsection (2), the Treasury must have regard to any conclusion of the Commission included in the report because of section 162(5)(b).

(5) Subsection (6) applies if—

(a) the Commission's conclusion, as stated in its report, is that the adverse effect on competition is justified; but

(b) the Treasury consider that the exceptional circumstances of the case require them to act.

(6) The Treasury may give a direction to the Authority requiring it to take such action—

(a) as they consider to be necessary in the light of the exceptional circumstances of the case; and

(b) as may be specified in the direction.

(7) The Authority may not be required as a result of this section to take any action—

(a) that it would not have power to take in the absence of a direction under this section; or

(b) that would otherwise be incompatible with any of the functions conferred, or obligations imposed, on it by or under this Act.

(8) Subsection (9) applies if the Treasury are considering—

(a) whether subsection (2) applies and, if so, what action is to be specified in a direction under that subsection; or

(b) whether to give a direction under subsection (6).

(9) The Treasury must—

(a) do what they consider appropriate to allow the Authority, and any other person appearing to the Treasury to be affected, an opportunity to make representations; and

(b) have regard to any such representations.

(10) If, in reliance on subsection (3)(a) or (b), the Treasury decline to act under subsection (2), they must make a statement to that effect, giving their reasons.

(11) If the Treasury give a direction under this section they must make a statement giving—

(a) details of the direction; and

(b) if the direction is given under subsection (6), their reasons for giving it.

(12) The Treasury must—

(a) publish any statement made under this section in the way appearing to them best calculated to bring it to the attention of the public; and

(b) lay a copy of it before Parliament.

164.—(1) The Chapter I prohibition does not apply to an agreement the parties to which consist of or include— The Competition Act 1998.

(a) an authorised person, or

(b) a person who is otherwise subject to the Authority's regulating provisions,

to the extent to which the agreement consists of provisions the inclusion of which in the agreement is encouraged by any of the Authority's regulating provisions.

(2) The Chapter I prohibition does not apply to the practices of an authorised person or a person who is otherwise subject to the regulating provisions to the extent to which the practices are encouraged by any of the Authority's regulating provisions.

(3) The Chapter II prohibition does not apply to conduct of—

(a) an authorised person, or

(b) a person who is otherwise subject to the Authority's regulating provisions,

to the extent to which the conduct is encouraged by any of the Authority's regulating provisions.

1998 c. 41.

(4) "The Chapter I prohibition" means the prohibition imposed by section 2(1) of the Competition Act 1998.

(5) "The Chapter II prohibition" means the prohibition imposed by section 18(1) of that Act.

Part XI

Information Gathering and Investigations

Powers to gather information

Authority's power to require information.

165.—(1) The Authority may, by notice in writing given to an authorised person, require him—

(a) to provide specified information or information of a specified description; or

(b) to produce specified documents or documents of a specified description.

(2) The information or documents must be provided or produced—

(a) before the end of such reasonable period as may be specified; and

(b) at such place as may be specified.

(3) An officer who has written authorisation from the Authority to do so may require an authorised person without delay—

(a) to provide the officer with specified information or information of a specified description; or

(b) to produce to him specified documents or documents of a specified description.

(4) This section applies only to information and documents reasonably required in connection with the exercise by the Authority of functions conferred on it by or under this Act.

(5) The Authority may require any information provided under this section to be provided in such form as it may reasonably require.

(6) The Authority may require—

(a) any information provided, whether in a document or otherwise, to be verified in such manner, or

(b) any document produced to be authenticated in such manner,

as it may reasonably require.

(7) The powers conferred by subsections (1) and (3) may also be exercised to impose requirements on—

(a) a person who is connected with an authorised person;

(b) an operator, trustee or depositary of a scheme recognised under section 270 or 272 who is not an authorised person;

(c) a recognised investment exchange or recognised clearing house.

(8) "Authorised person" includes a person who was at any time an authorised person but who has ceased to be an authorised person.

(9) "Officer" means an officer of the Authority and includes a member of the Authority's staff or an agent of the Authority.

(10) "Specified" means—

(a) in subsections (1) and (2), specified in the notice; and

(b) in subsection (3), specified in the authorisation.

(11) For the purposes of this section, a person is connected with an authorised person ("A") if he is or has at any relevant time been—

(a) a member of A's group;

(b) a controller of A;

(c) any other member of a partnership of which A is a member; or

(d) in relation to A, a person mentioned in Part I of Schedule 15.

Reports by skilled persons.

166.—(1) The Authority may, by notice in writing given to a person to whom subsection (2) applies, require him to provide the Authority with a report on any matter about which the Authority has required or could require the provision of information or production of documents under section 165.

(2) This subsection applies to—

(a) an authorised person ("A"),

(b) any other member of A's group,

(c) a partnership of which A is a member, or

(d) a person who has at any relevant time been a person falling within paragraph (a), (b) or (c),

who is, or was at the relevant time, carrying on a business.

(3) The Authority may require the report to be in such form as may be specified in the notice.

(4) The person appointed to make a report required by subsection (1) must be a person—

(a) nominated or approved by the Authority; and

(b) appearing to the Authority to have the skills necessary to make a report on the matter concerned.

(5) It is the duty of any person who is providing (or who at any time has provided) services to a person to whom subsection (2) applies in

relation to a matter on which a report is required under subsection (1) to give a person appointed to provide such a report all such assistance as the appointed person may reasonably require.

(6) The obligation imposed by subsection (5) is enforceable, on the application of the Authority, by an injunction or, in Scotland, by an order for specific performance under section 45 of the Court of Session Act 1988.

1988 c. 36.

Appointment of investigators

Appointment of persons to carry out general investigations.

167.—(1) If it appears to the Authority or the Secretary of State ("the investigating authority") that there is good reason for doing so, the investigating authority may appoint one or more competent persons to conduct an investigation on its behalf into—

(a) the nature, conduct or state of the business of an authorised person or of an appointed representative;

(b) a particular aspect of that business; or

(c) the ownership or control of an authorised person.

(2) If a person appointed under subsection (1) thinks it necessary for the purposes of his investigation, he may also investigate the business of a person who is or has at any relevant time been—

(a) a member of the group of which the person under investigation ("A") is part; or

(b) a partnership of which A is a member.

(3) If a person appointed under subsection (1) decides to investigate the business of any person under subsection (2) he must give that person written notice of his decision.

(4) The power conferred by this section may be exercised in relation to a former authorised person (or appointed representative) but only in relation to—

(a) business carried on at any time when he was an authorised person (or appointed representative); or

(b) the ownership or control of a former authorised person at any time when he was an authorised person.

(5) "Business" includes any part of a business even if it does not consist of carrying on regulated activities.

Appointment of persons to carry out investigations in particular cases.

168.—(1) Subsection (3) applies if it appears to an investigating authority that there are circumstances suggesting that—

(a) a person may have contravened any regulation made under section 142; or

(b) a person may be guilty of an offence under section 177, 191, 346 or 398(1) or under Schedule 4.

(2) Subsection (3) also applies if it appears to an investigating authority that there are circumstances suggesting that—

(a) an offence under section 24(1) or 397 or under Part V of the Criminal Justice Act 1993 may have been committed;

1993 c. 36.

(b) there may have been a breach of the general prohibition;

(c) there may have been a contravention of section 21 or 238; or

(d) market abuse may have taken place.

(3) The investigating authority may appoint one or more competent persons to conduct an investigation on its behalf.

(4) Subsection (5) applies if it appears to the Authority that there are circumstances suggesting that—

(a) a person may have contravened section 20;

(b) a person may be guilty of an offence under prescribed regulations relating to money laundering;

(c) an authorised person may have contravened a rule made by the Authority;

(d) an individual may not be a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised or exempt person;

(e) an individual may have performed or agreed to perform a function in breach of a prohibition order;

(f) an authorised or exempt person may have failed to comply with section 56(6);

(g) an authorised person may have failed to comply with section 59(1) or (2);

(h) a person in relation to whom the Authority has given its approval under section 59 may not be a fit and proper person to perform the function to which that approval relates; or

(i) a person may be guilty of misconduct for the purposes of section 66.

(5) The Authority may appoint one or more competent persons to conduct an investigation on its behalf.

(6) “Investigating authority” means the Authority or the Secretary of State.

Assistance to overseas regulators

Investigations etc. in support of overseas regulator.

169.—(1) At the request of an overseas regulator, the Authority may—

(a) exercise the power conferred by section 165; or

(b) appoint one or more competent persons to investigate any matter.

(2) An investigator has the same powers as an investigator appointed under section 168(3) (as a result of subsection (1) of that section).

(3) If the request has been made by a competent authority in pursuance of any Community obligation the Authority must, in deciding whether or not to exercise its investigative power, consider whether its exercise is necessary to comply with any such obligation.

(4) In deciding whether or not to exercise its investigative power, the Authority may take into account in particular—

(a) whether in the country or territory of the overseas regulator concerned, corresponding assistance would be given to a United Kingdom regulatory authority;

(b) whether the case concerns the breach of a law, or other requirement, which has no close parallel in the United Kingdom or involves the assertion of a jurisdiction not recognised by the United Kingdom;

(c) the seriousness of the case and its importance to persons in the United Kingdom;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

(5) The Authority may decide that it will not exercise its investigative power unless the overseas regulator undertakes to make such contribution towards the cost of its exercise as the Authority considers appropriate.

(6) Subsections (4) and (5) do not apply if the Authority considers that the exercise of its investigative power is necessary to comply with a Community obligation.

(7) If the Authority has appointed an investigator in response to a request from an overseas regulator, it may direct the investigator to permit a representative of that regulator to attend, and take part in, any interview conducted for the purposes of the investigation.

(8) A direction under subsection (7) is not to be given unless the Authority is satisfied that any information obtained by an overseas regulator as a result of the interview will be subject to safeguards equivalent to those contained in Part XXIII.

(9) The Authority must prepare a statement of its policy with respect to the conduct of interviews in relation to which a direction under subsection (7) has been given.

(10) The statement requires the approval of the Treasury.

(11) If the Treasury approve the statement, the Authority must publish it.

(12) No direction may be given under subsection (7) before the statement has been published.

(13) "Overseas regulator" has the same meaning as in section 195.

(14) "Investigative power" means one of the powers mentioned in subsection (1).

(15) "Investigator" means a person appointed under subsection (1)(b).

Conduct of investigations

Investigations: general.

170.—(1) This section applies if an investigating authority appoints one or more competent persons ("investigators") under section 167 or 168(3) or (5) to conduct an investigation on its behalf.

(2) The investigating authority must give written notice of the appointment of an investigator to the person who is the subject of the investigation ("the person under investigation").

(3) Subsections (2) and (9) do not apply if —

(a) the investigator is appointed as a result of section 168(1) or (4) and the investigating authority believes that the notice required by subsection (2) or (9) would be likely to result in the investigation being frustrated; or

(b) the investigator is appointed as a result of subsection (2) of section 168.

(4) A notice under subsection (2) must—

(a) specify the provisions under which, and as a result of which, the investigator was appointed; and

(b) state the reason for his appointment.

(5) Nothing prevents the investigating authority from appointing a person who is a member of its staff as an investigator.

(6) An investigator must make a report of his investigation to the investigating authority.

(7) The investigating authority may, by a direction to an investigator, control—

(a) the scope of the investigation;

(b) the period during which the investigation is to be conducted;

(c) the conduct of the investigation; and

(d) the reporting of the investigation.

(8) A direction may, in particular—

(a) confine the investigation to particular matters;

(b) extend the investigation to additional matters;

(c) require the investigator to discontinue the investigation or to take only such steps as are specified in the direction;

(d) require the investigator to make such interim reports as are so specified.

(9) If there is a change in the scope or conduct of the investigation and, in the opinion of the investigating authority, the person subject to investigation is likely to be significantly prejudiced by not being made aware of it, that person must be given written notice of the change.

(10) "Investigating authority", in relation to an investigator, means—

(a) the Authority, if the Authority appointed him;

(b) the Secretary of State, if the Secretary of State appointed him.

Powers of persons appointed under section 167.

171.—(1) An investigator may require the person who is the subject of the investigation ("the person under investigation") or any person connected with the person under investigation—

(a) to attend before the investigator at a specified time and place and answer questions; or

(b) otherwise to provide such information as the investigator may require.

(2) An investigator may also require any person to produce at a specified time and place any specified documents or documents of a specified description.

(3) A requirement under subsection (1) or (2) may be imposed only so far as the investigator concerned reasonably considers the question, provision of information or production of the document to be relevant to the purposes of the investigation.

(4) For the purposes of this section and section 172, a person is connected with the person under investigation ("A") if he is or has at any relevant time been—

(a) a member of A's group;

(b) a controller of A;

(c) a partnership of which A is a member; or

(d) in relation to A, a person mentioned in Part I or II of Schedule 15.

(5) "Investigator" means a person conducting an investigation under section 167.

(6) "Specified" means specified in a notice in writing.

Additional power of persons appointed as a result of section 168(1) or (4).

172.—(1) An investigator has the powers conferred by section 171.

(2) An investigator may also require a person who is neither the subject of the investigation ("the person under investigation") nor a person connected with the person under investigation—

(a) to attend before the investigator at a specified time and place and answer questions; or

(b) otherwise to provide such information as the investigator may require for the purposes of the investigation.

(3) A requirement may only be imposed under subsection (2) if the investigator is satisfied that the requirement is necessary or expedient for the purposes of the investigation.

(4) "Investigator" means a person appointed as a result of subsection (1) or (4) of section 168.

(5) "Specified" means specified in a notice in writing.

Powers of persons appointed as a result of section 168(2).

173.—(1) Subsections (2) to (4) apply if an investigator considers that any person ("A") is or may be able to give information which is or may be relevant to the investigation.

(2) The investigator may require A—

(a) to attend before him at a specified time and place and answer questions; or

(b) otherwise to provide such information as he may require for the purposes of the investigation.

(3) The investigator may also require A to produce at a specified time and place any specified documents or documents of a specified description which appear to the investigator to relate to any matter relevant to the investigation.

(4) The investigator may also otherwise require A to give him all assistance in connection with the investigation which A is reasonably able to give.

(5) "Investigator" means a person appointed under subsection (3) of section 168 (as a result of subsection (2) of that section).

Admissibility of statements made to investigators.

174.—(1) A statement made to an investigator by a person in compliance with an information requirement is admissible in evidence in any proceedings, so long as it also complies with any requirements governing the admissibility of evidence in the circumstances in question.

(2) But in criminal proceedings in which that person is charged with an offence to which this subsection applies or in proceedings in relation to action to be taken against that person under section 123—

(a) no evidence relating to the statement may be adduced, and

(b) no question relating to it may be asked,

by or on behalf of the prosecution or (as the case may be) the Authority, unless evidence relating to it is adduced, or a question relating to it is asked, in the proceedings by or on behalf of that person.

(3) Subsection (2) applies to any offence other than one—

(a) under section 177(4) or 398;

(b) under section 5 of the Perjury Act 1911 (false statements made otherwise than on oath); 1911 c. 6.

(c) under section 44(2) of the Criminal Law (Consolidation)(Scotland) Act 1995 (false statements made otherwise than on oath); or 1995 c. 39.

(d) under Article 10 of the Perjury (Northern Ireland) Order 1979. S.I. 1979/1714 (N.I. 19).

(4) "Investigator" means a person appointed under section 167 or 168(3) or (5).

(5) "Information requirement" means a requirement imposed by an investigator under section 171, 172, 173 or 175.

Information and documents: supplemental provisions.

175.—(1) If the Authority or an investigator has power under this Part to require a person to produce a document but it appears that the document is in the possession of a third person, that power may be exercised in relation to the third person.

(2) If a document is produced in response to a requirement imposed under this Part, the person to whom it is produced may—

(a) take copies or extracts from the document; or

(b) require the person producing the document, or any relevant person, to provide an explanation of the document.

(3) If a person who is required under this Part to produce a document fails to do so, the Authority or an investigator may require him to state, to the best of his knowledge and belief, where the document is.

(4) A lawyer may be required under this Part to furnish the name and address of his client.

(5) No person may be required under this Part to disclose information or produce a document in respect of which he owes an obligation of confidence by virtue of carrying on the business of banking unless—

(a) he is the person under investigation or a member of that person's group;

(b) the person to whom the obligation of confidence is owed is the person under investigation or a member of that person's group;

(c) the person to whom the obligation of confidence is owed consents to the disclosure or production; or

(d) the imposing on him of a requirement with respect to such information or document has been specifically authorised by the investigating authority.

(6) If a person claims a lien on a document, its production under this Part does not affect the lien.

(7) "Relevant person", in relation to a person who is required to produce a document, means a person who—

(a) has been or is or is proposed to be a director or controller of that person;

(b) has been or is an auditor of that person;

(c) has been or is an actuary, accountant or lawyer appointed or instructed by that person; or

(d) has been or is an employee of that person.

(8) "Investigator" means a person appointed under section 167 or 168(3) or (5).

Entry of premises under warrant.

176.—(1) A justice of the peace may issue a warrant under this section if satisfied on information on oath given by or on behalf of the Secretary of State, the Authority or an investigator that there are reasonable grounds for believing that the first, second or third set of conditions is satisfied.

(2) The first set of conditions is—

(a) that a person on whom an information requirement has been imposed has failed (wholly or in part) to comply with it; and

(b) that on the premises specified in the warrant—

(i) there are documents which have been required; or

(ii) there is information which has been required.

(3) The second set of conditions is—

(a) that the premises specified in the warrant are premises of an authorised person or an appointed representative;

(b) that there are on the premises documents or information in relation to which an information requirement could be imposed; and

(c) that if such a requirement were to be imposed—

(i) it would not be complied with; or

(ii) the documents or information to which it related would be removed, tampered with or destroyed.

(4) The third set of conditions is—

(a) that an offence mentioned in section 168 for which the maximum sentence on conviction on indictment is two years or more has been (or is being) committed by any person;

(b) that there are on the premises specified in the warrant documents or information relevant to whether that offence has been (or is being) committed;

(c) that an information requirement could be imposed in relation to those documents or information; and

(d) that if such a requirement were to be imposed—

(i) it would not be complied with; or

(ii) the documents or information to which it related would be removed, tampered with or destroyed.

(5) A warrant under this section shall authorise a constable—

(a) to enter the premises specified in the warrant;

(b) to search the premises and take possession of any documents or information appearing to be documents or information of a kind in respect of which a warrant under this section was issued ("the relevant kind") or to take, in relation to any such documents or information, any other steps which may appear to be necessary for preserving them or preventing interference with them;

(c) to take copies of, or extracts from, any documents or information appearing to be of the relevant kind;

(d) to require any person on the premises to provide an explanation of any document or information appearing to be of the relevant kind or to state where it may be found; and

(e) to use such force as may be reasonably necessary.

(6) In England and Wales, sections 15(5) to (8) and section 16 of the Police and Criminal Evidence Act 1984 (execution of search warrants and safeguards) apply to warrants issued under this section. 1984 c. 60.

(7) In Northern Ireland, Articles 17(5) to (8) and 18 of the Police and Criminal Evidence (Northern Ireland) Order 1989 apply to warrants issued under this section. S.I. 1989/1341 (N.I. 12).

(8) Any document of which possession is taken under this section may be retained—

(a) for a period of three months; or

(b) if within that period proceedings to which the document is relevant are commenced against any person for any criminal offence, until the conclusion of those proceedings.

(9) In the application of this section to Scotland—

(a) for the references to a justice of the peace substitute references to a justice of the peace or a sheriff; and

(b) for the references to information on oath substitute references to evidence on oath.

(10) "Investigator" means a person appointed under section 167 or 168(3) or (5).

(11) "Information requirement" means a requirement imposed—

(a) by the Authority under section 165 or 175; or

(b) by an investigator under section 171, 172, 173 or 175.

Offences

Offences.

177.—(1) If a person other than the investigator ("the defaulter") fails to comply with a requirement imposed on him under this Part the person imposing the requirement may certify that fact in writing to the court.

(2) If the court is satisfied that the defaulter failed without reasonable excuse to comply with the requirement, it may deal with the defaulter (and in the case of a body corporate, any director or officer) as if he were in contempt.

(3) A person who knows or suspects that an investigation is being or is likely to be conducted under this Part is guilty of an offence if—

(a) he falsifies, conceals, destroys or otherwise disposes of a document which he knows or suspects is or would be relevant to such an investigation, or

(b) he causes or permits the falsification, concealment, destruction or disposal of such a document,

unless he shows that he had no intention of concealing facts disclosed by the documents from the investigator.

(4) A person who, in purported compliance with a requirement imposed on him under this Part—

(a) provides information which he knows to be false or misleading in a material particular, or

(b) recklessly provides information which is false or misleading in a material particular,

is guilty of an offence.

(5) A person guilty of an offence under subsection (3) or (4) is liable—

(a) on summary conviction, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

(6) Any person who intentionally obstructs the exercise of any rights conferred by a warrant under section 176 is guilty of an offence and liable on summary conviction to imprisonment for a term not exceeding three months or a fine not exceeding level 5 on the standard scale, or both.

(7) "Court" means—

(a) the High Court;

(b) in Scotland, the Court of Session.

PART XII

CONTROL OVER AUTHORISED PERSONS

Notice of control

Obligation to notify the Authority.

178.—(1) If a step which a person proposes to take would result in his acquiring—

(a) control over a UK authorised person,

(b) an additional kind of control over a UK authorised person, or

(c) an increase in a relevant kind of control which he already has over a UK authorised person,

he must notify the Authority of his proposal.

(2) A person who, without himself taking any such step, acquires any such control or additional or increased control must notify the Authority before the end of the period of 14 days beginning with the day on which he first becomes aware that he has acquired it.

(3) A person who is under the duty to notify the Authority imposed by subsection (1) must also give notice to the Authority on acquiring, or increasing, the control in question.

(4) In this Part "UK authorised person" means an authorised person who—

(a) is a body incorporated in, or an unincorporated association formed under the law of, any part of the United Kingdom; and

(b) is not a person authorised as a result of paragraph 1 of Schedule 5.

(5) A notice under subsection (1) or (2) is referred to in this Part as "a notice of control".

Acquiring, increasing and reducing control

179.—(1) For the purposes of this Part, a person ("the acquirer") acquires control over a UK authorised person ("A") on first falling within any of the cases in subsection (2). Acquiring control.

(2) The cases are where the acquirer—

(a) holds 10% or more of the shares in A;

(b) is able to exercise significant influence over the management of A by virtue of his shareholding in A;

(c) holds 10% or more of the shares in a parent undertaking ("P") of A;

(d) is able to exercise significant influence over the management of P by virtue of his shareholding in P;

(e) is entitled to exercise, or control the exercise of, 10% or more of the voting power in A;

(f) is able to exercise significant influence over the management of A by virtue of his voting power in A;

(g) is entitled to exercise, or control the exercise of, 10% or more of the voting power in P; or

(h) is able to exercise significant influence over the management of P by virtue of his voting power in P.

(3) In subsection (2) "the acquirer" means—

(a) the acquirer;

(b) any of the acquirer's associates; or

(c) the acquirer and any of his associates.

(4) For the purposes of this Part, each of the following is to be regarded as a kind of control—

(a) control arising as a result of the holding of shares in A;

(b) control arising as a result of the holding of shares in P;

(c) control arising as a result of the entitlement to exercise, or control the exercise of, voting power in A;

(d) control arising as a result of the entitlement to exercise, or control the exercise of, voting power in P.

(5) For the purposes of this section and sections 180 and 181, "associate", "shares" and "voting power" have the same meaning as in section 422.

Increasing control.

180.—(1) For the purposes of this Part, a controller of a person ("A") who is a UK authorised person increases his control over A if—

(a) the percentage of shares held by the controller in A increases by any of the steps mentioned in subsection (2);

(b) the percentage of shares held by the controller in a parent undertaking ("P") of A increases by any of the steps mentioned in subsection (2);

(c) the percentage of voting power which the controller is entitled to exercise, or control the exercise of, in A increases by any of the steps mentioned in subsection (2);

(d) the percentage of voting power which the controller is entitled to exercise, or control the exercise of, in P increases by any of the steps mentioned in subsection (2); or

(e) the controller becomes a parent undertaking of A.

(2) The steps are—

(a) from below 10% to 10% or more but less than 20%;

(b) from below 20% to 20% or more but less than 33%;

(c) from below 33% to 33% or more but less than 50%;

(d) from below 50% to 50% or more.

(3) In paragraphs (a) to (d) of subsection (1) "the controller" means—

(a) the controller;

(b) any of the controller's associates; or

(c) the controller and any of his associates.

(4) In the rest of this Part "acquiring control" or "having control" includes—

(a) acquiring or having an additional kind of control; or

(b) acquiring an increase in a relevant kind of control, or having increased control of a relevant kind.

Reducing control.

181.—(1) For the purposes of this Part, a controller of a person ("A") who is a UK authorised person reduces his control over A if—

(a) the percentage of shares held by the controller in A decreases by any of the steps mentioned in subsection (2),

(b) the percentage of shares held by the controller in a parent undertaking ("P") of A decreases by any of the steps mentioned in subsection (2),

(c) the percentage of voting power which the controller is entitled to exercise, or control the exercise of, in A decreases by any of the steps mentioned in subsection (2),

(d) the percentage of voting power which the controller is entitled to exercise, or control the exercise of, in P decreases by any of the steps mentioned in subsection (2), or

(e) the controller ceases to be a parent undertaking of A,

unless the controller ceases to have the kind of control concerned over A as a result.

(2) The steps are—

(a) from 50% or more to 33% or more but less than 50%;

(b) from 33% or more to 20% or more but less than 33%;

(c) from 20% or more to 10% or more but less than 20%;

(d) from 10% or more to less than 10%.

(3) In paragraphs (a) to (d) of subsection (1) "the controller" means—

(a) the controller;

(b) any of the controller's associates; or

(c) the controller and any of his associates.

Acquiring or increasing control: procedure

182.—(1) A notice of control must— Notification.

(a) be given to the Authority in writing; and

(b) include such information and be accompanied by such documents as the Authority may reasonably require.

(2) The Authority may require the person giving a notice of control to provide such additional information or documents as it reasonably considers necessary in order to enable it to determine what action it is to take in response to the notice.

(3) Different requirements may be imposed in different circumstances.

183.—(1) The Authority must, before the end of the period of three months beginning with the date on which it receives a notice of control ("the period for consideration"), determine whether— Duty of Authority in relation to notice of control.

(a) to approve of the person concerned having the control to which the notice relates; or

(b) to serve a warning notice under subsection (3) or section 185(3).

(2) Before doing so, the Authority must comply with such requirements as to consultation with competent authorities outside the United Kingdom as may be prescribed.

(3) If the Authority proposes to give the person concerned a notice of objection under section 186(1), it must give him a warning notice.

184.—(1) If the Authority decides to approve of the person concerned having the control to which the notice relates it must notify that person of its approval in writing without delay. Approval of acquisition of control.

(2) If the Authority fails to comply with subsection (1) of section 183 it is to be treated as having given its approval and notified the person concerned at the end of the period fixed by that subsection.

(3) The Authority's approval remains effective only if the person to whom it relates acquires the control in question—

(a) before the end of such period as may be specified in the notice; or

(b) if no period is specified, before the end of the period of one year beginning with the date—

(i) of the notice of approval;

(ii) on which the Authority is treated as having given approval under subsection (2); or

(iii) of a decision on a reference to the Tribunal which results in the person concerned receiving approval.

Conditions attached to approval.

185.—(1) The Authority's approval under section 184 may be given unconditionally or subject to such conditions as the Authority considers appropriate.

(2) In imposing any conditions, the Authority must have regard to its duty under section 41.

(3) If the Authority proposes to impose conditions on a person it must give him a warning notice.

(4) If the Authority decides to impose conditions on a person it must give him a decision notice.

(5) A person who is subject to a condition imposed under this section may apply to the Authority—

(a) for the condition to be varied; or

(b) for the condition to be cancelled.

(6) The Authority may, on its own initiative, cancel a condition imposed under this section.

(7) If the Authority has given its approval to a person subject to a condition, he may refer to the Tribunal—

(a) the imposition of the condition; or

(b) the Authority's decision to refuse an application made by him under subsection (5).

Objection to acquisition of control.

186.—(1) On considering a notice of control, the Authority may give a decision notice under this section to the person acquiring control ("the acquirer") unless it is satisfied that the approval requirements are met.

(2) The approval requirements are that—

(a) the acquirer is a fit and proper person to have the control over the authorised person that he has or would have if he acquired the control in question; and

(b) the interests of consumers would not be threatened by the acquirer's control or by his acquiring that control.

(3) In deciding whether the approval requirements are met, the Authority must have regard, in relation to the control that the acquirer—

(a) has over the authorised person concerned ("A"), or

(b) will have over A if the proposal to which the notice of control relates is carried into effect,

to its duty under section 41 in relation to each regulated activity carried on by A.

(4) If the Authority gives a notice under this section but considers that the approval requirements would be met if the person to whom a notice is given were to take, or refrain from taking, a particular step, the notice must identify that step.

(5) A person to whom a notice under this section is given may refer the matter to the Tribunal.

(6) "Consumers" means persons who are consumers for the purposes of section 138.

Objection to existing control.

187.—(1) If the Authority is not satisfied that the approval requirements are met, it may give a decision notice under this section to a person if he has failed to comply with a duty to notify imposed by section 178.

(2) If the failure relates to subsection (1) or (2) of that section, the Authority may (instead of giving a notice under subsection (1)) approve the acquisition of the control in question by the person concerned as if he had given it a notice of control.

(3) The Authority may also give a decision notice under this section to a person who is a controller of a UK authorised person if the Authority becomes aware of matters as a result of which it is satisfied that—

(a) the approval requirements are not met with respect to the controller; or

(b) a condition imposed under section 185 required that person to do (or refrain from doing) a particular thing and the condition has been breached as a result of his failing to do (or doing) that thing.

(4) A person to whom a notice under this section is given may refer the matter to the Tribunal.

(5) "Approval requirements" has the same meaning as in section 186.

Notices of objection under section 187: procedure.

188.—(1) If the Authority proposes to give a notice of objection to a person under section 187, it must give him a warning notice.

(2) Before doing so, the Authority must comply with such requirements as to consultation with competent authorities outside the United Kingdom as may be prescribed.

(3) If the Authority decides to give a warning notice under this section, it must do so before the end of the period of three months beginning—

(a) in the case of a notice to be given under section 187(1), with the date on which it became aware of the failure to comply with the duty in question;

(b) in the case of a notice to be given under section 187(3), with the date on which it became aware of the matters in question.

(4) The Authority may require the person concerned to provide such additional information or documents as it considers reasonable.

(5) Different requirements may be imposed in different circumstances.

(6) In this Part "notice of objection" means a notice under section 186 or 187.

Improperly acquired shares

Improperly acquired shares.

189.—(1) The powers conferred by this section are exercisable if a person has acquired, or has continued to hold, any shares in contravention of—

(a) a notice of objection; or

(b) a condition imposed on the Authority's approval.

(2) The Authority may by notice in writing served on the person concerned ("a restriction notice") direct that any such shares which are specified in the notice are, until further notice, subject to one or more of the following restrictions—

(a) a transfer of (or agreement to transfer) those shares, or in the case of unissued shares any transfer of (or agreement to transfer) the right to be issued with them, is void;

(b) no voting rights are to be exercisable in respect of the shares;

(c) no further shares are to be issued in right of them or in pursuance of any offer made to their holder;

(d) except in a liquidation, no payment is to be made of any sums due from the body corporate on the shares, whether in respect of capital or otherwise.

(3) The court may, on the application of the Authority, order the sale of any shares to which this section applies and, if they are for the time being subject to any restriction under subsection (2), that they are to cease to be subject to that restriction.

(4) No order may be made under subsection (3)—

(a) until the end of the period within which a reference may be made to the Tribunal in respect of the notice of objection; and

(b) if a reference is made, until the matter has been determined or the reference withdrawn.

(5) If an order has been made under subsection (3), the court may, on the application of the Authority, make such further order relating to the sale or transfer of the shares as it thinks fit.

(6) If shares are sold in pursuance of an order under this section, the proceeds of sale, less the costs of the sale, must be paid into court for the benefit of the persons beneficially interested in them; and any such person may apply to the court for the whole or part of the proceeds to be paid to him.

(7) This section applies—

(a) in the case of an acquirer falling within section 178(1), to all the shares—

(i) in the authorised person which the acquirer has acquired;

(ii) which are held by him or an associate of his; and

(iii) which were not so held immediately before he became a person with control over the authorised person;

(b) in the case of an acquirer falling within section 178(2), to all the shares held by him or an associate of his at the time when he first became aware that he had acquired control over the authorised person; and

(c) to all the shares in an undertaking ("C")—

(i) which are held by the acquirer or an associate of his, and

(ii) which were not so held before he became a person with control in relation to the authorised person,

where C is the undertaking in which shares were acquired by the acquirer (or an associate of his) and, as a result, he became a person with control in relation to that authorised person.

(8) A copy of the restriction notice must be served on—

(a) the authorised person to whose shares it relates; and

(b) if it relates to shares held by an associate of that authorised person, on that associate.

(9) The jurisdiction conferred by this section may be exercised by the High Court and the Court of Session.

Reducing control: procedure

190.—(1) If a step which a controller of a UK authorised person proposes to take would result in his— Notification.

(a) ceasing to have control of a relevant kind over the authorised person, or

(b) reducing a relevant kind of control over that person,

he must notify the Authority of his proposal.

(2) A controller of a UK authorised person who, without himself taking any such step, ceases to have that control or reduces that control must notify the Authority before the end of the period of 14 days beginning with the day on which he first becomes aware that—

(a) he has ceased to have the control in question; or

(b) he has reduced that control.

(3) A person who is under the duty to notify the Authority imposed by subsection (1) must also give a notice to the Authority—

(a) on ceasing to have the control in question; or

(b) on reducing that control.

(4) A notice under this section must—

(a) be given to the Authority in writing; and

(b) include details of the extent of the control (if any) which the person concerned will retain (or still retains) over the authorised person concerned.

Offences

Offences under this Part.

191.—(1) A person who fails to comply with the duty to notify the Authority imposed on him by section 178(1) or 190(1) is guilty of an offence.

(2) A person who fails to comply with the duty to notify the Authority imposed on him by section 178(2) or 190(2) is guilty of an offence.

(3) If a person who has given a notice of control to the Authority carries out the proposal to which the notice relates, he is guilty of an offence if—

(a) the period of three months beginning with the date on which the Authority received the notice is still running; and

(b) the Authority has not responded to the notice by either giving its approval or giving him a warning notice under section 183(3) or 185(3).

(4) A person to whom the Authority has given a warning notice under section 183(3) is guilty of an offence if he carries out the proposal to which the notice relates before the Authority has decided whether to give him a notice of objection.

(5) A person to whom a notice of objection has been given is guilty of an offence if he acquires the control to which the notice applies at a time when the notice is still in force.

(6) A person guilty of an offence under subsection (1), (2), (3) or (4) is liable on summary conviction to a fine not exceeding level 5 on the standard scale.

(7) A person guilty of an offence under subsection (5) is liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum; and

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

(8) A person guilty of an offence under subsection (5) is also liable on summary conviction to a fine not exceeding one tenth of the statutory maximum for each day on which the offence has continued.

(9) It is a defence for a person charged with an offence under subsection (1) to show that he had, at the time of the alleged offence, no knowledge of the act or circumstances by virtue of which the duty to notify the Authority arose.

(10) If a person—

(a) was under the duty to notify the Authority imposed by section 178(1) or 190(1) but had no knowledge of the act or circumstances by virtue of which that duty arose, but

(b) subsequently becomes aware of that act or those circumstances,

he must notify the Authority before the end of the period of 14 days beginning with the day on which he first became so aware.

(11) A person who fails to comply with the duty to notify the Authority imposed by subsection (10) is guilty of an offence and liable, on summary conviction, to a fine not exceeding level 5 on the standard scale.

Miscellaneous

Power to change definitions of control etc.

192. The Treasury may by order—

(a) provide for exemptions from the obligations to notify imposed by sections 178 and 190;

(b) amend section 179 by varying, or removing, any of the cases in which a person is treated as having control over a UK authorised person or by adding a case;

(c) amend section 180 by varying, or removing, any of the cases in which a person is treated as increasing control over a UK authorised person or by adding a case;

(d) amend section 181 by varying, or removing, any of the cases in which a person is treated as reducing his control over a UK authorised person or by adding a case;

(e) amend section 422 by varying, or removing, any of the cases in which a person is treated as being a controller of a person or by adding a case.

Part XIII

Incoming Firms: Intervention by Authority

Interpretation

Interpretation of this Part.

193.—(1) In this Part—

"additional procedure" means the procedure described in section 199;

"incoming firm" means—

(a) an EEA firm which is exercising, or has exercised, its right to carry on a regulated activity in the United Kingdom in accordance with Schedule 3; or

(b) a Treaty firm which is exercising, or has exercised, its right to carry on a regulated activity in the United Kingdom in accordance with Schedule 4; and

"power of intervention" means the power conferred on the Authority by section 196.

(2) In relation to an incoming firm which is an EEA firm, expressions used in this Part and in Schedule 3 have the same meaning in this Part as they have in that Schedule.

General grounds on which power of intervention is exercisable.

194.—(1) The Authority may exercise its power of intervention in respect of an incoming firm if it appears to it that—

(a) the firm has contravened, or is likely to contravene, a requirement which is imposed on it by or under this Act (in a case where the Authority is responsible for enforcing compliance in the United Kingdom);

(b) the firm has, in purported compliance with any requirement imposed by or under this Act, knowingly or recklessly given the Authority information which is false or misleading in a material particular; or

(c) it is desirable to exercise the power in order to protect the interests of actual or potential customers.

(2) Subsection (3) applies to an incoming EEA firm falling within sub-paragraph (a) or (b) of paragraph 5 of Schedule 3 which is exercising an EEA right to carry on any Consumer Credit Act business in the United Kingdom.

(3) The Authority may exercise its power of intervention in respect of the firm if the Director General of Fair Trading has informed the Authority that—

(a) the firm,

(b) any of the firm's employees, agents or associates (whether past or present), or

(c) if the firm is a body corporate, a controller of the firm or an associate of such a controller,

has done any of the things specified in paragraphs (a) to (d) of section 25(2) of the Consumer Credit Act 1974.

1974 c. 39.

(4) "Associate", "Consumer Credit Act business" and "controller" have the same meaning as in section 203.

Exercise of power in support of overseas regulator.

195.—(1) The Authority may exercise its power of intervention in respect of an incoming firm at the request of, or for the purpose of assisting, an overseas regulator.

(2) Subsection (1) applies whether or not the Authority's power of intervention is also exercisable as a result of section 194.

(3) "An overseas regulator" means an authority in a country or territory outside the United Kingdom—

(a) which is a home state regulator; or

(b) which exercises any function of a kind mentioned in subsection (4).

(4) The functions are—

(a) a function corresponding to any function of the Authority under this Act;

(b) a function corresponding to any function exercised by the competent authority under Part VI in relation to the listing of shares;

(c) a function corresponding to any function exercised by the Secretary of State under the Companies Act 1985;

1985 c. 6.

(d) a function in connection with —

(i) the investigation of conduct of the kind prohibited by Part V of the Criminal Justice Act 1993 (insider dealing); or

1993 c. 36.

(ii) the enforcement of rules (whether or not having the force of law) relating to such conduct;

(e) a function prescribed by regulations made for the purposes of this subsection which, in the opinion of the Treasury, relates to companies or financial services.

(5) If—

(a) a request to the Authority for the exercise of its power of intervention has been made by a home state regulator in pursuance of a Community obligation, or

(b) a home state regulator has notified the Authority that an EEA firm's EEA authorisation has been withdrawn,

the Authority must, in deciding whether or not to exercise its power of intervention, consider whether exercising it is necessary in order to comply with a Community obligation.

(6) In deciding in any case in which the Authority does not consider that the exercise of its power of intervention is necessary in order to comply with a Community obligation, it may take into account in particular—

(a) whether in the country or territory of the overseas regulator concerned, corresponding assistance would be given to a United Kingdom regulatory authority;

(b) whether the case concerns the breach of a law, or other requirement, which has no close parallel in the United Kingdom or involves the assertion of a jurisdiction not recognised by the United Kingdom;

(c) the seriousness of the case and its importance to persons in the United Kingdom;

(d) whether it is otherwise appropriate in the public interest to give the assistance sought.

(7) The Authority may decide not to exercise its power of intervention, in response to a request, unless the regulator concerned undertakes to make such contribution to the cost of its exercise as the Authority considers appropriate.

(8) Subsection (7) does not apply if the Authority decides that it is necessary for it to exercise its power of intervention in order to comply with a Community obligation.

The power of intervention.

196. If the Authority is entitled to exercise its power of intervention in respect of an incoming firm under this Part, it may impose any requirement in relation to the firm which it could impose if—

(a) the firm's permission was a Part IV permission; and

(b) the Authority was entitled to exercise its power under that Part to vary that permission.

Exercise of power of intervention

Procedure on exercise of power of intervention.

197.—(1) A requirement takes effect—

(a) immediately, if the notice given under subsection (3) states that that is the case;

(b) on such date as may be specified in the notice; or

(c) if no date is specified in the notice, when the matter to which it relates is no longer open to review.

(2) A requirement may be expressed to take effect immediately (or on a specified date) only if the Authority, having regard to the ground on which it is exercising its power of intervention, considers that it is necessary for the requirement to take effect immediately (or on that date).

(3) If the Authority proposes to impose a requirement under section 196 on an incoming firm, or imposes such a requirement with immediate effect, it must give the firm written notice.

(4) The notice must—

(a) give details of the requirement;

(b) inform the firm of when the requirement takes effect;

(c) state the Authority's reasons for imposing the requirement and for its determination as to when the requirement takes effect;

(d) inform the firm that it may make representations to the Authority within such period as may be specified in the notice (whether or not it has referred the matter to the Tribunal); and

(e) inform it of its right to refer the matter to the Tribunal.

(5) The Authority may extend the period allowed under the notice for making representations.

(6) If, having considered any representations made by the firm, the Authority decides—

(a) to impose the requirement proposed, or

(b) if it has been imposed, not to rescind the requirement,

it must give it written notice.

(7) If, having considered any representations made by the firm, the Authority decides—

(a) not to impose the requirement proposed,

(b) to impose a different requirement from that proposed, or

(c) to rescind a requirement which has effect,

it must give it written notice.

(8) A notice given under subsection (6) must inform the firm of its right to refer the matter to the Tribunal.

(9) A notice under subsection (7)(b) must comply with subsection (4).

(10) If a notice informs a person of his right to refer a matter to the Tribunal, it must give an indication of the procedure on such a reference.

Power to apply to court for injunction in respect of certain overseas insurance companies.

198.—(1) This section applies if the Authority has received a request made in respect of an incoming EEA firm in accordance with—

(a) Article 20.5 of the first non-life insurance directive; or

(b) Article 24.5 of the first life insurance directive.

(2) The court may, on an application made to it by the Authority with respect to the firm, grant an injunction restraining (or in Scotland an interdict prohibiting) the firm disposing of or otherwise dealing with any of its assets.

(3) If the court grants an injunction, it may by subsequent orders make provision for such incidental, consequential and supplementary matters as it considers necessary to enable the Authority to perform any of its functions under this Act.

(4) "The court" means—

(a) the High Court; or

(b) in Scotland, the Court of Session.

Additional procedure for EEA firms in certain cases.

199.—(1) This section applies if it appears to the Authority that its power of intervention is exercisable in relation to an EEA firm exercising EEA rights in the United Kingdom ("an incoming EEA firm") in respect of the contravention of a relevant requirement.

(2) A requirement is relevant if—

(a) it is imposed by the Authority under this Act; and

(b) as respects its contravention, any of the single market directives provides that a procedure of the kind set out in the following provisions of this section is to apply.

(3) The Authority must, in writing, require the firm to remedy the situation.

(4) If the firm fails to comply with the requirement under subsection (3) within a reasonable time, the Authority must give a notice to that effect to the firm's home state regulator requesting it—

(a) to take all appropriate measures for the purpose of ensuring that the firm remedies the situation which has given rise to the notice; and

(b) to inform the Authority of the measures it proposes to take or has taken or the reasons for not taking such measures.

(5) Except as mentioned in subsection (6), the Authority may not exercise its power of intervention unless satisfied—

(a) that the firm's home state regulator has failed or refused to take measures for the purpose mentioned in subsection (4)(a); or

(b) that the measures taken by the home state regulator have proved inadequate for that purpose.

(6) If the Authority decides that it should exercise its power of intervention in respect of the incoming EEA firm as a matter of urgency in order to protect the interests of consumers, it may exercise that power—

(a) before complying with subsections (3) and (4); or

(b) where it has complied with those subsections, before it is satisfied as mentioned in subsection (5).

(7) In such a case the Authority must at the earliest opportunity inform the firm's home state regulator and the Commission.

(8) If—

(a) the Authority has (by virtue of subsection (6)) exercised its power of intervention before complying with subsections (3) and (4) or before it is satisfied as mentioned in subsection (5), and

(b) the Commission decides under any of the single market directives that the Authority must rescind or vary any requirement imposed in the exercise of its power of intervention,

the Authority must in accordance with the decision rescind or vary the requirement.

Supplemental

Rescission and variation of requirements.

200.—(1) The Authority may rescind or vary a requirement imposed in exercise of its power of intervention on its own initiative or on the application of the person subject to the requirement.

(2) The power of the Authority on its own initiative to rescind a requirement is exercisable by written notice given by the Authority to the person concerned, which takes effect on the date specified in the notice.

(3) Section 197 applies to the exercise of the power of the Authority on its own initiative to vary a requirement as it applies to the imposition of a requirement.

(4) If the Authority proposes to refuse an application for the variation or rescission of a requirement, it must give the applicant a warning notice.

(5) If the Authority decides to refuse an application for the variation or rescission of a requirement—

(a) the Authority must give the applicant a decision notice; and

(b) that person may refer the matter to the Tribunal.

Effect of certain requirements on other persons.

201. If the Authority, in exercising its power of intervention, imposes on an incoming firm a requirement of a kind mentioned in subsection (3) of section 48, the requirement has the same effect in relation to the firm as it would have in relation to an authorised person if it had been imposed on the authorised person by the Authority acting under section 45.

Contravention of requirement imposed under this Part.

202.—(1) Contravention of a requirement imposed by the Authority under this Part does not—

(a) make a person guilty of an offence;

(b) make any transaction void or unenforceable; or

(c) (subject to subsection (2)) give rise to any right of action for breach of statutory duty.

(2) In prescribed cases the contravention is actionable at the suit of a person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty.

Powers of Director General of Fair Trading

Power to prohibit the carrying on of Consumer Credit Act business.

203.—(1) If it appears to the Director General of Fair Trading ("the Director") that subsection (4) has been, or is likely to be, contravened as respects a consumer credit EEA firm, he may by written notice given to the firm impose on the firm a consumer credit prohibition.

(2) If it appears to the Director that a restriction imposed under section 204 on an EEA consumer credit firm has not been complied with, he may by written notice given to the firm impose a consumer credit prohibition.

(3) "Consumer credit prohibition" means a prohibition on carrying on, or purporting to carry on, in the United Kingdom any Consumer Credit Act business which consists of or includes carrying on one or more listed activities.

(4) This subsection is contravened as respects a firm if—

(a) the firm or any of its employees, agents or associates (whether past or present), or

(b) if the firm is a body corporate, any controller of the firm or an associate of any such controller,

does any of the things specified in paragraphs (a) to (d) of section 25(2) of the Consumer Credit Act 1974. 1974 c. 39.

(5) A consumer credit prohibition may be absolute or may be imposed—

(a) for such period,

(b) until the occurrence of such event, or

(c) until such conditions are complied with,

as may be specified in the notice given under subsection (1) or (2).

(6) Any period, event or condition so specified may be varied by the Director on the application of the firm concerned.

(7) A consumer credit prohibition may be withdrawn by written notice served by the Director on the firm concerned, and any such notice takes effect on such date as is specified in the notice.

(8) Schedule 16 has effect as respects consumer credit prohibitions and restrictions under section 204.

(9) A firm contravening a prohibition under this section is guilty of an offence and liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to a fine.

(10) In this section and section 204—

"a consumer credit EEA firm" means an EEA firm falling within any of paragraphs (a) to (c) of paragraph 5 of Schedule 3 whose EEA authorisation covers any Consumer Credit Act business;

"Consumer Credit Act business" means consumer credit business, consumer hire business or ancillary credit business;

"consumer credit business", "consumer hire business" and "ancillary credit business" have the same meaning as in the Consumer Credit Act 1974;

"listed activity" means an activity listed in the Annex to the second banking co-ordination directive or the Annex to the investment services directive;

"associate" has the same meaning as in section 25(2) of the Consumer Credit Act 1974;

"controller" has the meaning given by section 189(1) of that Act.

Power to restrict the carrying on of Consumer Credit Act business.

204.—(1) In this section "restriction" means a direction that a consumer credit EEA firm may not carry on in the United Kingdom, otherwise than in accordance with such condition or conditions as may be specified in the direction, any Consumer Credit Act business which—

(a) consists of or includes carrying on any listed activity; and

(b) is specified in the direction.

(2) If it appears to the Director that the situation as respects a consumer credit EEA firm is such that the powers conferred by section 203(1) are exercisable, the Director may, instead of imposing a prohibition, impose such restriction as appears to him desirable.

(3) A restriction—

(a) may be withdrawn, or

(b) may be varied with the agreement of the firm concerned,

by written notice served by the Director on the firm, and any such notice takes effect on such date as is specified in the notice.

(4) A firm contravening a restriction is guilty of an offence and liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to a fine.

PART XIV

DISCIPLINARY MEASURES

Public censure.

205. If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, the Authority may publish a statement to that effect.

Financial penalties.

206.—(1) If the Authority considers that an authorised person has contravened a requirement imposed on him by or under this Act, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.

(2) The Authority may not in respect of any contravention both require a person to pay a penalty under this section and withdraw his authorisation under section 33.

(3) A penalty under this section is payable to the Authority.

Proposal to take disciplinary measures.

207.—(1) If the Authority proposes—

(a) to publish a statement in respect of an authorised person (under section 205), or

(b) to impose a penalty on an authorised person (under section 206),

it must give the authorised person a warning notice.

(2) A warning notice about a proposal to publish a statement must set out the terms of the statement.

(3) A warning notice about a proposal to impose a penalty, must state the amount of the penalty.

Decision notice.

208.—(1) If the Authority decides—

(a) to publish a statement under section 205 (whether or not in the terms proposed), or

(b) to impose a penalty under section 206 (whether or not of the amount proposed),

it must without delay give the authorised person concerned a decision notice.

(2) In the case of a statement, the decision notice must set out the terms of the statement.

(3) In the case of a penalty, the decision notice must state the amount of the penalty.

(4) If the Authority decides to—

(a) publish a statement in respect of an authorised person under section 205, or

(b) impose a penalty on an authorised person under section 206,

the authorised person may refer the matter to the Tribunal.

Publication.

209. After a statement under section 205 is published, the Authority must send a copy of it to the authorised person and to any person on whom a copy of the decision notice was given under section 393(4).

Statements of policy.

210.—(1) The Authority must prepare and issue a statement of its policy with respect to—

(a) the imposition of penalties under this Part; and

(b) the amount of penalties under this Part.

(2) The Authority's policy in determining what the amount of a penalty should be must include having regard to—

(a) the seriousness of the contravention in question in relation to the nature of the requirement contravened;

(b) the extent to which that contravention was deliberate or reckless; and

(c) whether the person on whom the penalty is to be imposed is an individual.

(3) The Authority may at any time alter or replace a statement issued under this section.

(4) If a statement issued under this section is altered or replaced, the Authority must issue the altered or replacement statement.

(5) The Authority must, without delay, give the Treasury a copy of any statement which it publishes under this section.

(6) A statement issued under this section must be published by the Authority in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(7) In exercising, or deciding whether to exercise, its power under section 206 in the case of any particular contravention, the Authority must have regard to any statement published under this section and in force at the time when the contravention in question occurred.

(8) The Authority may charge a reasonable fee for providing a person with a copy of the statement.

Statements of policy: procedure.

211.—(1) Before issuing a statement under section 210, the Authority must publish a draft of the proposed statement in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(2) The draft must be accompanied by notice that representations about the proposal may be made to the Authority within a specified time.

(3) Before issuing the proposed statement, the Authority must have regard to any representations made to it in accordance with subsection (2).

(4) If the Authority issues the proposed statement it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2); and

(b) its response to them.

(5) If the statement differs from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant, the Authority must (in addition to complying with subsection (4)) publish details of the difference.

(6) The Authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

(7) This section also applies to a proposal to alter or replace a statement.

PART XV

THE FINANCIAL SERVICES COMPENSATION SCHEME

The scheme manager

The scheme manager.

212.—(1) The Authority must establish a body corporate ("the scheme manager") to exercise the functions conferred on the scheme manager by or under this Part.

(2) The Authority must take such steps as are necessary to ensure that the scheme manager is, at all times, capable of exercising those functions.

(3) The constitution of the scheme manager must provide for it to have—

(a) a chairman; and

(b) a board (which must include the chairman) whose members are the scheme manager's directors.

(4) The chairman and other members of the board must be persons appointed, and liable to removal from office, by the Authority (acting, in the case of the chairman, with the approval of the Treasury).

(5) But the terms of their appointment (and in particular those governing removal from office) must be such as to secure their independence from the Authority in the operation of the compensation scheme.

(6) The scheme manager is not to be regarded as exercising functions on behalf of the Crown.

(7) The scheme manager's board members, officers and staff are not to be regarded as Crown servants.

The scheme

The compensation scheme.

213.—(1) The Authority must by rules establish a scheme for compensating persons in cases where relevant persons are unable, or are likely to be unable, to satisfy claims against them.

(2) The rules are to be known as the Financial Services Compensation Scheme (but are referred to in this Act as "the compensation scheme").

(3) The compensation scheme must, in particular, provide for the scheme manager—

(a) to assess and pay compensation, in accordance with the scheme, to claimants in respect of claims made in connection with regulated activities carried on (whether or not with permission) by relevant persons; and

(b) to have power to impose levies on authorised persons, or any class of authorised person, for the purpose of meeting its expenses (including in particular expenses incurred, or expected to be incurred, in paying compensation, borrowing or insuring risks).

(4) The compensation scheme may provide for the scheme manager to have power to impose levies on authorised persons, or any class of authorised person, for the purpose of recovering the cost (whenever incurred) of establishing the scheme.

(5) In making any provision of the scheme by virtue of subsection (3)(b), the Authority must take account of the desirability of ensuring that the amount of the levies imposed on a particular class of authorised person reflects, so far as practicable, the amount of the claims made, or likely to be made, in respect of that class of person.

(6) An amount payable to the scheme manager as a result of any provision of the scheme made by virtue of subsection (3)(b) or (4) may be recovered as a debt due to the scheme manager.

(7) Sections 214 to 217 make further provision about the scheme but are not to be taken as limiting the power conferred on the Authority by subsection (1).

(8) In those sections "specified" means specified in the scheme.

(9) In this Part (except in sections 219, 220 or 224) "relevant person" means a person who was—

(a) an authorised person at the time the act or omission giving rise to the claim against him took place; or

(b) an appointed representative at that time.

(10) But a person who, at that time—

(a) qualified for authorisation under Schedule 3, and

(b) fell within a prescribed category,

is not to be regarded as a relevant person in relation to any activities for which he had permission as a result of any provision of, or made under, that Schedule unless he had elected to participate in the scheme in relation to those activities at that time.

Provisions of the scheme

General.

214.—(1) The compensation scheme may, in particular, make provision—

(a) as to the circumstances in which a relevant person is to be taken (for the purposes of the scheme) to be unable, or likely to be unable, to satisfy claims made against him;

(b) for the establishment of different funds for meeting different kinds of claim;

(c) for the imposition of different levies in different cases;

(d) limiting the levy payable by a person in respect of a specified period;

(e) for repayment of the whole or part of a levy in specified circumstances;

(f) for a claim to be entertained only if it is made by a specified kind of claimant;

(g) for a claim to be entertained only if it falls within a specified kind of claim;

(h) as to the procedure to be followed in making a claim;

(i) for the making of interim payments before a claim is finally determined;

(j) limiting the amount payable on a claim to a specified maximum amount or a maximum amount calculated in a specified manner;

(k) for payment to be made, in specified circumstances, to a person other than the claimant.

(2) Different provision may be made with respect to different kinds of claim.

(3) The scheme may provide for the determination and regulation of matters relating to the scheme by the scheme manager.

(4) The scheme, or particular provisions of the scheme, may be made so as to apply only in relation to—

(a) activities carried on,

(b) claimants,

(c) matters arising, or

(d) events occurring,

in specified territories, areas or localities.

(5) The scheme may provide for a person who—

(a) qualifies for authorisation under Schedule 3, and

(b) falls within a prescribed category,

to elect to participate in the scheme in relation to some or all of the activities for which he has permission as a result of any provision of, or made under, that Schedule.

(6) The scheme may provide for the scheme manager to have power—

(a) in specified circumstances,

(b) but only if the scheme manager is satisfied that the claimant is entitled to receive a payment in respect of his claim—

(i) under a scheme which is comparable to the compensation scheme, or

(ii) as the result of a guarantee given by a government or other authority,

to make a full payment of compensation to the claimant and recover the whole or part of the amount of that payment from the other scheme or under that guarantee.

Rights of the scheme in relevant person's insolvency.

215.—(1) The compensation scheme may, in particular, make provision—

(a) as to the effect of a payment of compensation under the scheme in relation to rights or obligations arising out of the claim against a relevant person in respect of which the payment was made;

(b) for conferring on the scheme manager a right of recovery against that person.

(2) Such a right of recovery conferred by the scheme does not, in the event of the relevant person's insolvency, exceed such right (if any) as the claimant would have had in that event.

(3) If a person other than the scheme manager presents a petition under section 9 of the 1986 Act or Article 22 of the 1989 Order in relation to a company or partnership which is a relevant person, the scheme manager has the same rights as are conferred on the Authority by section 362.

(4) If a person other than the scheme manager presents a petition for the winding up of a body which is a relevant person, the scheme manager has the same rights as are conferred on the Authority by section 371.

(5) If a person other than the scheme manager presents a bankruptcy petition to the court in relation to an individual who, or an entity which, is a relevant person, the scheme manager has the same rights as are conferred on the Authority by section 374.

(6) Insolvency rules may be made for the purpose of integrating any procedure for which provision is made as a result of subsection (1) into the general procedure on the administration of a company or partnership or on a winding-up, bankruptcy or sequestration.

(7) "Bankruptcy petition" means a petition to the court—

(a) under section 264 of the 1986 Act or Article 238 of the 1989 Order for a bankruptcy order to be made against an individual;

(b) under section 5 of the 1985 Act for the sequestration of the estate of an individual; or

(c) under section 6 of the 1985 Act for the sequestration of the estate belonging to or held for or jointly by the members of an entity mentioned in subsection (1) of that section.

(8) "Insolvency rules" are—

(a) for England and Wales, rules made under sections 411 and 412 of the 1986 Act;

(b) for Scotland, rules made by order by the Treasury, after consultation with the Scottish Ministers, for the purposes of this section; and

1978 c. 23.

(c) for Northern Ireland, rules made under Article 359 of the 1989 Order and section 55 of the Judicature (Northern Ireland) Act 1978.

(9) "The 1985 Act", "the 1986 Act", "the 1989 Order" and "court" have the same meaning as in Part XXIV.

Continuity of long-term insurance policies.

216.—(1) The compensation scheme may, in particular, include provision requiring the scheme manager to make arrangements for securing continuity of insurance for policyholders, or policyholders of a specified class, of relevant long-term insurers.

(2) "Relevant long-term insurers" means relevant persons who—

(a) have permission to effect or carry out contracts of long-term insurance; and

(b) are unable, or likely to be unable, to satisfy claims made against them.

(3) The scheme may provide for the scheme manager to take such measures as appear to him to be appropriate—

(a) for securing or facilitating the transfer of a relevant long-term insurer's business so far as it consists of the carrying out of contracts of long-term insurance, or of any part of that business, to another authorised person;

(b) for securing the issue by another authorised person to the policyholders concerned of policies in substitution for their existing policies.

(4) The scheme may also provide for the scheme manager to make payments to the policyholders concerned—

(a) during any period while he is seeking to make arrangements mentioned in subsection (1);

(b) if it appears to him that it is not reasonably practicable to make such arrangements.

(5) A provision of the scheme made by virtue of section 213(3)(b) may include power to impose levies for the purpose of meeting expenses of the scheme manager incurred in—

(a) taking measures as a result of any provision of the scheme made by virtue of subsection (3);

(b) making payments as a result of any such provision made by virtue of subsection (4).

Insurers in financial difficulties.

217.—(1) The compensation scheme may, in particular, include provision for the scheme manager to have power to take measures for safeguarding policyholders, or policyholders of a specified class, of relevant insurers.

(2) "Relevant insurers" means relevant persons who—

(a) have permission to effect or carry out contracts of insurance; and

(b) are in financial difficulties.

(3) The measures may include such measures as the scheme manager considers appropriate for—

(a) securing or facilitating the transfer of a relevant insurer's business so far as it consists of the carrying out of contracts of insurance, or of any part of that business, to another authorised person;

(b) giving assistance to the relevant insurer to enable it to continue to effect or carry out contracts of insurance.

(4) The scheme may provide—

(a) that if measures of a kind mentioned in subsection (3)(a) are to be taken, they should be on terms appearing to the scheme manager to be appropriate, including terms reducing, or deferring payment of, any of the things to which any of those who are eligible policyholders in relation to the relevant insurer are entitled in their capacity as such;

(b) that if measures of a kind mentioned in subsection (3)(b) are to be taken, they should be conditional on the reduction of, or the deferment of the payment of, the things to which any of those who are eligible policyholders in relation to the relevant insurer are entitled in their capacity as such;

(c) for ensuring that measures of a kind mentioned in subsection (3)(b) do not benefit to any material extent persons who were members of a relevant insurer when it began to be in financial difficulties or who had any responsibility for, or who may have profited from, the circumstances giving rise to its financial difficulties, except in specified circumstances;

(d) for requiring the scheme manager to be satisfied that any measures he proposes to take are likely to cost less than it would cost to pay compensation under the scheme if the relevant insurer became unable, or likely to be unable, to satisfy claims made against him.

(5) The scheme may provide for the Authority to have power—

(a) to give such assistance to the scheme manager as it considers appropriate for assisting the scheme manager to determine what measures are practicable or desirable in the case of a particular relevant insurer;

(b) to impose constraints on the taking of measures by the scheme manager in the case of a particular relevant insurer;

(c) to require the scheme manager to provide it with information about any particular measures which the scheme manager is proposing to take.

(6) The scheme may include provision for the scheme manager to have power—

(a) to make interim payments in respect of eligible policyholders of a relevant insurer;

(b) to indemnify any person making payments to eligible policyholders of a relevant insurer.

(7) A provision of the scheme made by virtue of section 213(3)(b) may include power to impose levies for the purpose of meeting expenses of the scheme manager incurred in—

(a) taking measures as a result of any provision of the scheme made by virtue of subsection (1);

(b) making payments or giving indemnities as a result of any such provision made by virtue of subsection (6).

(8) "Financial difficulties" and "eligible policyholders" have such meanings as may be specified.

Annual report

Annual report.

218.—(1) At least once a year, the scheme manager must make a report to the Authority on the discharge of its functions.

(2) The report must—

(a) include a statement setting out the value of each of the funds established by the compensation scheme; and

(b) comply with any requirements specified in rules made by the Authority.

(3) The scheme manager must publish each report in the way it considers appropriate.

Information and documents

Scheme manager's power to require information.

219.—(1) The scheme manager may, by notice in writing given to the relevant person in respect of whom a claim is made under the scheme or to a person otherwise involved, require that person—

(a) to provide specified information or information of a specified description; or

(b) to produce specified documents or documents of a specified description.

(2) The information or documents must be provided or produced—

(a) before the end of such reasonable period as may be specified; and

(b) in the case of information, in such manner or form as may be specified.

(3) This section applies only to information and documents the provision or production of which the scheme manager considers—

(a) to be necessary for the fair determination of the claim; or

(b) to be necessary (or likely to be necessary) for the fair determination of other claims made (or which it expects may be made) in respect of the relevant person concerned.

(4) If a document is produced in response to a requirement imposed under this section, the scheme manager may—

(a) take copies or extracts from the document; or

(b) require the person producing the document to provide an explanation of the document.

(5) If a person who is required under this section to produce a document fails to do so, the scheme manager may require the person to state, to the best of his knowledge and belief, where the document is.

(6) If the relevant person is insolvent, no requirement may be imposed under this section on a person to whom section 220 or 224 applies.

(7) If a person claims a lien on a document, its production under this Part does not affect the lien.

(8) "Relevant person" has the same meaning as in section 224.

(9) "Specified" means specified in the notice given under subsection (1).

(10) A person is involved in a claim made under the scheme if he was knowingly involved in the act or omission giving rise to the claim.

Scheme manager's power to inspect information held by liquidator etc.

220.—(1) For the purpose of assisting the scheme manager to discharge its functions in relation to a claim made in respect of an insolvent relevant person, a person to whom this section applies must permit a person authorised by the scheme manager to inspect relevant documents.

(2) A person inspecting a document under this section may take copies of, or extracts from, the document.

(3) This section applies to—

(a) the administrative receiver, administrator, liquidator or trustee in bankruptcy of an insolvent relevant person;

(b) the permanent trustee, within the meaning of the Bankruptcy (Scotland) Act 1985, on the estate of an insolvent relevant person. 1985 c. 66.

(4) This section does not apply to a liquidator, administrator or trustee in bankruptcy who is—

(a) the Official Receiver;

(b) the Official Receiver for Northern Ireland; or

(c) the Accountant in Bankruptcy.

(5) "Relevant person" has the same meaning as in section 224.

Powers of court where information required.

221.—(1) If a person ("the defaulter")—

(a) fails to comply with a requirement imposed under section 219, or

(b) fails to permit documents to be inspected under section 220,

the scheme manager may certify that fact in writing to the court and the court may enquire into the case.

(2) If the court is satisfied that the defaulter failed without reasonable excuse to comply with the requirement (or to permit the documents to be inspected), it may deal with the defaulter (and, in the case of a body corporate, any director or officer) as if he were in contempt.

(3) "Court" means—

(a) the High Court;

(b) in Scotland, the Court of Session.

Miscellaneous

Statutory immunity.

222.—(1) Neither the scheme manager nor any person who is, or is acting as, its board member, officer or member of staff is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of the scheme manager's functions.

(2) Subsection (1) does not apply—

(a) if the act or omission is shown to have been in bad faith; or

(b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998.

1998 c. 42.

Management expenses.

223.—(1) The amount which the scheme manager may recover, from the sums levied under the scheme, as management expenses attributable to a particular period may not exceed such amount as may be fixed by the scheme as the limit applicable to that period.

(2) In calculating the amount of any levy to be imposed by the scheme manager, no amount may be included to reflect management expenses unless the limit mentioned in subsection (1) has been fixed by the scheme.

(3) "Management expenses" means expenses incurred, or expected to be incurred, by the scheme manager in connection with its functions under this Act other than those incurred—

(a) in paying compensation;

(b) as a result of any provision of the scheme made by virtue of section 216(3) or (4) or 217(1) or (6).

Scheme manager's power to inspect documents held by Official Receiver etc.

224.—(1) If, as a result of the insolvency or bankruptcy of a relevant person, any documents have come into the possession of a person to whom this section applies, he must permit any person authorised by the scheme manager to inspect the documents for the purpose of establishing—

(a) the identity of persons to whom the scheme manager may be liable to make a payment in accordance with the compensation scheme; or

(b) the amount of any payment which the scheme manager may be liable to make.

(2) A person inspecting a document under this section may take copies or extracts from the document.

(3) In this section "relevant person" means a person who was—

(a) an authorised person at the time the act or omission which may give rise to the liability mentioned in subsection (1)(a) took place; or

(b) an appointed representative at that time.

(4) But a person who, at that time—

(a) qualified for authorisation under Schedule 3, and

(b) fell within a prescribed category,

is not to be regarded as a relevant person for the purposes of this section in relation to any activities for which he had permission as a result of any provision of, or made under, that Schedule unless he had elected to participate in the scheme in relation to those activities at that time.

(5) This section applies to—

(a) the Official Receiver;

(b) the Official Receiver for Northern Ireland; and

(c) the Accountant in Bankruptcy.

Part XVI

The Ombudsman Scheme

The scheme

The scheme and the scheme operator.

225.—(1) This Part provides for a scheme under which certain disputes may be resolved quickly and with minimum formality by an independent person.

(2) The scheme is to be administered by a body corporate ("the scheme operator").

(3) The scheme is to be operated under a name chosen by the scheme operator but is referred to in this Act as "the ombudsman scheme".

(4) Schedule 17 makes provision in connection with the ombudsman scheme and the scheme operator.

Compulsory jurisdiction.

226.—(1) A complaint which relates to an act or omission of a person ("the respondent") in carrying on an activity to which compulsory jurisdiction rules apply is to be dealt with under the ombudsman scheme if the conditions mentioned in subsection (2) are satisfied.

(2) The conditions are that—

(a) the complainant is eligible and wishes to have the complaint dealt with under the scheme;

(b) the respondent was an authorised person at the time of the act or omission to which the complaint relates; and

(c) the act or omission to which the complaint relates occurred at a time when compulsory jurisdiction rules were in force in relation to the activity in question.

(3) "Compulsory jurisdiction rules" means rules—

(a) made by the Authority for the purposes of this section; and

(b) specifying the activities to which they apply.

(4) Only activities which are regulated activities, or which could be made regulated activities by an order under section 22, may be specified.

(5) Activities may be specified by reference to specified categories (however described).

(6) A complainant is eligible, in relation to the compulsory jurisdiction of the ombudsman scheme, if he falls within a class of person specified in the rules as eligible.

(7) The rules—

(a) may include provision for persons other than individuals to be eligible; but

(b) may not provide for authorised persons to be eligible except in specified circumstances or in relation to complaints of a specified kind.

(8) The jurisdiction of the scheme which results from this section is referred to in this Act as the "compulsory jurisdiction".

Voluntary jurisdiction.

227.—(1) A complaint which relates to an act or omission of a person ("the respondent") in carrying on an activity to which voluntary jurisdiction rules apply is to be dealt with under the ombudsman scheme if the conditions mentioned in subsection (2) are satisfied.

(2) The conditions are that—

(a) the complainant is eligible and wishes to have the complaint dealt with under the scheme;

(b) at the time of the act or omission to which the complaint relates, the respondent was participating in the scheme;

(c) at the time when the complaint is referred under the scheme, the respondent has not withdrawn from the scheme in accordance with its provisions;

(d) the act or omission to which the complaint relates occurred at a time when voluntary jurisdiction rules were in force in relation to the activity in question; and

(e) the complaint cannot be dealt with under the compulsory jurisdiction.

(3) "Voluntary jurisdiction rules" means rules—

(a) made by the scheme operator for the purposes of this section; and

(b) specifying the activities to which they apply.

(4) The only activities which may be specified in the rules are activities which are, or could be, specified in compulsory jurisdiction rules.

(5) Activities may be specified by reference to specified categories (however described).

(6) The rules require the Authority's approval.

(7) A complainant is eligible, in relation to the voluntary jurisdiction of the ombudsman scheme, if he falls within a class of person specified in the rules as eligible.

(8) The rules may include provision for persons other than individuals to be eligible.

(9) A person qualifies for participation in the ombudsman scheme if he falls within a class of person specified in the rules in relation to the activity in question.

(10) Provision may be made in the rules for persons other than authorised persons to participate in the ombudsman scheme.

(11) The rules may make different provision in relation to complaints arising from different activities.

(12) The jurisdiction of the scheme which results from this section is referred to in this Act as the "voluntary jurisdiction".

(13) In such circumstances as may be specified in voluntary jurisdiction rules, a complaint—

(a) which relates to an act or omission occurring at a time before the rules came into force, and

(b) which could have been dealt with under a scheme which has to any extent been replaced by the voluntary jurisdiction,

is to be dealt with under the ombudsman scheme even though paragraph (b) or (d) of subsection (2) would otherwise prevent that.

(14) In such circumstances as may be specified in voluntary jurisdiction rules, a complaint is to be dealt with under the ombudsman scheme even though—

(a) paragraph (b) or (d) of subsection (2) would otherwise prevent that, and

(b) the complaint is not brought within the scheme as a result of subsection (13),

but only if the respondent has agreed that complaints of that kind were to be dealt with under the scheme.

Determination of complaints

Determination under the compulsory jurisdiction.

228.—(1) This section applies only in relation to the compulsory jurisdiction.

(2) A complaint is to be determined by reference to what is, in the opinion of the ombudsman, fair and reasonable in all the circumstances of the case.

(3) When the ombudsman has determined a complaint he must give a written statement of his determination to the respondent and to the complainant.

(4) The statement must—

(a) give the ombudsman's reasons for his determination;

(b) be signed by him; and

(c) require the complainant to notify him in writing, before a date specified in the statement, whether he accepts or rejects the determination.

(5) If the complainant notifies the ombudsman that he accepts the determination, it is binding on the respondent and the complainant and final.

(6) If, by the specified date, the complainant has not notified the ombudsman of his acceptance or rejection of the determination he is to be treated as having rejected it.

(7) The ombudsman must notify the respondent of the outcome.

(8) A copy of the determination on which appears a certificate signed by an ombudsman is evidence (or in Scotland sufficient evidence) that the determination was made under the scheme.

(9) Such a certificate purporting to be signed by an ombudsman is to be taken to have been duly signed unless the contrary is shown.

Awards.

229.—(1) This section applies only in relation to the compulsory jurisdiction.

(2) If a complaint which has been dealt with under the scheme is determined in favour of the complainant, the determination may include—

(a) an award against the respondent of such amount as the ombudsman considers fair compensation for loss or damage (of a kind falling within subsection (3)) suffered by the complainant ("a money award");

(b) a direction that the respondent take such steps in relation to the complainant as the ombudsman considers just and appropriate (whether or not a court could order those steps to be taken).

(3) A money award may compensate for—

(a) financial loss; or

(b) any other loss, or any damage, of a specified kind.

(4) The Authority may specify the maximum amount which may be regarded as fair compensation for a particular kind of loss or damage specified under subsection (3)(b).

(5) A money award may not exceed the monetary limit; but the ombudsman may, if he considers that fair compensation requires payment of a larger amount, recommend that the respondent pay the complainant the balance.

(6) The monetary limit is such amount as may be specified.

(7) Different amounts may be specified in relation to different kinds of complaint.

(8) A money award—

(a) may provide for the amount payable under the award to bear interest at a rate and as from a date specified in the award; and

(b) is enforceable by the complainant in accordance with Part III of Schedule 17.

(9) Compliance with a direction under subsection (2)(b)—

(a) is enforceable by an injunction; or

(b) in Scotland, is enforceable by an order under section 45 of the Court of Session Act 1988.

1988 c. 36.

(10) Only the complainant may bring proceedings for an injunction or proceedings for an order.

(11) “Specified” means specified in compulsory jurisdiction rules.

Costs.

230.—(1) The scheme operator may by rules (“costs rules”) provide for an ombudsman to have power, on determining a complaint under the compulsory jurisdiction, to award costs in accordance with the provisions of the rules.

(2) Costs rules require the approval of the Authority.

(3) Costs rules may not provide for the making of an award against the complainant in respect of the respondent’s costs.

(4) But they may provide for the making of an award against the complainant in favour of the scheme operator, for the purpose of providing a contribution to resources deployed in dealing with the complaint, if in the opinion of the ombudsman—

(a) the complainant’s conduct was improper or unreasonable; or

(b) the complainant was responsible for an unreasonable delay.

(5) Costs rules may authorise an ombudsman making an award in accordance with the rules to order that the amount payable under the award bears interest at a rate and as from a date specified in the order.

(6) An amount due under an award made in favour of the scheme operator is recoverable as a debt due to the scheme operator.

(7) Any other award made against the respondent is to be treated as a money award for the purposes of paragraph 16 of Schedule 17.

Information

Ombudsman's power to require information.

231.—(1) An ombudsman may, by notice in writing given to a party to a complaint, require that party—

(a) to provide specified information or information of a specified description; or

(b) to produce specified documents or documents of a specified description.

(2) The information or documents must be provided or produced—

(a) before the end of such reasonable period as may be specified; and

(b) in the case of information, in such manner or form as may be specified.

(3) This section applies only to information and documents the production of which the ombudsman considers necessary for the determination of the complaint.

(4) If a document is produced in response to a requirement imposed under this section, the ombudsman may—

(a) take copies or extracts from the document; or

(b) require the person producing the document to provide an explanation of the document.

(5) If a person who is required under this section to produce a document fails to do so, the ombudsman may require him to state, to the best of his knowledge and belief, where the document is.

(6) If a person claims a lien on a document, its production under this Part does not affect the lien.

(7) "Specified" means specified in the notice given under subsection (1).

Powers of court where information required.

232.—(1) If a person ("the defaulter") fails to comply with a requirement imposed under section 231, the ombudsman may certify that fact in writing to the court and the court may enquire into the case.

(2) If the court is satisfied that the defaulter failed without reasonable excuse to comply with the requirement, it may deal with the defaulter (and, in the case of a body corporate, any director or officer) as if he were in contempt.

(3) "Court" means—

(a) the High Court;

(b) in Scotland, the Court of Session.

Data protection. 1998 c. 29.

233. In section 31 of the Data Protection Act 1998 (regulatory activity), after subsection (4), insert—

"(4A) Personal data processed for the purpose of discharging any function which is conferred by or under Part XVI of the Financial Services and Markets Act 2000 on the body established by the Financial Services Authority for the purposes of that Part are exempt from the subject information provisions in any case to the extent to which the application of those provisions to the data would be likely to prejudice the proper discharge of the function."

Funding

Industry funding.

234.—(1) For the purpose of funding—

(a) the establishment of the ombudsman scheme (whenever any relevant expense is incurred), and

(b) its operation in relation to the compulsory jurisdiction,

the Authority may make rules requiring the payment to it or to the scheme operator, by authorised persons or any class of authorised person of specified amounts (or amounts calculated in a specified way).

(2) "Specified" means specified in the rules.

PART XVII

COLLECTIVE INVESTMENT SCHEMES

CHAPTER I

INTERPRETATION

Collective investment schemes.

235.—(1) In this Part "collective investment scheme" means any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.

(2) The arrangements must be such that the persons who are to participate ("participants") do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions.

(3) The arrangements must also have either or both of the following characteristics—

(a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled;

(b) the property is managed as a whole by or on behalf of the operator of the scheme.

(4) If arrangements provide for such pooling as is mentioned in subsection (3)(a) in relation to separate parts of the property, the arrangements are not to be regarded as constituting a single collective investment scheme unless the participants are entitled to exchange rights in one part for rights in another.

(5) The Treasury may by order provide that arrangements do not amount to a collective investment scheme—

(a) in specified circumstances; or

(b) if the arrangements fall within a specified category of arrangement.

236.—(1) In this Part "an open-ended investment company" means a collective investment scheme which satisfies both the property condition and the investment condition. Open-ended investment companies.

(2) The property condition is that the property belongs beneficially to, and is managed by or on behalf of, a body corporate ("BC") having as its purpose the investment of its funds with the aim of—

(a) spreading investment risk; and

(b) giving its members the benefit of the results of the management of those funds by or on behalf of that body.

(3) The investment condition is that, in relation to BC, a reasonable investor would, if he were to participate in the scheme—

(a) expect that he would be able to realize, within a period appearing to him to be reasonable, his investment in the scheme (represented, at any given time, by the value of shares in, or securities of, BC held by him as a participant in the scheme); and

(b) be satisfied that his investment would be realized on a basis calculated wholly or mainly by reference to the value of property in respect of which the scheme makes arrangements.

(4) In determining whether the investment condition is satisfied, no account is to be taken of any actual or potential redemption or repurchase of shares or securities under—

(a) Chapter VII of Part V of the Companies Act 1985; 1985 c. 6.

(b) Chapter VII of Part VI of the Companies (Northern Ireland) Order 1986; S.I. 1986/1032 (N.I. 6.)

(c) corresponding provisions in force in another EEA State; or

(d) provisions in force in a country or territory other than an EEA state which the Treasury have, by order, designated as corresponding provisions.

(5) The Treasury may by order amend the definition of "an open-ended investment company" for the purposes of this Part.

237.—(1) In this Part "unit trust scheme" means a collective investment scheme under which the property is held on trust for the participants. Other definitions.

(2) In this Part—

"trustee", in relation to a unit trust scheme, means the person holding the property in question on trust for the participants;

"depositary", in relation to—

(a) a collective investment scheme which is constituted by a body incorporated by virtue of regulations under section 262, or

(b) any other collective investment scheme which is not a unit trust scheme,

means any person to whom the property subject to the scheme is entrusted for safekeeping;

"the operator", in relation to a unit trust scheme with a separate trustee, means the manager and in relation to an open-ended investment company, means that company;

"units" means the rights or interests (however described) of the participants in a collective investment scheme.

(3) In this Part—

"an authorised unit trust scheme" means a unit trust scheme which is authorised for the purposes of this Act by an authorisation order in force under section 243;

"an authorised open-ended investment company" means a body incorporated by virtue of regulations under section 262 in respect of which an authorisation order is in force under any provision made in such regulations by virtue of subsection (2)(l) of that section;

"a recognised scheme" means a scheme recognised under section 264, 270 or 272.

Chapter II

Restrictions on Promotion

Restrictions on promotion.

238.—(1) An authorised person must not communicate an invitation or inducement to participate in a collective investment scheme.

(2) But that is subject to the following provisions of this section and to section 239.

(3) Subsection (1) applies in the case of a communication originating outside the United Kingdom only if the communication is capable of having an effect in the United Kingdom.

(4) Subsection (1) does not apply in relation to—

(a) an authorised unit trust scheme;

(b) a scheme constituted by an authorised open-ended investment company; or

(c) a recognised scheme.

(5) Subsection (1) does not apply to anything done in accordance with rules made by the Authority for the purpose of exempting from that subsection the promotion otherwise than to the general public of schemes of specified descriptions.

(6) The Treasury may by order specify circumstances in which subsection (1) does not apply.

(7) An order under subsection (6) may, in particular, provide that subsection (1) does not apply in relation to communications—

(a) of a specified description;

(b) originating in a specified country or territory outside the United Kingdom;

(c) originating in a country or territory which falls within a specified description of country or territory outside the United Kingdom; or

(d) originating outside the United Kingdom.

(8) The Treasury may by order repeal subsection (3).

(9) "Communicate" includes causing a communication to be made.

(10) "Promotion otherwise than to the general public" includes promotion in a way designed to reduce, so far as possible, the risk of participation by persons for whom participation would be unsuitable.

(11) "Participate", in relation to a collective investment scheme, means become a participant (within the meaning given by section 235(2)) in the scheme.

Single property schemes.

239.—(1) The Treasury may by regulations make provision for exempting single property schemes from section 238(1).

(2) For the purposes of subsection (1) a single property scheme is a scheme which has the characteristics mentioned in subsection (3) and satisfies such other requirements as are prescribed by the regulations conferring the exemption.

(3) The characteristics are—

(a) that the property subject to the scheme (apart from cash or other assets held for management purposes) consists of—

(i) a single building (or a single building with ancillary buildings) managed by or on behalf of the operator of the scheme, or

(ii) a group of adjacent or contiguous buildings managed by him or on his behalf as a single enterprise,

with or without ancillary land and with or without furniture, fittings or other contents of the building or buildings in question; and

(b) that the units of the participants in the scheme are either dealt in on a recognised investment exchange or offered on terms such that any agreement for their acquisition is conditional on their admission to dealings on such an exchange.

(4) If regulations are made under subsection (1), the Authority may make rules imposing duties or liabilities on the operator and (if any) the trustee or depositary of a scheme exempted by the regulations.

(5) The rules may include, to such extent as the Authority thinks appropriate, provision for purposes corresponding to those for which provision can be made under section 248 in relation to authorised unit trust schemes.

Restriction on approval of promotion.

240.—(1) An authorised person may not approve for the purposes of section 21 the content of a communication relating to a collective investment scheme if he would be prohibited by section 238(1) from effecting the communication himself or from causing it to be communicated.

(2) For the purposes of determining in any case whether there has been a contravention of section 21(1), an approval given in contravention of subsection (1) is to be regarded as not having been given.

Actions for damages.

241. If an authorised person contravenes a requirement imposed on him by section 238 or 240, section 150 applies to the contravention as it applies to a contravention mentioned in that section.

CHAPTER III

AUTHORISED UNIT TRUST SCHEMES

Applications for authorisation

Applications for authorisation of unit trust schemes.

242.—(1) Any application for an order declaring a unit trust scheme to be an authorised unit trust scheme must be made to the Authority by the manager and trustee, or proposed manager and trustee, of the scheme.

(2) The manager and trustee (or proposed manager and trustee) must be different persons.

(3) The application—

(a) must be made in such manner as the Authority may direct; and

(b) must contain or be accompanied by such information as the Authority may reasonably require for the purpose of determining the application.

(4) At any time after receiving an application and before determining it, the Authority may require the applicants to provide it with such further information as it reasonably considers necessary to enable it to determine the application.

(5) Different directions may be given, and different requirements imposed, in relation to different applications.

(6) The Authority may require applicants to present information which they are required to give under this section in such form, or to verify it in such a way, as the Authority may direct.

Authorisation orders.

243.—(1) If, on an application under section 242 in respect of a unit trust scheme, the Authority—

(a) is satisfied that the scheme complies with the requirements set out in this section,

(b) is satisfied that the scheme complies with the requirements of the trust scheme rules, and

(c) has been provided with a copy of the trust deed and a certificate signed by a solicitor to the effect that it complies with such of the requirements of this section or those rules as relate to its contents,

the Authority may make an order declaring the scheme to be an authorised unit trust scheme.

(2) If the Authority makes an order under subsection (1), it must give written notice of the order to the applicant.

(3) In this Chapter "authorisation order" means an order under subsection (1).

(4) The manager and the trustee must be persons who are independent of each other.

(5) The manager and the trustee must each—

(a) be a body corporate incorporated in the United Kingdom or another EEA State, and

(b) have a place of business in the United Kingdom,

and the affairs of each must be administered in the country in which it is incorporated.

(6) If the manager is incorporated in another EEA State, the scheme must not be one which satisfies the requirements prescribed for the purposes of section 264.

(7) The manager and the trustee must each be an authorised person and the manager must have permission to act as manager and the trustee must have permission to act as trustee.

(8) The name of the scheme must not be undesirable or misleading.

(9) The purposes of the scheme must be reasonably capable of being successfully carried into effect.

(10) The participants must be entitled to have their units redeemed in accordance with the scheme at a price—

(a) related to the net value of the property to which the units relate; and

(b) determined in accordance with the scheme.

(11) But a scheme is to be treated as complying with subsection (10) if it requires the manager to ensure that a participant is able to sell his units on an investment exchange at a price not significantly different from that mentioned in that subsection.

Determination of applications.

244.—(1) An application under section 242 must be determined by the Authority before the end of the period of six months beginning with the date on which it receives the completed application.

(2) The Authority may determine an incomplete application if it considers it appropriate to do so; and it must in any event determine such an application within twelve months beginning with the date on which it first receives the application.

(3) The applicant may withdraw his application, by giving the Authority written notice, at any time before the Authority determines it.

Applications refused

Procedure when refusing an application.

245.—(1) If the Authority proposes to refuse an application made under section 242 it must give each of the applicants a warning notice.

(2) If the Authority decides to refuse the application—

(a) it must give each of the applicants a decision notice; and

(b) either applicant may refer the matter to the Tribunal.

Certificates

Certificates.

246.—(1) If the manager or trustee of a unit trust scheme which complies with the conditions necessary for it to enjoy the rights conferred by any relevant Community instrument so requests, the Authority may issue a certificate to the effect that the scheme complies with those conditions.

(2) Such a certificate may be issued on the making of an authorisation order in respect of the scheme or at any subsequent time.

Rules

Trust scheme rules.

247.—(1) The Authority may make rules ("trust scheme rules") as to—

(a) the constitution, management and operation of authorised unit trust schemes;

(b) the powers, duties, rights and liabilities of the manager and trustee of any such scheme;

(c) the rights and duties of the participants in any such scheme; and

(d) the winding up of any such scheme.

(2) Trust scheme rules may, in particular, make provision—

(a) as to the issue and redemption of the units under the scheme;

(b) as to the expenses of the scheme and the means of meeting them;

(c) for the appointment, removal, powers and duties of an auditor for the scheme;

(d) for restricting or regulating the investment and borrowing powers exercisable in relation to the scheme;

(e) requiring the keeping of records with respect to the transactions and financial position of the scheme and for the inspection of those records;

(f) requiring the preparation of periodical reports with respect to the scheme and the provision of those reports to the participants and to the Authority; and

(g) with respect to the amendment of the scheme.

(3) Trust scheme rules may make provision as to the contents of the trust deed, including provision requiring any of the matters mentioned in subsection (2) to be dealt with in the deed.

(4) But trust scheme rules are binding on the manager, trustee and participants independently of the contents of the trust deed and, in the case of the participants, have effect as if contained in it.

(5) If—

(a) a modification is made of the statutory provisions in force in Great Britain or Northern Ireland relating to companies,

(b) the modification relates to the rights and duties of persons who hold the beneficial title to any shares in a company without also holding the legal title, and

(c) it appears to the Treasury that, for the purpose of assimilating the law relating to authorised unit trust schemes to the law relating to companies as so modified, it is expedient to modify the rule-making powers conferred on the Authority by this section,

the Treasury may by order make such modifications of those powers as they consider appropriate.

Scheme particulars rules.

248.—(1) The Authority may make rules ("scheme particulars rules") requiring the manager of an authorised unit trust scheme—

(a) to submit scheme particulars to the Authority; and

(b) to publish scheme particulars or make them available to the public on request.

(2) "Scheme particulars" means particulars in such form, containing such information about the scheme and complying with such requirements, as are specified in scheme particulars rules.

(3) Scheme particulars rules may require the manager of an authorised unit trust scheme to submit, and to publish or make available, revised or further scheme particulars if there is a significant change affecting any matter—

(a) which is contained in scheme particulars previously published or made available; and

(b) whose inclusion in those particulars was required by the rules.

(4) Scheme particulars rules may require the manager of an authorised unit trust scheme to submit, and to publish or make available, revised or further scheme particulars if—

(a) a significant new matter arises; and

(b) the inclusion of information in respect of that matter would have been required in previous particulars if it had arisen when those particulars were prepared.

(5) Scheme particulars rules may provide for the payment, by the person or persons who in accordance with the rules are treated as responsible for any scheme particulars, of compensation to any qualifying person who has suffered loss as a result of—

(a) any untrue or misleading statement in the particulars; or

(b) the omission from them of any matter required by the rules to be included.

(6) "Qualifying person" means a person who—

(a) has become or agreed to become a participant in the scheme; or

(b) although not being a participant, has a beneficial interest in units in the scheme.

(7) Scheme particulars rules do not affect any liability which any person may incur apart from the rules.

Disqualification of auditor for breach of trust scheme rules.

249.—(1) If it appears to the Authority that an auditor has failed to comply with a duty imposed on him by trust scheme rules, it may disqualify him from being the auditor for any authorised unit trust scheme or authorised open-ended investment company.

(2) Subsections (2) to (5) of section 345 have effect in relation to disqualification under subsection (1) as they have effect in relation to disqualification under subsection (1) of that section.

Modification or waiver of rules.

250.—(1) In this section "rules" means—

(a) trust scheme rules; or

(b) scheme particulars rules.

(2) The Authority may, on the application or with the consent of any person to whom any rules apply, direct that all or any of the rules—

(a) are not to apply to him as respects a particular scheme; or

(b) are to apply to him, as respects a particular scheme, with such modifications as may be specified in the direction.

(3) The Authority may, on the application or with the consent of the manager and trustee of a particular scheme acting jointly, direct that all or any of the rules—

(a) are not to apply to the scheme; or

(b) are to apply to the scheme with such modifications as may be specified in the direction.

(4) Subsections (3) to (9) and (11) of section 148 have effect in relation to a direction under subsection (2) as they have effect in relation to a direction under section 148(2) but with the following modifications—

(a) subsection (4)(a) is to be read as if the words "by the authorised person" were omitted;

(b) any reference to the authorised person (except in subsection (4)(a)) is to be read as a reference to the person mentioned in subsection (2); and

(c) subsection (7)(b) is to be read, in relation to a participant of the scheme, as if the word "commercial" were omitted.

(5) Subsections (3) to (9) and (11) of section 148 have effect in relation to a direction under subsection (3) as they have effect in relation to a direction under section 148(2) but with the following modifications—

(a) subsection (4)(a) is to be read as if the words "by the authorised person" were omitted;

(b) subsections (7)(b) and (11) are to be read as if references to the authorised person were references to each of the manager and the trustee of the scheme;

(c) subsection (7)(b) is to be read, in relation to a participant of the scheme, as if the word "commercial" were omitted;

(d) subsection (8) is to be read as if the reference to the authorised person concerned were a reference to the scheme concerned and to its manager and trustee; and

(e) subsection (9) is to be read as if the reference to the authorised person were a reference to the manager and trustee of the scheme acting jointly.

Alterations

Alteration of schemes and changes of manager or trustee.

251.—(1) The manager of an authorised unit trust scheme must give written notice to the Authority of any proposal to alter the scheme or to replace its trustee.

(2) Any notice given in respect of a proposal to alter the scheme involving a change in the trust deed must be accompanied by a certificate signed by a solicitor to the effect that the change will not affect the compliance of the deed with the trust scheme rules.

(3) The trustee of an authorised unit trust scheme must give written notice to the Authority of any proposal to replace the manager of the scheme.

(4) Effect is not to be given to any proposal of which notice has been given under subsection (1) or (3) unless—

(a) the Authority, by written notice, has given its approval to the proposal; or

(b) one month, beginning with the date on which the notice was given, has expired without the manager or trustee having received from the Authority a warning notice under section 252 in respect of the proposal.

(5) The Authority must not approve a proposal to replace the manager or the trustee of an authorised unit trust scheme unless it is satisfied that, if the proposed replacement is made, the scheme will continue to comply with the requirements of section 243(4) to (7).

Procedure when refusing approval of change of manager or trustee.

252.—(1) If the Authority proposes to refuse approval of a proposal to replace the trustee or manager of an authorised unit trust scheme, it must give a warning notice to the person by whom notice of the proposal was given under section 251(1) or (3).

(2) If the Authority proposes to refuse approval of a proposal to alter an authorised unit trust scheme it must give separate warning notices to the manager and the trustee of the scheme.

(3) To be valid the warning notice must be received by that person before the end of one month beginning with the date on which notice of the proposal was given.

(4) If, having given a warning notice to a person, the Authority decides to refuse approval—

(a) it must give him a decision notice; and

(b) he may refer the matter to the Tribunal.

Exclusion clauses

Avoidance of exclusion clauses.

253. Any provision of the trust deed of an authorised unit trust scheme is void in so far as it would have the effect of exempting the manager or trustee from liability for any failure to exercise due care and diligence in the discharge of his functions in respect of the scheme.

Ending of authorisation

Revocation of authorisation order otherwise than by consent.

254.—(1) An authorisation order may be revoked by an order made by the Authority if it appears to the Authority that—

(a) one or more of the requirements for the making of the order are no longer satisfied;

(b) the manager or trustee of the scheme concerned has contravened a requirement imposed on him by or under this Act;

(c) the manager or trustee of the scheme has, in purported compliance with any such requirement, knowingly or recklessly given the Authority information which is false or misleading in a material particular;

(d) no regulated activity is being carried on in relation to the scheme and the period of that inactivity began at least twelve months earlier; or

(e) none of paragraphs (a) to (d) applies, but it is desirable to revoke the authorisation order in order to protect the interests of participants or potential participants in the scheme.

(2) For the purposes of subsection (1)(e), the Authority may take into account any matter relating to—

(a) the scheme;

(b) the manager or trustee;

(c) any person employed by or associated with the manager or trustee in connection with the scheme;

(d) any director of the manager or trustee;

(e) any person exercising influence over the manager or trustee;

(f) any body corporate in the same group as the manager or trustee;

(g) any director of any such body corporate;

(h) any person exercising influence over any such body corporate.

Procedure.

255.—(1) If the Authority proposes to make an order under section 254 revoking an authorisation order ("a revoking order"), it must give separate warning notices to the manager and the trustee of the scheme.

(2) If the Authority decides to make a revoking order, it must without delay give each of them a decision notice and either of them may refer the matter to the Tribunal.

Requests for revocation of authorisation order.

256.—(1) An authorisation order may be revoked by an order made by the Authority at the request of the manager or trustee of the scheme concerned.

(2) If the Authority makes an order under subsection (1), it must give written notice of the order to the manager and trustee of the scheme concerned.

(3) The Authority may refuse a request to make an order under this section if it considers that—

(a) the public interest requires that any matter concerning the scheme should be investigated before a decision is taken as to whether the authorisation order should be revoked; or

(b) revocation would not be in the interests of the participants or would be incompatible with a Community obligation.

(4) If the Authority proposes to refuse a request under this section, it must give separate warning notices to the manager and the trustee of the scheme.

(5) If the Authority decides to refuse the request, it must without delay give each of them a decision notice and either of them may refer the matter to the Tribunal.

Powers of intervention

Directions.

257.—(1) The Authority may give a direction under this section if it appears to the Authority that—

(a) one or more of the requirements for the making of an authorisation order are no longer satisfied;

(b) the manager or trustee of an authorised unit trust scheme has contravened, or is likely to contravene, a requirement imposed on him by or under this Act;

(c) the manager or trustee of such a scheme has, in purported compliance with any such requirement, knowingly or recklessly given the Authority information which is false or misleading in a material particular; or

(d) none of paragraphs (a) to (c) applies, but it is desirable to give a direction in order to protect the interests of participants or potential participants in such a scheme.

(2) A direction under this section may—

(a) require the manager of the scheme to cease the issue or redemption, or both the issue and redemption, of units under the scheme;

(b) require the manager and trustee of the scheme to wind it up.

(3) If the authorisation order is revoked, the revocation does not affect any direction under this section which is then in force.

(4) A direction may be given under this section in relation to a scheme in the case of which the authorisation order has been revoked if a direction under this section was already in force at the time of revocation.

(5) If a person contravenes a direction under this section, section 150 applies to the contravention as it applies to a contravention mentioned in that section.

(6) The Authority may, either on its own initiative or on the application of the manager or trustee of the scheme concerned, revoke or vary a direction given under this section if it appears to the Authority—

(a) in the case of revocation, that it is no longer necessary for the direction to take effect or continue in force;

(b) in the case of variation, that the direction should take effect or continue in force in a different form.

Applications to the court.

258.—(1) If the Authority could give a direction under section 257, it may also apply to the court for an order—

(a) removing the manager or the trustee, or both the manager and the trustee, of the scheme; and

(b) replacing the person or persons removed with a suitable person or persons nominated by the Authority.

(2) The Authority may nominate a person for the purposes of subsection (1)(b) only if it is satisfied that, if the order was made, the requirements of section 243(4) to (7) would be complied with.

(3) If it appears to the Authority that there is no person it can nominate for the purposes of subsection (1)(b), it may apply to the court for an order—

(a) removing the manager or the trustee, or both the manager and the trustee, of the scheme; and

(b) appointing an authorised person to wind up the scheme.

(4) On an application under this section the court may make such order as it thinks fit.

(5) The court may, on the application of the Authority, rescind any such order as is mentioned in subsection (3) and substitute such an order as is mentioned in subsection (1).

(6) The Authority must give written notice of the making of an application under this section to the manager and trustee of the scheme concerned.

(7) The jurisdiction conferred by this section may be exercised by—

(a) the High Court;

(b) in Scotland, the Court of Session.

Procedure on giving directions under section 257 and varying them on Authority's own initiative.

259.—(1) A direction takes effect—

(a) immediately, if the notice given under subsection (3) states that that is the case;

(b) on such date as may be specified in the notice; or

(c) if no date is specified in the notice, when the matter to which it relates is no longer open to review.

(2) A direction may be expressed to take effect immediately (or on a specified date) only if the Authority, having regard to the ground on which it is exercising its power under section 257, considers that it is necessary for the direction to take effect immediately (or on that date).

(3) If the Authority proposes to give a direction under section 257, or gives such a direction with immediate effect, it must give separate written notice to the manager and the trustee of the scheme concerned.

(4) The notice must—

(a) give details of the direction;

(b) inform the person to whom it is given of when the direction takes effect;

(c) state the Authority's reasons for giving the direction and for its determination as to when the direction takes effect;

(d) inform the person to whom it is given that he may make representations to the Authority within such period as may be specified in it (whether or not he has referred the matter to the Tribunal); and

(e) inform him of his right to refer the matter to the Tribunal.

(5) If the direction imposes a requirement under section 257(2)(a), the notice must state that the requirement has effect until—

(a) a specified date; or

(b) a further direction.

(6) If the direction imposes a requirement under section 257(2)(b), the scheme must be wound up—

(a) by a date specified in the notice; or

(b) if no date is specified, as soon as practicable.

(7) The Authority may extend the period allowed under the notice for making representations.

(8) If, having considered any representations made by a person to whom the notice was given, the Authority decides—

(a) to give the direction in the way proposed, or

(b) if it has been given, not to revoke the direction,

it must give separate written notice to the manager and the trustee of the scheme concerned.

(9) If, having considered any representations made by a person to whom the notice was given, the Authority decides—

(a) not to give the direction in the way proposed,

(b) to give the direction in a way other than that proposed, or

(c) to revoke a direction which has effect,

it must give separate written notice to the manager and the trustee of the scheme concerned.

(10) A notice given under subsection (8) must inform the person to whom it is given of his right to refer the matter to the Tribunal.

(11) A notice under subsection (9)(b) must comply with subsection (4).

(12) If a notice informs a person of his right to refer a matter to the Tribunal, it must give an indication of the procedure on such a reference.

(13) This section applies to the variation of a direction on the Authority's own initiative as it applies to the giving of a direction.

(14) For the purposes of subsection (1)(c), whether a matter is open to review is to be determined in accordance with section 391(8).

Procedure: refusal to revoke or vary direction.

260.—(1) If on an application under section 257(6) for a direction to be revoked or varied the Authority proposes—

(a) to vary the direction otherwise than in accordance with the application, or

(b) to refuse to revoke or vary the direction,

it must give the applicant a warning notice.

(2) If the Authority decides to refuse to revoke or vary the direction—

(a) it must give the applicant a decision notice; and

(b) the applicant may refer the matter to the Tribunal.

Procedure: revocation of direction and grant of request for variation.

261.—(1) If the Authority decides on its own initiative to revoke a direction under section 257 it must give separate written notices of its decision to the manager and trustee of the scheme.

(2) If on an application under section 257(6) for a direction to be revoked or varied the Authority decides to revoke the direction or vary it in accordance with the application, it must give the applicant written notice of its decision.

(3) A notice under this section must specify the date on which the decision takes effect.

(4) The Authority may publish such information about the revocation or variation, in such way, as it considers appropriate.

CHAPTER IV

OPEN-ENDED INVESTMENT COMPANIES

Open-ended investment companies.

262.—(1) The Treasury may by regulations make provision for—

(a) facilitating the carrying on of collective investment by means of open-ended investment companies;

(b) regulating such companies.

(2) The regulations may, in particular, make provision—

(a) for the incorporation and registration in Great Britain of bodies corporate;

(b) for a body incorporated by virtue of the regulations to take such form as may be determined in accordance with the regulations;

(c) as to the purposes for which such a body may exist, the investments which it may issue and otherwise as to its constitution;

(d) as to the management and operation of such a body and the management of its property;

(e) as to the powers, duties, rights and liabilities of such a body and of other persons, including—

(i) the directors or sole director of such a body;

(ii) its depositary (if any);

(iii) its shareholders, and persons who hold the beneficial title to shares in it without holding the legal title;

(iv) its auditor; and

(v) any persons who act or purport to act on its behalf;

(f) as to the merger of one or more such bodies and the division of such a body;

(g) for the appointment and removal of an auditor for such a body;

(h) as to the winding up and dissolution of such a body;

(i) for such a body, or any director or depositary of such a body, to be required to comply with directions given by the Authority;

(j) enabling the Authority to apply to a court for an order removing and replacing any director or depositary of such a body;

(k) for the carrying out of investigations by persons appointed by the Authority or the Secretary of State;

(l) corresponding to any provision made in relation to unit trust schemes by Chapter III of this Part.

(3) Regulations under this section may—

(a) impose criminal liability;

(b) confer functions on the Authority;

(c) in the case of provision made by virtue of subsection (2)(l), authorise the making of rules by the Authority;

(d) confer jurisdiction on any court or on the Tribunal;

(e) provide for fees to be charged by the Authority in connection with the carrying out of any of its functions under the regulations (including fees payable on a periodical basis);

(f) modify, exclude or apply (with or without modifications) any primary or subordinate legislation (including any provision of, or made under, this Act);

(g) make consequential amendments, repeals and revocations of any such legislation;

(h) modify or exclude any rule of law.

(4) The provision that may be made by virtue of subsection (3)(f) includes provision extending or adapting any power to make subordinate legislation.

(5) Regulations under this section may, in particular—

(a) revoke the Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations 1996; and S.I. 1996/2827.

(b) provide for things done under or in accordance with those regulations to be treated as if they had been done under or in accordance with regulations under this section.

Amendment of section 716 Companies Act 1985.
1985 c. 6.

263. In section 716(1) of the Companies Act 1985 (prohibition on formation of companies with more than 20 members unless registered under the Act etc.), after "this Act," insert "is incorporated by virtue of regulations made under section 262 of the Financial Services and Markets Act 2000".

CHAPTER V

RECOGNISED OVERSEAS SCHEMES

Schemes constituted in other EEA States

Schemes constituted in other EEA States.

264.—(1) A collective investment scheme constituted in another EEA State is a recognised scheme if—

(a) it satisfies such requirements as are prescribed for the purposes of this section; and

(b) not less than two months before inviting persons in the United Kingdom to become participants in the scheme, the operator of the scheme gives notice to the Authority of his intention to do so, specifying the way in which the invitation is to be made.

(2) But this section does not make the scheme a recognised scheme if within two months of receiving the notice under subsection (1) the Authority notifies—

(a) the operator of the scheme, and

(b) the authorities of the State in question who are responsible for the authorisation of collective investment schemes,

that the way in which the invitation is to be made does not comply with the law in force in the United Kingdom.

(3) The notice to be given to the Authority under subsection (1)—

(a) must be accompanied by a certificate from the authorities mentioned in subsection (2)(b) to the effect that the scheme complies with the conditions necessary for it to enjoy the rights conferred by any relevant Community instrument;

(b) must contain the address of a place in the United Kingdom for the service on the operator of notices or other documents required or authorised to be served on him under this Act; and

(c) must contain or be accompanied by such other information and documents as may be prescribed.

(4) A notice given by the Authority under subsection (2) must—

(a) give the reasons for which the Authority considers that the law in force in the United Kingdom will not be complied with; and

(b) specify a reasonable period (which may not be less than 28 days) within which any person to whom it is given may make representations to the Authority.

(5) For the purposes of this section a collective investment scheme is constituted in another EEA State if—

(a) it is constituted under the law of that State by a contract or under a trust and is managed by a body corporate incorporated under that law; or

(b) it takes the form of an open-ended investment company incorporated under that law.

(6) The operator of a recognised scheme may give written notice to the Authority that he desires the scheme to be no longer recognised by virtue of this section.

(7) On the giving of notice under subsection (6), the scheme ceases to be a recognised scheme.

Representations and references to the Tribunal.

265.—(1) This section applies if any representations are made to the Authority, before the period for making representations has ended, by a person to whom a notice was given by the Authority under section 264(2).

(2) The Authority must, within a reasonable period, decide in the light of those representations whether or not to withdraw its notice.

(3) If the Authority withdraws its notice the scheme is a recognised scheme from the date on which the notice is withdrawn.

(4) If the Authority decides not to withdraw its notice, it must give a decision notice to each person to whom the notice under section 264(2) was given.

(5) The operator of the scheme to whom the decision notice is given may refer the matter to the Tribunal.

Disapplication of rules.

266.—(1) Apart from—

(a) financial promotion rules, and

(b) rules under section 283(1),

rules made by the Authority under this Act do not apply to the operator, trustee or depositary of a scheme in relation to the carrying on by him of regulated activities for which he has permission in that capacity.

(2) "Scheme" means a scheme which is a recognised scheme by virtue of section 264.

Power of Authority to suspend promotion of scheme.

267.—(1) Subsection (2) applies if it appears to the Authority that the operator of a scheme has communicated an invitation or inducement in relation to the scheme in a manner contrary to financial promotion rules.

(2) The Authority may direct that—

(a) the exemption from subsection (1) of section 238 provided by subsection (4)(c) of that section is not to apply in relation to the scheme; and

(b) subsection (5) of that section does not apply with respect to things done in relation to the scheme.

(3) A direction under subsection (2) has effect—

(a) for a specified period;

(b) until the occurrence of a specified event; or

(c) until specified conditions are complied with.

(4) The Authority may, either on its own initiative or on the application of the operator of the scheme concerned, vary a direction given under subsection (2) if it appears to the Authority that the direction should take effect or continue in force in a different form.

(5) The Authority may, either on its own initiative or on the application of the operator of the recognised scheme concerned, revoke a direction given under subsection (2) if it appears to the Authority—

(a) that the conditions specified in the direction have been complied with; or

(b) that it is no longer necessary for the direction to take effect or continue in force.

(6) If an event is specified, the direction ceases to have effect (unless revoked earlier) on the occurrence of that event.

(7) For the purposes of this section and sections 268 and 269—

(a) the scheme's home State is the EEA State in which the scheme is constituted (within the meaning given by section 264);

(b) the competent authorities in the scheme's home State are the authorities in that State who are responsible for the authorisation of collective investment schemes.

(8) "Scheme" means a scheme which is a recognised scheme by virtue of section 264.

(9) "Specified", in relation to a direction, means specified in it.

Procedure on giving directions under section 267 and varying them on Authority's own initiative.

268.—(1) A direction under section 267 takes effect—

(a) immediately, if the notice given under subsection (3)(a) states that that is the case;

(b) on such date as may be specified in the notice; or

(c) if no date is specified in the notice, when the matter to which it relates is no longer open to review.

(2) A direction may be expressed to take effect immediately (or on a specified date) only if the Authority, having regard to its reasons for exercising its power under section 267, considers that it is necessary for the direction to take effect immediately (or on that date).

(3) If the Authority proposes to give a direction under section 267, or gives such a direction with immediate effect, it must—

(a) give the operator of the scheme concerned written notice; and

(b) inform the competent authorities in the scheme's home State of its proposal or (as the case may be) of the direction.

(4) The notice must—

(a) give details of the direction;

(b) inform the operator of when the direction takes effect;

(c) state the Authority's reasons for giving the direction and for its determination as to when the direction takes effect;

(d) inform the operator that he may make representations to the Authority within such period as may be specified in it (whether or not he has referred the matter to the Tribunal); and

(e) inform him of his right to refer the matter to the Tribunal.

(5) The Authority may extend the period allowed under the notice for making representations.

(6) Subsection (7) applies if, having considered any representations made by the operator, the Authority decides—

(a) to give the direction in the way proposed, or

(b) if it has been given, not to revoke the direction.

(7) The Authority must—

(a) give the operator of the scheme concerned written notice; and

(b) inform the competent authorities in the scheme's home State of the direction.

(8) Subsection (9) applies if, having considered any representations made by a person to whom the notice was given, the Authority decides—

(a) not to give the direction in the way proposed,

(b) to give the direction in a way other than that proposed, or

(c) to revoke a direction which has effect.

(9) The Authority must—

(a) give the operator of the scheme concerned written notice; and

(b) inform the competent authorities in the scheme's home State of its decision.

(10) A notice given under subsection (7)(a) must inform the operator of his right to refer the matter to the Tribunal.

(11) A notice under subsection (9)(a) given as a result of subsection (8)(b) must comply with subsection (4).

(12) If a notice informs a person of his right to refer a matter to the Tribunal, it must give an indication of the procedure on such a reference.

(13) This section applies to the variation of a direction on the Authority's own initiative as it applies to the giving of a direction.

(14) For the purposes of subsection (1)(c), whether a matter is open to review is to be determined in accordance with section 391(8).

Procedure on application for variation or revocation of direction.

269.—(1) If, on an application under subsection (4) or (5) of section 267, the Authority proposes—

(a) to vary a direction otherwise than in accordance with the application, or

(b) to refuse the application,

it must give the operator of the scheme concerned a warning notice.

(2) If, on such an application, the Authority decides—

(a) to vary a direction otherwise than in accordance with the application, or

(b) to refuse the application,

it must give the operator of the scheme concerned a decision notice.

(3) If the application is refused, the operator of the scheme may refer the matter to the Tribunal.

(4) If, on such an application, the Authority decides to grant the application it must give the operator of the scheme concerned written notice.

(5) If the Authority decides on its own initiative to revoke a direction given under section 267 it must give the operator of the scheme concerned written notice.

(6) The Authority must inform the competent authorities in the scheme's home State of any notice given under this section.

Schemes authorised in designated countries or territories

Schemes authorised in designated countries or territories.

270.—(1) A collective investment scheme which is not a recognised scheme by virtue of section 264 but is managed in, and authorised under the law of, a country or territory outside the United Kingdom is a recognised scheme if—

(a) that country or territory is designated for the purposes of this section by an order made by the Treasury;

(b) the scheme is of a class specified by the order;

(c) the operator of the scheme has given written notice to the Authority that he wishes it to be recognised; and

(d) either—

(i) the Authority, by written notice, has given its approval to the scheme's being recognised; or

(ii) two months, beginning with the date on which notice was given under paragraph (c), have expired without the operator receiving a warning notice from the Authority under section 271.

(2) The Treasury may not make an order designating any country or territory for the purposes of this section unless satisfied—

(a) that the law and practice under which relevant collective investment schemes are authorised and supervised in that country or territory affords to investors in the United Kingdom protection at least equivalent to that provided for them by or under this Part in the case of comparable authorised schemes; and

(b) that adequate arrangements exist, or will exist, for co-operation between the authorities of the country or territory responsible for the authorisation and supervision of relevant collective investment schemes and the Authority.

(3) "Relevant collective investment schemes" means collective investment schemes of the class or classes to be specified by the order.

(4) "Comparable authorised schemes" means whichever of the following the Treasury consider to be the most appropriate, having regard to the class or classes of scheme to be specified by the order—

(a) authorised unit trust schemes;

(b) authorised open-ended investment companies;

(c) both such unit trust schemes and such companies.

(5) If the Treasury are considering whether to make an order designating a country or territory for the purposes of this section—

(a) the Treasury must ask the Authority for a report—

(i) on the law and practice of that country or territory in relation to the authorisation and supervision of relevant collective investment schemes,

(ii) on any existing or proposed arrangements for co-operation between it and the authorities responsible in that country or territory for the authorisation and supervision of relevant collective investment schemes,

having regard to the Treasury's need to be satisfied as mentioned in subsection (2);

(b) the Authority must provide the Treasury with such a report; and

(c) the Treasury must have regard to it in deciding whether to make the order.

(6) The notice to be given by the operator under subsection (1)(c)—

(a) must contain the address of a place in the United Kingdom for the service on the operator of notices or other documents required or authorised to be served on him under this Act; and

(b) must contain or be accompanied by such information and documents as may be specified by the Authority.

Procedure.

271.—(1) If the Authority proposes to refuse approval of a scheme's being a recognised scheme by virtue of section 270, it must give the operator of the scheme a warning notice.

(2) To be valid the warning notice must be received by the operator before the end of two months beginning with the date on which notice was given under section 270(1)(c).

(3) If, having given a warning notice, the Authority decides to refuse approval—

(a) it must give the operator of the scheme a decision notice; and

(b) the operator may refer the matter to the Tribunal.

Individually recognised overseas schemes

Individually recognised overseas schemes.

272.—(1) The Authority may, on the application of the operator of a collective investment scheme which—

(a) is managed in a country or territory outside the United Kingdom,

(b) does not satisfy the requirements prescribed for the purposes of section 264,

(c) is not managed in a country or territory designated for the purposes of section 270 or, if it is so managed, is of a class not specified by the designation order, and

(d) appears to the Authority to satisfy the requirements set out in the following provisions of this section,

make an order declaring the scheme to be a recognised scheme.

(2) Adequate protection must be afforded to participants in the scheme.

(3) The arrangements for the scheme's constitution and management must be adequate.

(4) The powers and duties of the operator and, if the scheme has a trustee or depositary, of the trustee or depositary must be adequate.

(5) In deciding whether the matters mentioned in subsection (3) or (4) are adequate, the Authority must have regard to—

(a) any rule of law, and

(b) any matters which are, or could be, the subject of rules,

applicable in relation to comparable authorised schemes.

(6) "Comparable authorised schemes" means whichever of the following the Authority considers the most appropriate, having regard to the nature of scheme in respect of which the application is made—

(a) authorised unit trust schemes;

(b) authorised open-ended investment companies;

(c) both such unit trust schemes and such companies.

(7) The scheme must take the form of an open-ended investment company or (if it does not take that form) the operator must be a body corporate.

(8) The operator of the scheme must—

(a) if an authorised person, have permission to act as operator;

(b) if not an authorised person, be a fit and proper person to act as operator.

(9) The trustee or depositary (if any) of the scheme must—

(a) if an authorised person, have permission to act as trustee or depositary;

(b) if not an authorised person, be a fit and proper person to act as trustee or depositary.

(10) The operator and the trustee or depositary (if any) of the scheme must be able and willing to co-operate with the Authority by the sharing of information and in other ways.

(11) The name of the scheme must not be undesirable or misleading.

(12) The purposes of the scheme must be reasonably capable of being successfully carried into effect.

(13) The participants must be entitled to have their units redeemed in accordance with the scheme at a price related to the net value of the property to which the units relate and determined in accordance with the scheme.

(14) But a scheme is to be treated as complying with subsection (13) if it requires the operator to ensure that a participant is able to sell his units on an investment exchange at a price not significantly different from that mentioned in that subsection.

(15) Subsection (13) is not to be read as imposing a requirement that the participants must be entitled to have their units redeemed (or sold as mentioned in subsection (14)) immediately following a demand to that effect.

Matters that may be taken into account.

273. For the purposes of subsections (8)(b) and (9)(b) of section 272, the Authority may take into account any matter relating to—

(a) any person who is or will be employed by or associated with the operator, trustee or depositary in connection with the scheme;

(b) any director of the operator, trustee or depositary;

(c) any person exercising influence over the operator, trustee or depositary;

(d) any body corporate in the same group as the operator, trustee or depositary;

(e) any director of any such body corporate;

(f) any person exercising influence over any such body corporate.

Applications for recognition of individual schemes.

274.—(1) An application under section 272 for an order declaring a scheme to be a recognised scheme must be made to the Authority by the operator of the scheme.

(2) The application—

(a) must be made in such manner as the Authority may direct;

(b) must contain the address of a place in the United Kingdom for the service on the operator of notices or other documents required or authorised to be served on him under this Act;

(c) must contain or be accompanied by such information as the Authority may reasonably require for the purpose of determining the application.

(3) At any time after receiving an application and before determining it, the Authority may require the applicant to provide it with such further information as it reasonably considers necessary to enable it to determine the application.

(4) Different directions may be given, and different requirements imposed, in relation to different applications.

(5) The Authority may require an applicant to present information which he is required to give under this section in such form, or to verify it in such a way, as the Authority may direct.

Determination of applications.

275.—(1) An application under section 272 must be determined by the Authority before the end of the period of six months beginning with the date on which it receives the completed application.

(2) The Authority may determine an incomplete application if it considers it appropriate to do so; and it must in any event determine such an application within twelve months beginning with the date on which it first receives the application.

(3) If the Authority makes an order under section 272(1), it must give written notice of the order to the applicant.

Procedure when refusing an application.

276.—(1) If the Authority proposes to refuse an application made under section 272 it must give the applicant a warning notice.

(2) If the Authority decides to refuse the application—

(a) it must give the applicant a decision notice; and

(b) the applicant may refer the matter to the Tribunal.

Alteration of schemes and changes of operator, trustee or depositary.

277.—(1) The operator of a scheme recognised by virtue of section 272 must give written notice to the Authority of any proposed alteration to the scheme.

(2) Effect is not to be given to any such proposal unless—

(a) the Authority, by written notice, has given its approval to the proposal; or

(b) one month, beginning with the date on which notice was given under subsection (1), has expired without the Authority having given written notice to the operator that it has decided to refuse approval.

(3) At least one month before any replacement of the operator, trustee or depositary of such a scheme, notice of the proposed replacement must be given to the Authority—

(a) by the operator, trustee or depositary (as the case may be); or

(b) by the person who is to replace him.

Schemes recognised under sections 270 and 272

Rules as to scheme particulars.

278. The Authority may make rules imposing duties or liabilities on the operator of a scheme recognised under section 270 or 272 for purposes corresponding to those for which rules may be made under section 248 in relation to authorised unit trust schemes.

Revocation of recognition.

279. The Authority may direct that a scheme is to cease to be recognised by virtue of section 270 or revoke an order under section 272 if it appears to the Authority—

(a) that the operator, trustee or depositary of the scheme has contravened a requirement imposed on him by or under this Act;

(b) that the operator, trustee or depositary of the scheme has, in purported compliance with any such requirement, knowingly or recklessly given the Authority information which is false or misleading in a material particular;

(c) in the case of an order under section 272, that one or more of the requirements for the making of the order are no longer satisfied; or

(d) that none of paragraphs (a) to (c) applies, but it is undesirable in the interests of the participants or potential participants that the scheme should continue to be recognised.

Procedure.

280.—(1) If the Authority proposes to give a direction under section 279 or to make an order under that section revoking a recognition order, it must give a warning notice to the operator and (if any) the trustee or depositary of the scheme.

(2) If the Authority decides to give a direction or make an order under that section—

(a) it must without delay give a decision notice to the operator and (if any) the trustee or depositary of the scheme; and

(b) the operator or the trustee or depositary may refer the matter to the Tribunal.

Directions.

281.—(1) In this section a "relevant recognised scheme" means a scheme recognised under section 270 or 272.

(2) If it appears to the Authority that—

(a) the operator, trustee or depositary of a relevant recognised scheme has contravened, or is likely to contravene, a requirement imposed on him by or under this Act,

(b) the operator, trustee or depositary of such a scheme has, in purported compliance with any such requirement, knowingly or recklessly given the Authority information which is false or misleading in a material particular,

(c) one or more of the requirements for the recognition of a scheme under section 272 are no longer satisfied, or

(d) none of paragraphs (a) to (c) applies, but the exercise of the power conferred by this section is desirable in order to protect the interests of participants or potential participants in a relevant recognised scheme who are in the United Kingdom,

it may direct that the scheme is not to be a recognised scheme for a specified period or until the occurrence of a specified event or until specified conditions are complied with.

Procedure on giving directions under section 281 and varying them otherwise than as requested.

282.—(1) A direction takes effect—

(a) immediately, if the notice given under subsection (3) states that that is the case;

(b) on such date as may be specified in the notice; or

(c) if no date is specified in the notice, when the matter to which it relates is no longer open to review.

(2) A direction may be expressed to take effect immediately (or on a specified date) only if the Authority, having regard to the ground on which it is exercising its power under section 281, considers that it is necessary for the direction to take effect immediately (or on that date).

(3) If the Authority proposes to give a direction under section 281, or gives such a direction with immediate effect, it must give separate written notice to the operator and (if any) the trustee or depositary of the scheme concerned.

(4) The notice must—

(a) give details of the direction;

(b) inform the person to whom it is given of when the direction takes effect;

(c) state the Authority's reasons for giving the direction and for its determination as to when the direction takes effect;

(d) inform the person to whom it is given that he may make representations to the Authority within such period as may be specified in it (whether or not he has referred the matter to the Tribunal); and

(e) inform him of his right to refer the matter to the Tribunal.

(5) The Authority may extend the period allowed under the notice for making representations.

(6) If, having considered any representations made by a person to whom the notice was given, the Authority decides—

(a) to give the direction in the way proposed, or

(b) if it has been given, not to revoke the direction,

it must give separate written notice to the operator and (if any) the trustee or depositary of the scheme concerned.

(7) If, having considered any representations made by a person to whom the notice was given, the Authority decides—

(a) not to give the direction in the way proposed,

(b) to give the direction in a way other than that proposed, or

(c) to revoke a direction which has effect,

it must give separate written notice to the operator and (if any) the trustee or depositary of the scheme concerned.

(8) A notice given under subsection (6) must inform the person to whom it is given of his right to refer the matter to the Tribunal.

(9) A notice under subsection (7)(b) must comply with subsection (4).

(10) If a notice informs a person of his right to refer a matter to the Tribunal, it must give an indication of the procedure on such a reference.

(11) This section applies to the variation of a direction on the Authority's own initiative as it applies to the giving of a direction.

(12) For the purposes of subsection (1)(c), whether a matter is open to review is to be determined in accordance with section 391(8).

Facilities and information in UK

Facilities and information in UK.

283.—(1) The Authority may make rules requiring operators of recognised schemes to maintain in the United Kingdom, or in such part or parts of it as may be specified, such facilities as the Authority thinks desirable in the interests of participants and as are specified in rules.

(2) The Authority may by notice in writing require the operator of any recognised scheme to include such explanatory information as is specified in the notice in any communication of his which—

(a) is a communication of an invitation or inducement of a kind mentioned in section 21(1); and

(b) names the scheme.

(3) In the case of a communication originating outside the United Kingdom, subsection (2) only applies if the communication is capable of having an effect in the United Kingdom.

CHAPTER VI

INVESTIGATIONS

Power to investigate.

284.—(1) An investigating authority may appoint one or more competent persons to investigate on its behalf—

(a) the affairs of, or of the manager or trustee of, any authorised unit trust scheme,

(b) the affairs of, or of the operator, trustee or depositary of, any recognised scheme so far as relating to activities carried on in the United Kingdom, or

(c) the affairs of, or of the operator, trustee or depositary of, any other collective investment scheme except a body incorporated by virtue of regulations under section 262,

if it appears to the investigating authority that it is in the interests of the participants or potential participants to do so or that the matter is of public concern.

(2) A person appointed under subsection (1) to investigate the affairs of, or of the manager, trustee, operator or depositary of, any scheme (scheme "A"), may also, if he thinks it necessary for the purposes of that investigation, investigate—

(a) the affairs of, or of the manager, trustee, operator or depositary of, any other such scheme as is mentioned in subsection (1) whose manager, trustee, operator or depositary is the same person as the manager, trustee, operator or depositary of scheme A;

(b) the affairs of such other schemes and persons (including bodies incorporated by virtue of regulations under section 262 and the directors and depositaries of such bodies) as may be prescribed.

(3) If the person appointed to conduct an investigation under this section ("B") considers that a person ("C") is or may be able to give information which is relevant to the investigation, B may require C—

(a) to produce to B any documents in C's possession or under his control which appear to B to be relevant to the investigation,

(b) to attend before B, and

(c) otherwise to give B all assistance in connection with the investigation which C is reasonably able to give,

and it is C's duty to comply with that requirement.

(4) Subsections (5) to (9) of section 170 apply if an investigating authority appoints a person under this section to conduct an investigation on its behalf as they apply in the case mentioned in subsection (1) of that section.

(5) Section 174 applies to a statement made by a person in compliance with a requirement imposed under this section as it applies to a statement mentioned in that section.

(6) Subsections (2) to (4) and (6) of section 175 and section 177 have effect as if this section were contained in Part XI.

(7) Subsections (1) to (9) of section 176 apply in relation to a person appointed under subsection (1) as if—

(a) references to an investigator were references to a person so appointed;

(b) references to an information requirement were references to a requirement imposed under section 175 or under subsection (3) by a person so appointed;

(c) the premises mentioned in subsection (3)(a) were the premises of a person whose affairs are the subject of an investigation under this section or of an appointed representative of such a person.

(8) No person may be required under this section to disclose information or produce a document in respect of which he owes an obligation of confidence by virtue of carrying on the business of banking unless subsection (9) or (10) applies.

(9) This subsection applies if—

(a) the person to whom the obligation of confidence is owed consents to the disclosure or production; or

(b) the imposing on the person concerned of a requirement with respect to information or a document of a kind mentioned in subsection (8) has been specifically authorised by the investigating authority.

(10) This subsection applies if the person owing the obligation of confidence or the person to whom it is owed is—

(a) the manager, trustee, operator or depositary of any collective investment scheme which is under investigation;

(b) the director of a body incorporated by virtue of regulations under section 262 which is under investigation;

(c) any other person whose own affairs are under investigation.

(11) "Investigating authority" means the Authority or the Secretary of State.

PART XVIII

RECOGNISED INVESTMENT EXCHANGES AND CLEARING HOUSES

CHAPTER I

EXEMPTION

General

Exemption for recognised investment exchanges and clearing houses.

285.—(1) In this Act—

(a) "recognised investment exchange" means an investment exchange in relation to which a recognition order is in force; and

(b) "recognised clearing house" means a clearing house in relation to which a recognition order is in force.

(2) A recognised investment exchange is exempt from the general prohibition as respects any regulated activity—

(a) which is carried on as a part of the exchange's business as an investment exchange; or

(b) which is carried on for the purposes of, or in connection with, the provision of clearing services by the exchange.

(3) A recognised clearing house is exempt from the general prohibition as respects any regulated activity which is carried on for the purposes of, or in connection with, the provision of clearing services by the clearing house.

Qualification for recognition.

286.—(1) The Treasury may make regulations setting out the requirements—

(a) which must be satisfied by an investment exchange or clearing house if it is to qualify as a body in respect of which the Authority may make a recognition order under this Part; and

(b) which, if a recognition order is made, it must continue to satisfy if it is to remain a recognised body.

(2) But if regulations contain provision as to the default rules of an investment exchange or clearing house, or as to proceedings taken under such rules by such a body, they require the approval of the Secretary of State.

(3) "Default rules" means rules of an investment exchange or clearing house which provide for the taking of action in the event of a person's appearing to be unable, or likely to become unable, to meet his obligations in respect of one or more market contracts connected with the exchange or clearing house.

(4) "Market contract" means—

1989 c. 40.

S.I. 1990/1504 (N.I. 10).

(a) a contract to which Part VII of the Companies Act 1989 applies as a result of section 155 of that Act or a contract to which Part V of the Companies (No. 2)(Northern Ireland) Order 1990 applies as a result of Article 80 of that Order; and

(b) such other kind of contract as may be prescribed.

(5) Requirements resulting from this section are referred to in this Part as "recognition requirements".

Applications for recognition

Application by an investment exchange.

287.—(1) Any body corporate or unincorporated association may apply to the Authority for an order declaring it to be a recognised investment exchange for the purposes of this Act.

(2) The application must be made in such manner as the Authority may direct and must be accompanied by—

(a) a copy of the applicant's rules;

(b) a copy of any guidance issued by the applicant;

(c) the required particulars; and

(d) such other information as the Authority may reasonably require for the purpose of determining the application.

(3) The required particulars are—

(a) particulars of any arrangements which the applicant has made, or proposes to make, for the provision of clearing services in respect of transactions effected on the exchange;

(b) if the applicant proposes to provide clearing services in respect of transactions other than those effected on the exchange, particulars of the criteria which the applicant will apply when determining to whom it will provide those services.

Application by a clearing house.

288.—(1) Any body corporate or unincorporated association may apply to the Authority for an order declaring it to be a recognised clearing house for the purposes of this Act.

(2) The application must be made in such manner as the Authority may direct and must be accompanied by—

(a) a copy of the applicant's rules;

(b) a copy of any guidance issued by the applicant;

(c) the required particulars; and

(d) such other information as the Authority may reasonably require for the purpose of determining the application.

(3) The required particulars are—

(a) if the applicant makes, or proposes to make, clearing arrangements with a recognised investment exchange, particulars of those arrangements;

(b) if the applicant proposes to provide clearing services for persons other than recognised investment exchanges, particulars of the criteria which it will apply when determining to whom it will provide those services.

Applications: supplementary.

289.—(1) At any time after receiving an application and before determining it, the Authority may require the applicant to provide such further information as it reasonably considers necessary to enable it to determine the application.

(2) Information which the Authority requires in connection with an application must be provided in such form, or verified in such manner, as the Authority may direct.

(3) Different directions may be given, or requirements imposed, by the Authority with respect to different applications.

Recognition orders.

290.—(1) If it appears to the Authority that the applicant satisfies the recognition requirements applicable in its case, the Authority may make a recognition order declaring the applicant to be—

(a) a recognised investment exchange, if the application is made under section 287;

(b) a recognised clearing house, if it is made under section 288.

(2) The Treasury's approval of the making of a recognition order is required under section 307.

(3) In considering an application, the Authority may have regard to any information which it considers is relevant to the application.

(4) A recognition order must specify a date on which it is to take effect.

(5) Section 298 has effect in relation to a decision to refuse to make a recognition order—

(a) as it has effect in relation to a decision to revoke such an order; and

(b) as if references to a recognised body were references to the applicant.

(6) Subsection (5) does not apply in a case in which the Treasury have failed to give their approval under section 307.

Liability in relation to recognised body's regulatory functions.

291.—(1) A recognised body and its officers and staff are not to be liable in damages for anything done or omitted in the discharge of the recognised body's regulatory functions unless it is shown that the act or omission was in bad faith.

(2) But subsection (1) does not prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998.

1998 c. 42.

(3) "Regulatory functions" means the functions of the recognised body so far as relating to, or to matters arising out of, the obligations to which the body is subject under or by virtue of this Act.

Overseas investment exchanges and overseas clearing houses.

292.—(1) An application under section 287 or 288 by an overseas applicant must contain the address of a place in the United Kingdom for the service on the applicant of notices or other documents required or authorised to be served on it under this Act.

(2) If it appears to the Authority that an overseas applicant satisfies the requirements of subsection (3) it may make a recognition order declaring the applicant to be—

(a) a recognised investment exchange;

(b) a recognised clearing house.

(3) The requirements are that—

(a) investors are afforded protection equivalent to that which they would be afforded if the body concerned were required to comply with recognition requirements;

(b) there are adequate procedures for dealing with a person who is unable, or likely to become unable, to meet his obligations in respect of one or more market contracts connected with the investment exchange or clearing house;

(c) the applicant is able and willing to co-operate with the Authority by the sharing of information and in other ways;

(d) adequate arrangements exist for co-operation between the Authority and those responsible for the supervision of the applicant in the country or territory in which the applicant's head office is situated.

(4) In considering whether it is satisfied as to the requirements mentioned in subsection (3)(a) and (b), the Authority is to have regard to—

(a) the relevant law and practice of the country or territory in which the applicant's head office is situated;

(b) the rules and practices of the applicant.

(5) In relation to an overseas applicant and a body or association declared to be a recognised investment exchange or recognised clearing house by a recognition order made by virtue of subsection (2)—

(a) the reference in section 313(2) to recognition requirements is to be read as a reference to matters corresponding to the matters in respect of which provision is made in the recognition requirements;

(b) sections 296(1) and 297(2) have effect as if the requirements mentioned in section 296(1)(a) and section 297(2)(a) were those of subsection (3)(a), (b), and (c) of this section;

(c) section 297(2) has effect as if the grounds on which a recognition order may be revoked under that provision included the ground that in the opinion of the Authority arrangements of the kind mentioned in subsection (3)(d) no longer exist.

Supervision

Notification requirements.

293.—(1) The Authority may make rules requiring a recognised body to give it—

(a) notice of such events relating to the body as may be specified; and

(b) such information in respect of those events as may be specified.

(2) The rules may also require a recognised body to give the Authority, at such times or in respect of such periods as may be specified, such information relating to the body as may be specified.

(3) An obligation imposed by the rules extends only to a notice or information which the Authority may reasonably require for the exercise of its functions under this Act.

(4) The rules may require information to be given in a specified form and to be verified in a specified manner.

(5) If a recognised body—

(a) alters or revokes any of its rules or guidance, or

(b) makes new rules or issues new guidance,

it must give written notice to the Authority without delay.

(6) If a recognised investment exchange makes a change—

(a) in the arrangements it makes for the provision of clearing services in respect of transactions effected on the exchange, or

(b) in the criteria which it applies when determining to whom it will provide clearing services,

it must give written notice to the Authority without delay.

(7) If a recognised clearing house makes a change—

(a) in the recognised investment exchanges for whom it provides clearing services, or

(b) in the criteria which it applies when determining to whom (other than recognised investment exchanges) it will provide clearing services,

it must give written notice to the Authority without delay.

(8) Subsections (5) to (7) do not apply to an overseas investment exchange or an overseas clearing house.

(9) "Specified" means specified in the Authority's rules.

Modification or waiver of rules.

294.—(1) The Authority may, on the application or with the consent of a recognised body, direct that rules made under section 293 or 295—

(a) are not to apply to the body; or

(b) are to apply to the body with such modifications as may be specified in the direction.

(2) An application must be made in such manner as the Authority may direct.

(3) Subsections (4) to (6) apply to a direction given under subsection (1).

(4) The Authority may not give a direction unless it is satisfied that—

(a) compliance by the recognised body with the rules, or with the rules as unmodified, would be unduly burdensome or would not achieve the purpose for which the rules were made; and

(b) the direction would not result in undue risk to persons whose interests the rules are intended to protect.

(5) A direction may be given subject to conditions.

(6) The Authority may—

(a) revoke a direction; or

(b) vary it on the application, or with the consent, of the recognised body to which it relates.

Notification: overseas investment exchanges and overseas clearing houses.

295.—(1) At least once a year, every overseas investment exchange and overseas clearing house must provide the Authority with a report.

(2) The report must contain a statement as to whether any events have occurred which are likely—

(a) to affect the Authority's assessment of whether it is satisfied as to the requirements set out in section 292(3); or

(b) to have any effect on competition.

(3) The report must also contain such information as may be specified in rules made by the Authority.

(4) The investment exchange or clearing house must provide the Treasury and the Director with a copy of the report.

Authority's power to give directions.

296.—(1) This section applies if it appears to the Authority that a recognised body—

(a) has failed, or is likely to fail, to satisfy the recognition requirements; or

(b) has failed to comply with any other obligation imposed on it by or under this Act.

(2) The Authority may direct the body to take specified steps for the purpose of securing the body's compliance with—

(a) the recognition requirements; or

(b) any obligation of the kind in question.

(3) A direction under this section is enforceable, on the application of the Authority, by an injunction or, in Scotland, by an order for specific performance under section 45 of the Court of Session Act 1988.

1988 c. 36.

(4) The fact that a rule made by a recognised body has been altered in response to a direction given by the Authority does not prevent it from being subsequently altered or revoked by the recognised body.

Revoking recognition.

297.—(1) A recognition order may be revoked by an order made by the Authority at the request, or with the consent, of the recognised body concerned.

(2) If it appears to the Authority that a recognised body—

(a) is failing, or has failed, to satisfy the recognition requirements, or

(b) is failing, or has failed, to comply with any other obligation imposed on it by or under this Act,

it may make an order revoking the recognition order for that body even though the body does not wish the order to be made.

(3) An order under this section ("a revocation order") must specify the date on which it is to take effect.

(4) In the case of a revocation order made under subsection (2), the specified date must not be earlier than the end of the period of three months beginning with the day on which the order is made.

(5) A revocation order may contain such transitional provisions as the Authority thinks necessary or expedient.

Directions and revocation: procedure.

298.—(1) Before giving a direction under section 296, or making a revocation order under section 297(2), the Authority must—

(a) give written notice of its intention to do so to the recognised body concerned;

(b) take such steps as it considers reasonably practicable to bring the notice to the attention of members (if any) of that body; and

(c) publish the notice in such manner as it thinks appropriate for bringing it to the attention of other persons who are, in its opinion, likely to be affected.

(2) A notice under subsection (1) must—

(a) state why the Authority intends to give the direction or make the order; and

(b) draw attention to the right to make representations conferred by subsection (3).

(3) Before the end of the period for making representations—

(a) the recognised body,

(b) any member of that body, and

(c) any other person who is likely to be affected by the proposed direction or revocation order,

may make representations to the Authority.

(4) The period for making representations is—

(a) two months beginning—

(i) with the date on which the notice is served on the recognised body; or

(ii) if later, with the date on which the notice is published; or

(b) such longer period as the Authority may allow in the particular case.

(5) In deciding whether to—

(a) give a direction, or

(b) make a revocation order,

the Authority must have regard to any representations made in accordance with subsection (3).

(6) When the Authority has decided whether to give a direction under section 296 or to make the proposed revocation order, it must—

(a) give the recognised body written notice of its decision; and

(b) if it has decided to give a direction or make an order, take such steps as it considers reasonably practicable for bringing its decision to the attention of members of the body or of other persons who are, in the Authority's opinion, likely to be affected.

(7) If the Authority considers it essential to do so, it may give a direction under section 296—

(a) without following the procedure set out in this section; or

(b) if the Authority has begun to follow that procedure, regardless of whether the period for making representations has expired.

(8) If the Authority has, in relation to a particular matter, followed the procedure set out in subsections (1) to (5), it need not follow it again if, in relation to that matter, it decides to take action other than that specified in its notice under subsection (1).

Complaints about recognised bodies.

299.—(1) The Authority must make arrangements for the investigation of any relevant complaint about a recognised body.

(2) "Relevant complaint" means a complaint which the Authority considers is relevant to the question of whether the body concerned should remain a recognised body.

Extension of functions of Tribunal.

300.—(1) If the Treasury are satisfied that the condition mentioned in subsection (2) is satisfied, they may by order confer functions on the Tribunal with respect to disciplinary proceedings—

(a) of one or more investment exchanges in relation to which a recognition order under section 290 is in force or of such investment exchanges generally, or

(b) of one or more clearing houses in relation to which a recognition order under that section is in force or of such clearing houses generally.

(2) The condition is that it is desirable to exercise the power conferred under subsection (1) with a view to ensuring that—

(a) decisions taken in disciplinary proceedings with respect to which functions are to be conferred on the Tribunal are consistent with—

(i) decisions of the Tribunal in cases arising under Part VIII; and

(ii) decisions taken in other disciplinary proceedings with respect to which the Tribunal has functions as a result of an order under this section; or

(b) the disciplinary proceedings are in accordance with the Convention rights.

(3) An order under this section may modify or exclude any provision made by or under this Act with respect to proceedings before the Tribunal.

(4) "Disciplinary proceedings" means proceedings under the rules of an investment exchange or clearing house in relation to market abuse by persons subject to the rules.

(5) "The Convention rights" has the meaning given in section 1 of the Human Rights Act 1998. 1998 c. 42.

Other matters

Supervision of certain contracts.

301.—(1) The Secretary of State and the Treasury, acting jointly, may by regulations provide for—

(a) Part VII of the Companies Act 1989 (financial markets and insolvency), and 1989 c. 40.

(b) Part V of the Companies (No. 2)(Northern Ireland) Order 1990, S.I. 1990/1504 (N.I. 10).

to apply to relevant contracts as it applies to contracts connected with a recognised body.

(2) "Relevant contracts" means contracts of a prescribed description in relation to which settlement arrangements are provided by a person for the time being included in a list ("the list") maintained by the Authority for the purposes of this section.

(3) Regulations may be made under this section only if the Secretary of State and the Treasury are satisfied, having regard to the extent to which the relevant contracts concerned are contracts of a kind dealt in by persons supervised by the Authority, that it is appropriate for the arrangements mentioned in subsection (2) to be supervised by the Authority.

(4) The approval of the Treasury is required for—

(a) the conditions set by the Authority for admission to the list; and

(b) the arrangements for admission to, and removal from, the list.

(5) If the Treasury withdraw an approval given by them under subsection (4), all regulations made under this section and then in force are to be treated as suspended.

(6) But if—

(a) the Authority changes the conditions or arrangements (or both), and

(b) the Treasury give a fresh approval under subsection (4),

the suspension of the regulations ends on such date as the Treasury may, in giving the fresh approval, specify.

(7) The Authority must—

(a) publish the list as for the time being in force; and

(b) provide a certified copy of it to any person who wishes to refer to it in legal proceedings.

(8) A certified copy of the list is evidence (or in Scotland sufficient evidence) of the contents of the list.

(9) A copy of the list which purports to be certified by or on behalf of the Authority is to be taken to have been duly certified unless the contrary is shown.

(10) Regulations under this section may, in relation to a person included in the list—

(a) apply (with such exceptions, additions and modifications as appear to the Secretary of State and the Treasury to be necessary or expedient) such provisions of, or made under, this Act as they consider appropriate;

1989 c. 40. S.I. 1990/1504 (N.I. 10).

(b) provide for the provisions of Part VII of the Companies Act 1989 and Part V of the Companies (No. 2)(Northern Ireland) Order 1990 to apply (with such exceptions, additions or modifications as appear to the Secretary of State and the Treasury to be necessary or expedient).

CHAPTER II

COMPETITION SCRUTINY

Interpretation.

302.—(1) In this Chapter and Chapter III—

"practices" means—

(a) in relation to a recognised investment exchange, the practices of the exchange in its capacity as such; and

(b) in relation to a recognised clearing house, the practices of the clearing house in respect of its clearing arrangements;

"regulatory provisions" means—

(a) the rules of an investment exchange or a clearing house;

(b) any guidance issued by an investment exchange or clearing house;

(c) in the case of an investment exchange, the arrangements and criteria mentioned in section 287(3);

(d) in the case of a clearing house, the arrangements and criteria mentioned in section 288(3).

(2) For the purposes of this Chapter, regulatory provisions or practices have a significantly adverse effect on competition if—

(a) they have, or are intended or likely to have, that effect; or

(b) the effect that they have, or are intended or likely to have, is to require or encourage behaviour which has, or is intended or likely to have, a significantly adverse effect on competition.

(3) If regulatory provisions or practices have, or are intended or likely to have, the effect of requiring or encouraging exploitation of the strength of a market position they are to be taken, for the purposes of this Chapter, to have an adverse effect on competition.

(4) In determining under this Chapter whether any regulatory provisions have, or are intended or likely to have, a particular effect, it may be assumed that persons to whom the provisions concerned are addressed will act in accordance with them.

Role of Director General of Fair Trading

Initial report by Director.

303.—(1) The Authority must send to the Treasury and to the Director a copy of any regulatory provisions with which it is provided on an application for recognition under section 287 or 288.

(2) The Authority must send to the Director such information in its possession as a result of the application for recognition as it considers will assist him in discharging his functions in connection with the application.

(3) The Director must issue a report as to whether—

(a) a regulatory provision of which a copy has been sent to him under subsection (1) has a significantly adverse effect on competition; or

(b) a combination of regulatory provisions so copied to him have such an effect.

(4) If the Director's conclusion is that one or more provisions have a significantly adverse effect on competition, he must state his reasons for that conclusion.

(5) When the Director issues a report under subsection (3), he must send a copy of it to the Authority, the Competition Commission and the Treasury.

Further reports by Director.

304.—(1) The Director must keep under review the regulatory provisions and practices of recognised bodies.

(2) If at any time the Director considers that—

(a) a regulatory provision or practice has a significantly adverse effect on competition, or

(b) regulatory provisions or practices, or a combination of regulating provisions and practices have such an effect,

he must make a report.

(3) If at any time the Director considers that—

(a) a regulatory provision or practice does not have a significantly adverse effect on competition, or

(b) regulatory provisions or practices, or a combination of regulatory provisions and practices do not have any such effect,

he may make a report to that effect.

(4) A report under subsection (2) must contain details of the adverse effect on competition.

(5) If the Director makes a report under subsection (2), he must—

(a) send a copy of it to the Treasury, to the Competition Commission and to the Authority; and

(b) publish it in the way appearing to him to be best calculated to bring it to the attention of the public.

(6) If the Director makes a report under subsection (3)—

(a) he must send a copy of it to the Treasury, to the Competition Commission and to the Authority; and

(b) he may publish it.

(7) Before publishing a report under this section, the Director must, so far as practicable, exclude any matter which relates to the private affairs of a particular individual the publication of which, in the opinion of the Director, would or might seriously and prejudicially affect his interests.

(8) Before publishing such a report, the Director must exclude any matter which relates to the affairs of a particular body the publication of which, in the opinion of the Director, would or might seriously and prejudicially affect its interests.

(9) Subsections (7) and (8) do not apply to the copy of a report which the Director is required to send to the Treasury, the Competition Commission and the Authority under subsection (5)(a) or (6)(a).

(10) For the purposes of the law of defamation, absolute privilege attaches to any report of the Director under this section.

Investigations by Director.

305.—(1) For the purpose of investigating any matter with a view to its consideration under section 303 or 304, the Director may exercise the powers conferred on him by this section.

(2) The Director may by notice in writing require any person to produce to him or to a person appointed by him for the purpose, at a time and place specified in the notice, any document which—

(a) is specified or described in the notice; and

(b) is a document in that person's custody or under his control.

(3) The Director may by notice in writing—

(a) require any person carrying on any business to provide him with such information as may be specified or described in the notice; and

(b) specify the time within which, and the manner and form in which, any such information is to be provided.

(4) A requirement may be imposed under subsection (2) or (3)(a) only in respect of documents or information which relate to any matter relevant to the investigation.

(5) If a person ("the defaulter") refuses, or otherwise fails, to comply with a notice under this section, the Director may certify that fact in writing to the court and the court may enquire into the case.

(6) If, after hearing any witness who may be produced against or on behalf of the defaulter and any statement which may be offered in defence, the court is satisfied that the defaulter did not have a reasonable excuse for refusing or otherwise failing to comply with the notice, the court may deal with the defaulter as if he were in contempt.

(7) In this section, "the court" means—

(a) the High Court; or

(b) in Scotland, the Court of Session.

Role of Competition Commission

Consideration by Competition Commission.

306.—(1) If subsection (2) or (3) applies, the Commission must investigate the matter which is the subject of the Director's report.

(2) This subsection applies if the Director sends to the Competition Commission a report—

(a) issued by him under section 303(3) which concludes that one or more regulatory provisions have a significantly adverse effect on competition, or

(b) made by him under section 304(2).

(3) This subsection applies if the Director asks the Commission to consider a report—

(a) issued by him under section 303(3) which concludes that one or more regulatory provisions do not have a significantly adverse effect on competition, or

(b) made by him under section 304(3).

(4) The Commission must then make its own report on the matter unless it considers that, as a result of a change of circumstances, no useful purpose would be served by a report.

(5) If the Commission decides in accordance with subsection (4) not to make a report, it must make a statement setting out the change of circumstances which resulted in that decision.

(6) A report made under this section must state the Commission's conclusion as to whether—

(a) the regulatory provision or practice which is the subject of the report has a significantly adverse effect on competition, or

(b) the regulatory provisions or practices or combination of regulatory provisions and practices which are the subject of the report have such an effect.

(7) A report under this section stating the Commission's conclusion that there is a significantly adverse effect on competition must also—

(a) state whether the Commission considers that that effect is justified; and

(b) if it states that the Commission considers that it is not justified, state its conclusion as to what action, if any, the Treasury ought to direct the Authority to take.

(8) Subsection (9) applies whenever the Commission is considering, for the purposes of this section, whether a particular adverse effect on competition is justified.

(9) The Commission must ensure, so far as that is reasonably possible, that the conclusion it reaches is compatible with the obligations imposed on the recognised body concerned by or under this Act.

(10) A report under this section must contain such an account of the Commission's reasons for its conclusions as is expedient, in the opinion of the Commission, for facilitating proper understanding of them.

(11) The provisions of Schedule 14 (except paragraph 2(b)) apply for the purposes of this section as they apply for the purposes of section 162.

(12) If the Commission makes a report under this section it must send a copy to the Treasury, the Authority and the Director.

Role of the Treasury

Recognition orders: role of the Treasury.

307.—(1) Subsection (2) applies if, on an application for a recognition order—

(a) the Director makes a report under section 303 but does not ask the Competition Commission to consider it under section 306;

(b) the Competition Commission concludes—

(i) that the applicant's regulatory provisions do not have a significantly adverse effect on competition; or

(ii) that if those provisions do have that effect, the effect is justified.

(2) The Treasury may refuse to approve the making of the recognition order only if they consider that the exceptional circumstances of the case make it inappropriate for them to give their approval.

(3) Subsection (4) applies if, on an application for a recognition order, the Competition Commission concludes—

(a) that the applicant's regulatory provisions have a significantly adverse effect on competition; and

(b) that that effect is not justified.

(4) The Treasury must refuse to approve the making of the recognition order unless they consider that the exceptional circumstances of the case make it inappropriate for them to refuse their approval.

Directions by the Treasury.

308.—(1) This section applies if the Competition Commission makes a report under section 306(4) (other than a report on an application for a recognition order) which states the Commission's conclusion that there is a significantly adverse effect on competition.

(2) If the Commission's conclusion, as stated in the report, is that the adverse effect on competition is not justified, the Treasury must give a remedial direction to the Authority.

(3) But subsection (2) does not apply if the Treasury consider—

(a) that, as a result of action taken by the Authority or the recognised body concerned in response to the Commission's report, it is unnecessary for them to give a direction; or

(b) that the exceptional circumstances of the case make it inappropriate or unnecessary for them to do so.

(4) In considering the action to be specified in a remedial direction, the Treasury must have regard to any conclusion of the Commission included in the report because of section 306(7)(b).

(5) Subsection (6) applies if—

(a) the Commission's conclusion, as stated in its report, is that the adverse effect on competition is justified; but

(b) the Treasury consider that the exceptional circumstances of the case require them to act.

(6) The Treasury may give a direction to the Authority requiring it to take such action—

(a) as they consider to be necessary in the light of the exceptional circumstances of the case; and

(b) as may be specified in the direction.

(7) If the action specified in a remedial direction is the giving by the Authority of a direction—

(a) the direction to be given must be compatible with the recognition requirements applicable to the recognised body in relation to which it is given; and

(b) subsections (3) and (4) of section 296 apply to it as if it were a direction given under that section.

(8) "Remedial direction" means a direction requiring the Authority—

(a) to revoke the recognition order for the body concerned; or

(b) to give such directions to the body concerned as may be specified in it.

Statements by the Treasury.

309.—(1) If, in reliance on subsection (3)(a) or (b) of section 308, the Treasury decline to act under subsection (2) of that section, they must make a statement to that effect, giving their reasons.

(2) If the Treasury give a direction under section 308 they must make a statement giving—

(a) details of the direction; and

(b) if the direction is given under subsection (6) of that section, their reasons for giving it.

(3) The Treasury must—

(a) publish any statement made under this section in the way appearing to them best calculated to bring it to the attention of the public; and

(b) lay a copy of it before Parliament.

Procedure on exercise of certain powers by the Treasury.

310.—(1) Subsection (2) applies if the Treasury are considering—

(a) whether to refuse their approval under section 307;

(b) whether section 308(2) applies; or

(c) whether to give a direction under section 308(6).

(2) The Treasury must—

(a) take such steps as they consider appropriate to allow the exchange or clearing house concerned, and any other person appearing to the Treasury to be affected, an opportunity to make representations—

(i) about any report made by the Director under section 303 or 304 or by the Competition Commission under section 306;

(ii) as to whether, and if so how, the Treasury should exercise their powers under section 307 or 308; and

(b) have regard to any such representations.

CHAPTER III

EXCLUSION FROM THE COMPETITION ACT 1998

The Chapter I prohibition.

311.—(1) The Chapter I prohibition does not apply to an agreement for the constitution of a recognised body to the extent to which the agreement relates to the regulatory provisions of that body.

(2) If the conditions set out in subsection (3) are satisfied, the Chapter I prohibition does not apply to an agreement for the constitution of—

(a) an investment exchange which is not a recognised investment exchange, or

(b) a clearing house which is not a recognised clearing house,

to the extent to which the agreement relates to the regulatory provisions of that body.

(3) The conditions are that—

(a) the body has applied for a recognition order in accordance with the provisions of this Act; and

(b) the application has not been determined.

(4) The Chapter I prohibition does not apply to a recognised body's regulatory provisions.

(5) The Chapter I prohibition does not apply to a decision made by a recognised body to the extent to which the decision relates to any of that body's regulatory provisions or practices.

(6) The Chapter I prohibition does not apply to practices of a recognised body.

(7) The Chapter I prohibition does not apply to an agreement the parties to which consist of or include—

(a) a recognised body, or

(b) a person who is subject to the rules of a recognised body,

to the extent to which the agreement consists of provisions the inclusion of which is required or encouraged by any of the body's regulatory provisions or practices.

(8) If a recognised body's recognition order is revoked, this section is to have effect as if that body had continued to be recognised until the end of the period of six months beginning with the day on which the revocation took effect.

(9) "The Chapter I prohibition" means the prohibition imposed by section 2(1) of the Competition Act 1998.

1998 c. 41.

(10) Expressions used in this section which are also used in Part I of the Competition Act 1998 are to be interpreted in the same way as for the purposes of that Part of that Act.

The Chapter II prohibition.

312.—(1) The Chapter II prohibition does not apply to—

(a) practices of a recognised body;

(b) the adoption or enforcement of such a body's regulatory provisions;

(c) any conduct which is engaged in by such a body or by a person who is subject to the rules of such a body to the extent to which it is encouraged or required by the regulatory provisions of the body.

(2) The Chapter II prohibition means the prohibition imposed by section 18(1) of the Competition Act 1998. 1998 c. 41.

CHAPTER IV

Interpretation

Interpretation of Part XVIII.

313.—(1) In this Part—

"application" means an application for a recognition order made under section 287 or 288;

"applicant" means a body corporate or unincorporated association which has applied for a recognition order;

"Director" means the Director General of Fair Trading;

"overseas applicant" means a body corporate or association which has neither its head office nor its registered office in the United Kingdom and which has applied for a recognition order;

"overseas investment exchange" means a body corporate or association which has neither its head office nor its registered office in the United Kingdom and in relation to which a recognition order is in force;

"overseas clearing house" means a body corporate or association which has neither its head office nor its registered office in the United Kingdom and in relation to which a recognition order is in force;

"recognised body" means a recognised investment exchange or a recognised clearing house;

"recognised clearing house" has the meaning given in section 285;

"recognised investment exchange" has the meaning given in section 285;

"recognition order" means an order made under section 290 or 292;

"recognition requirements" has the meaning given by section 286;

"remedial direction" has the meaning given in section 308(8);

"revocation order" has the meaning given in section 297.

(2) References in this Part to rules of an investment exchange (or a clearing house) are to rules made, or conditions imposed, by the investment exchange (or the clearing house) with respect to—

(a) recognition requirements;

(b) admission of persons to, or their exclusion from the use of, its facilities; or

(c) matters relating to its constitution.

(3) References in this Part to guidance issued by an investment exchange are references to guidance issued, or any recommendation made, in writing or other legible form and intended to have continuing effect, by the investment exchange to—

(a) all or any class of its members or users, or

(b) persons seeking to become members of the investment exchange or to use its facilities,

with respect to any of the matters mentioned in subsection (2)(a) to (c).

(4) References in this Part to guidance issued by a clearing house are to guidance issued, or any recommendation made, in writing or other legible form and intended to have continuing effect, by the clearing house to—

(a) all or any class of its members, or

(b) persons using or seeking to use its services,

with respect to the provision by it or its members of clearing services.

PART XIX

LLOYD'S

General

Authority's general duty.

314.—(1) The Authority must keep itself informed about—

(a) the way in which the Council supervises and regulates the market at Lloyd's; and

(b) the way in which regulated activities are being carried on in that market.

(2) The Authority must keep under review the desirability of exercising—

(a) any of its powers under this Part;

(b) any powers which it has in relation to the Society as a result of section 315.

The Society

The Society: authorisation and permission.

315.—(1) The Society is an authorised person.

(2) The Society has permission to carry on a regulated activity of any of the following kinds—

(a) arranging deals in contracts of insurance written at Lloyd's ("the basic market activity");

(b) arranging deals in participation in Lloyd's syndicates ("the secondary market activity"); and

(c) an activity carried on in connection with, or for the purposes of, the basic or secondary market activity.

(3) For the purposes of Part IV, the Society's permission is to be treated as if it had been given on an application for permission under that Part.

(4) The power conferred on the Authority by section 45 may be exercised in anticipation of the coming into force of the Society's permission (or at any other time).

(5) The Society is not subject to any requirement of this Act concerning the registered office of a body corporate.

Power to apply Act to Lloyd's underwriting

Direction by Authority.

316.—(1) The general prohibition or (if the general prohibition is not applied under this section) a core provision applies to the carrying on of an insurance market activity by—

(a) a member of the Society, or

(b) the members of the Society taken together,

only if the Authority so directs.

(2) A direction given under subsection (1) which applies a core provision is referred to in this Part as "an insurance market direction".

(3) In subsection (1)—

"core provision" means a provision of this Act mentioned in section 317; and

"insurance market activity" means a regulated activity relating to contracts of insurance written at Lloyd's.

(4) In deciding whether to give a direction under subsection (1), the Authority must have particular regard to—

(a) the interests of policyholders and potential policyholders;

(b) any failure by the Society to satisfy an obligation to which it is subject as a result of a provision of the law of another EEA State which—

(i) gives effect to any of the insurance directives; and

(ii) is applicable to an activity carried on in that State by a person to whom this section applies;

(c) the need to ensure the effective exercise of the functions which the Authority has in relation to the Society as a result of section 315.

(5) A direction under subsection (1) must be in writing.

(6) A direction under subsection (1) applying the general prohibition may apply it in relation to different classes of person.

(7) An insurance market direction—

(a) must specify each core provision, class of person and kind of activity to which it applies;

(b) may apply different provisions in relation to different classes of person and different kinds of activity.

(8) A direction under subsection (1) has effect from the date specified in it, which may not be earlier than the date on which it is made.

(9) A direction under subsection (1) must be published in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(10) The Authority may charge a reasonable fee for providing a person with a copy of the direction.

(11) The Authority must, without delay, give the Treasury a copy of any direction which it gives under this section.

The core provisions.

317.—(1) The core provisions are Parts V, X, XI, XII, XIV, XV, XVI, XXII and XXIV, sections 384 to 386 and Part XXVI.

(2) References in an applied core provision to an authorised person are (where necessary) to be read as references to a person in the class to which the insurance market direction applies.

(3) An insurance market direction may provide that a core provision is to have effect, in relation to persons to whom the provision is applied by the direction, with modifications.

Exercise of powers through Council.

318—(1) The Authority may give a direction under this subsection to the Council or to the Society (acting through the Council) or to both.

(2) A direction under subsection (1) is one given to the body concerned—

(a) in relation to the exercise of its powers generally with a view to achieving, or in support of, a specified objective; or

(b) in relation to the exercise of a specified power which it has, whether in a specified manner or with a view to achieving, or in support of, a specified objective.

(3) "Specified" means specified in the direction.

(4) A direction under subsection (1) may be given—

(a) instead of giving a direction under section 316(1); or

(b) if the Authority considers it necessary or expedient to do so, at the same time as, or following, the giving of such a direction.

(5) A direction may also be given under subsection (1) in respect of underwriting agents as if they were among the persons mentioned in section 316(1).

(6) A direction under this section—

(a) does not, at any time, prevent the exercise by the Authority of any of its powers;

(b) must be in writing.

(7) A direction under subsection (1) must be published in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(8) The Authority may charge a reasonable fee for providing a person with a copy of the direction.

(9) The Authority must, without delay, give the Treasury a copy of any direction which it gives under this section.

Consultation.

319.—(1) Before giving a direction under section 316 or 318, the Authority must publish a draft of the proposed direction.

(2) The draft must be accompanied by—

(a) a cost benefit analysis; and

(b) notice that representations about the proposed direction may be made to the Authority within a specified time.

(3) Before giving the proposed direction, the Authority must have regard to any representations made to it in accordance with subsection (2)(b).

(4) If the Authority gives the proposed direction it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2)(b); and

(b) its response to them.

(5) If the direction differs from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant—

(a) the Authority must (in addition to complying with subsection (4)) publish details of the difference; and

(b) those details must be accompanied by a cost benefit analysis.

(6) Subsections (1) to (5) do not apply if the Authority considers that the delay involved in complying with them would be prejudicial to the interests of consumers.

(7) Neither subsection (2)(a) nor subsection (5)(b) applies if the Authority considers—

(a) that, making the appropriate comparison, there will be no increase in costs; or

(b) that, making that comparison, there will be an increase in costs but the increase will be of minimal significance.

(8) The Authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

(9) When the Authority is required to publish a document under this section it must do so in the way appearing to it to be best calculated to bring it to the attention of the public.

(10) "Cost benefit analysis" means an estimate of the costs together with an analysis of the benefits that will arise—

(a) if the proposed direction is given; or

(b) if subsection (5)(b) applies, from the direction that has been given.

(11) "The appropriate comparison" means—

(a) in relation to subsection (2)(a), a comparison between the overall position if the direction is given and the overall position if it is not given;

(b) in relation to subsection (5)(b), a comparison between the overall position after the giving of the direction and the overall position before it was given.

Former underwriting members

Former underwriting members.

320.—(1) A former underwriting member may carry out each contract of insurance that he has underwritten at Lloyd's whether or not he is an authorised person.

(2) If he is an authorised person, any Part IV permission that he has does not extend to his activities in carrying out any of those contracts.

(3) The Authority may impose on a former underwriting member such requirements as appear to it to be appropriate for the purpose of protecting policyholders against the risk that he may not be able to meet his liabilities.

(4) A person on whom a requirement is imposed may refer the matter to the Tribunal.

Requirements imposed under section 320.

321.—(1) A requirement imposed under section 320 takes effect—

(a) immediately, if the notice given under subsection (2) states that that is the case;

(b) in any other case, on such date as may be specified in that notice.

(2) If the Authority proposes to impose a requirement on a former underwriting member ("A") under section 320, or imposes such a requirement on him which takes effect immediately, it must give him written notice.

(3) The notice must—

(a) give details of the requirement;

(b) state the Authority's reasons for imposing it;

(c) inform A that he may make representations to the Authority within such period as may be specified in the notice (whether or not he has referred the matter to the Tribunal);

(d) inform him of the date on which the requirement took effect or will take effect; and

(e) inform him of his right to refer the matter to the Tribunal.

(4) The Authority may extend the period allowed under the notice for making representations.

(5) If, having considered any representations made by A, the Authority decides—

(a) to impose the proposed requirement, or

(b) if it has been imposed, not to revoke it,

it must give him written notice.

(6) If the Authority decides—

(a) not to impose a proposed requirement, or

(b) to revoke a requirement that has been imposed,

it must give A written notice.

(7) If the Authority decides to grant an application by A for the variation or revocation of a requirement, it must give him written notice of its decision.

(8) If the Authority proposes to refuse an application by A for the variation or revocation of a requirement it must give him a warning notice.

(9) If the Authority, having considered any representations made in response to the warning notice, decides to refuse the application, it must give A a decision notice.

(10) A notice given under—

(a) subsection (5), or

(b) subsection (9) in the case of a decision to refuse the application,

must inform A of his right to refer the matter to the Tribunal.

(11) If the Authority decides to refuse an application for a variation or revocation of the requirement, the applicant may refer the matter to the Tribunal.

(12) If a notice informs a person of his right to refer a matter to the Tribunal, it must give an indication of the procedure on such a reference.

Rules applicable to former underwriting members.

322.—(1) The Authority may make rules imposing such requirements on persons to whom the rules apply as appear to it to be appropriate for protecting policyholders against the risk that those persons may not be able to meet their liabilities.

(2) The rules may apply to—

(a) former underwriting members generally; or

(b) to a class of former underwriting member specified in them.

(3) Section 319 applies to the making of proposed rules under this section as it applies to the giving of a proposed direction under section 316.

(4) Part X (except sections 152 to 154) does not apply to rules made under this section.

Transfers of business done at Lloyd's

Transfer schemes.

323. The Treasury may by order provide for the application of any provision of Part VII (with or without modification) in relation to schemes for the transfer of the whole or any part of the business carried on by one or more members of the Society or former underwriting members.

Supplemental

Interpretation of this Part.

324.—(1) In this Part—

"arranging deals", in relation to the investments to which this Part applies, has the same meaning as in paragraph 3 of Schedule 2;

"former underwriting member" means a person ceasing to be an underwriting member of the Society on, or at any time after, 24 December 1996; and

"participation in Lloyd's syndicates", in relation to the secondary market activity, means the investment described in sub-paragraph (1) of paragraph 21 of Schedule 2.

(2) A term used in this Part which is defined in Lloyd's Act 1982 has the same meaning as in that Act. 1982 c. xiv.

Part XX

Provision of Financial Services by Members of the Professions

Authority's general duty.

325.—(1) The Authority must keep itself informed about—

(a) the way in which designated professional bodies supervise and regulate the carrying on of exempt regulated activities by members of the professions in relation to which they are established;

(b) the way in which such members are carrying on exempt regulated activities.

(2) In this Part—

"exempt regulated activities" means regulated activities which may, as a result of this Part, be carried on by members of a profession which is supervised and regulated by a designated professional body without breaching the general prohibition; and

"members", in relation to a profession, means persons who are entitled to practise the profession in question and, in practising it, are subject to the rules of the body designated in relation to that profession, whether or not they are members of that body.

(3) The Authority must keep under review the desirability of exercising any of its powers under this Part.

(4) Each designated professional body must co-operate with the Authority, by the sharing of information and in other ways, in order to enable the Authority to perform its functions under this Part.

Designation of professional bodies.

326.—(1) The Treasury may by order designate bodies for the purposes of this Part.

(2) A body designated under subsection (1) is referred to in this Part as a designated professional body.

(3) The Treasury may designate a body under subsection (1) only if they are satisfied that—

(a) the basic condition, and

(b) one or more of the additional conditions,

are met in relation to it.

(4) The basic condition is that the body has rules applicable to the carrying on by members of the profession in relation to which it is established of regulated activities which, if the body were to be designated, would be exempt regulated activities.

(5) The additional conditions are that—

(a) the body has power under any enactment to regulate the practice of the profession;

(b) being a member of the profession is a requirement under any enactment for the exercise of particular functions or the holding of a particular office;

(c) the body has been recognised for the purpose of any enactment other than this Act and the recognition has not been withdrawn;

(d) the body is established in an EEA State other than the United Kingdom and in that State—

(i) the body has power corresponding to that mentioned in paragraph (a);

(ii) there is a requirement in relation to the body corresponding to that mentioned in paragraph (b); or

(iii) the body is recognised in a manner corresponding to that mentioned in paragraph (c).

(6) "Enactment" includes an Act of the Scottish Parliament, Northern Ireland legislation and subordinate legislation (whether made under an Act, an Act of the Scottish Parliament or Northern Ireland legislation).

(7) "Recognised" means recognised by—

(a) a Minister of the Crown;

(b) the Scottish Ministers;

(c) a Northern Ireland Minister;

(d) a Northern Ireland department or its head.

Exemption from the general prohibition.

327.—(1) The general prohibition does not apply to the carrying on of a regulated activity by a person ("P") if—

(a) the conditions set out in subsections (2) to (7) are satisfied; and

(b) there is not in force—

(i) a direction under section 328, or

(ii) an order under section 329,

which prevents this subsection from applying to the carrying on of that activity by him.

(2) P must be—

(a) a member of a profession; or

(b) controlled or managed by one or more such members.

(3) P must not receive from a person other than his client any pecuniary reward or other advantage, for which he does not account to his client, arising out of his carrying on of any of the activities.

(4) The manner of the provision by P of any service in the course of carrying on the activities must be incidental to the provision by him of professional services.

(5) P must not carry on, or hold himself out as carrying on, a regulated activity other than—

(a) one which rules made as a result of section 332(3) allow him to carry on; or

(b) one in relation to which he is an exempt person.

(6) The activities must not be of a description, or relate to an investment of a description, specified in an order made by the Treasury for the purposes of this subsection.

(7) The activities must be the only regulated activities carried on by P (other than regulated activities in relation to which he is an exempt person).

(8) "Professional services" means services—

(a) which do not constitute carrying on a regulated activity, and

(b) the provision of which is supervised and regulated by a designated professional body.

Directions in relation to the general prohibition.

328.—(1) The Authority may direct that section 327(1) is not to apply to the extent specified in the direction.

(2) A direction under subsection (1)—

(a) must be in writing;

(b) may be given in relation to different classes of person or different descriptions of regulated activity.

(3) A direction under subsection (1) must be published in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(4) The Authority may charge a reasonable fee for providing a person with a copy of the direction.

(5) The Authority must, without delay, give the Treasury a copy of any direction which it gives under this section.

(6) The Authority may exercise the power conferred by subsection (1) only if it is satisfied that it is desirable in order to protect the interests of clients.

(7) In considering whether it is so satisfied, the Authority must have regard amongst other things to the effectiveness of any arrangements made by any designated professional body—

(a) for securing compliance with rules made under section 332(1);

(b) for dealing with complaints against its members in relation to the carrying on by them of exempt regulated activities;

(c) in order to offer redress to clients who suffer, or claim to have suffered, loss as a result of misconduct by its members in their carrying on of exempt regulated activities;

(d) for co-operating with the Authority under section 325(4).

(8) In this Part "clients" means—

(a) persons who use, have used or are or may be contemplating using, any of the services provided by a member of a profession in the course of carrying on exempt regulated activities;

(b) persons who have rights or interests which are derived from, or otherwise attributable to, the use of any such services by other persons; or

(c) persons who have rights or interests which may be adversely affected by the use of any such services by persons acting on their behalf or in a fiduciary capacity in relation to them.

(9) If a member of a profession is carrying on an exempt regulated activity in his capacity as a trustee, the persons who are, have been or may be beneficiaries of the trust are to be treated as persons who use, have used or are or may be contemplating using services provided by that person in his carrying on of that activity.

Orders in relation to the general prohibition.

329.—(1) Subsection (2) applies if it appears to the Authority that a person to whom, as a result of section 327(1), the general prohibition does not apply is not a fit and proper person to carry on regulated activities in accordance with that section.

(2) The Authority may make an order disapplying section 327(1) in relation to that person to the extent specified in the order.

(3) The Authority may, on the application of the person named in an order under subsection (1), vary or revoke it.

(4) "Specified" means specified in the order.

(5) If a partnership is named in an order under this section, the order is not affected by any change in its membership.

(6) If a partnership named in an order under this section is dissolved, the order continues to have effect in relation to any partnership which succeeds to the business of the dissolved partnership.

(7) For the purposes of subsection (6), a partnership is to be regarded as succeeding to the business of another partnership only if—

(a) the members of the resulting partnership are substantially the same as those of the former partnership; and

(b) succession is to the whole or substantially the whole of the business of the former partnership.

330.—(1) Before giving a direction under section 328(1), the Authority must publish a draft of the proposed direction. Consultation.

(2) The draft must be accompanied by—

(a) a cost benefit analysis; and

(b) notice that representations about the proposed direction may be made to the Authority within a specified time.

(3) Before giving the proposed direction, the Authority must have regard to any representations made to it in accordance with subsection (2)(b).

(4) If the Authority gives the proposed direction it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2)(b); and

(b) its response to them.

(5) If the direction differs from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant—

(a) the Authority must (in addition to complying with subsection (4)) publish details of the difference; and

(b) those details must be accompanied by a cost benefit analysis.

(6) Subsections (1) to (5) do not apply if the Authority considers that the delay involved in complying with them would prejudice the interests of consumers.

(7) Neither subsection (2)(a) nor subsection (5)(b) applies if the Authority considers—

(a) that, making the appropriate comparison, there will be no increase in costs; or

(b) that, making that comparison, there will be an increase in costs but the increase will be of minimal significance.

(8) The Authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

(9) When the Authority is required to publish a document under this section it must do so in the way appearing to it to be best calculated to bring it to the attention of the public.

(10) "Cost benefit analysis" means an estimate of the costs together with an analysis of the benefits that will arise—

(a) if the proposed direction is given; or

(b) if subsection (5)(b) applies, from the direction that has been given.

(11) "The appropriate comparison" means—

(a) in relation to subsection (2)(a), a comparison between the overall position if the direction is given and the overall position if it is not given;

(b) in relation to subsection (5)(b), a comparison between the overall position after the giving of the direction and the overall position before it was given.

Procedure on making or varying orders under section 329.

331.—(1) If the Authority proposes to make an order under section 329, it must give the person concerned a warning notice.

(2) The warning notice must set out the terms of the proposed order.

(3) If the Authority decides to make an order under section 329, it must give the person concerned a decision notice.

(4) The decision notice must—

(a) name the person to whom the order applies;

(b) set out the terms of the order; and

(c) be given to the person named in the order.

(5) Subsections (6) to (8) apply to an application for the variation or revocation of an order under section 329.

(6) If the Authority decides to grant the application, it must give the applicant written notice of its decision.

(7) If the Authority proposes to refuse the application, it must give the applicant a warning notice.

(8) If the Authority decides to refuse the application, it must give the applicant a decision notice.

(9) A person—

(a) against whom the Authority have decided to make an order under section 329, or

(b) whose application for the variation or revocation of such an order the Authority had decided to refuse,

may refer the matter to the Tribunal.

(10) The Authority may not make an order under section 329 unless—

(a) the period within which the decision to make to the order may be referred to the Tribunal has expired and no such reference has been made; or

(b) if such a reference has been made, the reference has been determined.

Rules in relation to persons to whom the general prohibition does not apply.

332.—(1) The Authority may make rules applicable to persons to whom, as a result of section 327(1), the general prohibition does not apply.

(2) The power conferred by subsection (1) is to be exercised for the purpose of ensuring that clients are aware that such persons are not authorised persons.

(3) A designated professional body must make rules—

(a) applicable to members of the profession in relation to which it is established who are not authorised persons; and

(b) governing the carrying on by those members of regulated activities (other than regulated activities in relation to which they are exempt persons).

(4) Rules made in compliance with subsection (3) must be designed to secure that, in providing a particular professional service to a particular client, the member carries on only regulated activities which arise out of, or are complementary to, the provision by him of that service to that client.

(5) Rules made by a designated professional body under subsection (3) require the approval of the Authority.

False claims to be a person to whom the general prohibition does not apply.

333.—(1) A person who—

(a) describes himself (in whatever terms) as a person to whom the general prohibition does not apply, in relation to a particular regulated activity, as a result of this Part, or

(b) behaves, or otherwise holds himself out, in a manner which indicates (or which is reasonably likely to be understood as indicating) that he is such a person,

is guilty of an offence if he is not such a person.

(2) In proceedings for an offence under this section it is a defence for the accused to show that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.

(3) A person guilty of an offence under this section is liable on summary conviction to imprisonment for a term not exceeding six months or a fine not exceeding level 5 on the standard scale, or both.

(4) But where the conduct constituting the offence involved or included the public display of any material, the maximum fine for the offence is level 5 on the standard scale multiplied by the number of days for which the display continued.

PART XXI

MUTUAL SOCIETIES

Friendly societies

The Friendly Societies Commission.

334.—(1) The Treasury may by order provide—

(a) for any functions of the Friendly Societies Commission to be transferred to the Authority;

(b) for any functions of the Friendly Societies Commission which have not been, or are not being, transferred to the Authority to be transferred to the Treasury.

(2) If the Treasury consider it appropriate to do so, they may by order provide for the Friendly Societies Commission to cease to exist on a day specified in or determined in accordance with the order.

(3) The enactments relating to friendly societies which are mentioned in Part I of Schedule 18 are amended as set out in that Part.

(4) Part II of Schedule 18—

(a) removes certain restrictions on the ability of incorporated friendly societies to form subsidiaries and control corporate bodies; and

(b) makes connected amendments.

The Registry of Friendly Societies.

335.—(1) The Treasury may by order provide—

(a) for any functions of the Chief Registrar of Friendly Societies, or of an assistant registrar of friendly societies for the central registration area, to be transferred to the Authority;

(b) for any of their functions which have not been, or are not being, transferred to the Authority to be transferred to the Treasury.

(2) The Treasury may by order provide—

(a) for any functions of the central office of the registry of friendly societies to be transferred to the Authority;

(b) for any functions of that office which have not been, or are not being, transferred to the Authority to be transferred to the Treasury.

(3) The Treasury may by order provide—

(a) for any functions of the assistant registrar of friendly societies for Scotland to be transferred to the Authority;

(b) for any functions of the assistant registrar which have not been, or are not being, transferred to the Authority to be transferred to the Treasury.

(4) If the Treasury consider it appropriate to do so, they may by order provide for—

(a) the office of Chief Registrar of Friendly Societies,

(b) the office of assistant registrar of friendly societies for the central registration area,

(c) the central office, or

(d) the office of assistant registrar of friendly societies for Scotland,

to cease to exist on a day specified in or determined in accordance with the order.

Building societies

The Building Societies Commission.

336.—(1) The Treasury may by order provide—

(a) for any functions of the Building Societies Commission to be transferred to the Authority;

(b) for any functions of the Building Societies Commission which have not been, or are not being, transferred to the Authority to be transferred to the Treasury.

(2) If the Treasury consider it appropriate to do so, they may by order provide for the Building Societies Commission to cease to exist on a day specified in or determined in accordance with the order.

(3) The enactments relating to building societies which are mentioned in Part III of Schedule 18 are amended as set out in that Part.

The Building Societies Investor Protection Board.

337. The Treasury may by order provide for the Building Societies Investor Protection Board to cease to exist on a day specified in or determined in accordance with the order.

Industrial and provident societies and credit unions

Industrial and provident societies and credit unions.

338.—(1) The Treasury may by order provide for the transfer to the Authority of any functions conferred by—

(a) the Industrial and Provident Societies Act 1965; 1965 c. 12.

(b) the Industrial and Provident Societies Act 1967; 1967 c. 48.

(c) the Friendly and Industrial and Provident Societies Act 1968; 1968 c. 55.

(d) the Industrial and Provident Societies Act 1975; 1975 c. 41.

(e) the Industrial and Provident Societies Act 1978; 1978 c. 34.

(f) the Credit Unions Act 1979. 1979 c. 34.

(2) The Treasury may by order provide for the transfer to the Treasury of any functions under those enactments which have not been, or are not being, transferred to the Authority.

(3) The enactments relating to industrial and provident societies which are mentioned in Part IV of Schedule 18 are amended as set out in that Part.

(4) The enactments relating to credit unions which are mentioned in Part V of Schedule 18 are amended as set out in that Part.

Supplemental

Supplemental provisions.

339.—(1) The additional powers conferred by section 428 on a person making an order under this Act include power for the Treasury, when making an order under section 334, 335, 336 or 338 which transfers functions, to include provision—

(a) for the transfer of any functions of a member of the body, or servant or agent of the body or person, whose functions are transferred by the order;

(b) for the transfer of any property, rights or liabilities held, enjoyed or incurred by any person in connection with transferred functions;

(c) for the carrying on and completion by or under the authority of the person to whom functions are transferred of any proceedings, investigations or other matters commenced, before the order takes effect, by or under the authority of the person from whom the functions are transferred;

(d) amending any enactment relating to transferred functions in connection with their exercise by, or under the authority of, the person to whom they are transferred;

(e) for the substitution of the person to whom functions are transferred for the person from whom they are transferred, in any instrument, contract or legal proceedings made or begun before the order takes effect.

(2) The additional powers conferred by section 428 on a person making an order under this Act include power for the Treasury, when making an order under section 334(2), 335(4), 336(2) or 337, to include provision—

(a) for the transfer of any property, rights or liabilities held, enjoyed or incurred by any person in connection with the office or body which ceases to have effect as a result of the order;

(b) for the carrying on and completion by or under the authority of such person as may be specified in the order of any proceedings, investigations or other matters commenced, before the order takes effect, by or under the authority of the person whose office, or the body which, ceases to exist as a result of the order;

(c) amending any enactment which makes provision with respect to that office or body;

(d) for the substitution of the Authority, the Treasury or such other body as may be specified in the order in any instrument, contract or legal proceedings made or begun before the order takes effect.

(3) On or after the making of an order under any of sections 334 to 338 ("the original order"), the Treasury may by order make any incidental, supplemental, consequential or transitional provision which they had power to include in the original order.

(4) A certificate issued by the Treasury that property vested in a person immediately before an order under this Part takes effect has been transferred as a result of the order is conclusive evidence of the transfer.

(5) Subsections (1) and (2) are not to be read as affecting in any way the powers conferred by section 428.

PART XXII

AUDITORS AND ACTUARIES

Appointment

Appointment.

340.—(1) Rules may require an authorised person, or an authorised person falling within a specified class—

(a) to appoint an auditor, or

(b) to appoint an actuary,

if he is not already under an obligation to do so imposed by another enactment.

(2) Rules may require an authorised person, or an authorised person falling within a specified class—

(a) to produce periodic financial reports; and

(b) to have them reported on by an auditor or an actuary.

(3) Rules may impose such other duties on auditors of, or actuaries acting for, authorised persons as may be specified.

(4) Rules under subsection (1) may make provision—

(a) specifying the manner in which and time within which an auditor or actuary is to be appointed;

(b) requiring the Authority to be notified of an appointment;

(c) enabling the Authority to make an appointment if no appointment has been made or notified;

(d) as to remuneration;

(e) as to the term of office, removal and resignation of an auditor or actuary.

(5) An auditor or actuary appointed as a result of rules under subsection (1), or on whom duties are imposed by rules under subsection (3)—

(a) must act in accordance with such provision as may be made by rules; and

(b) is to have such powers in connection with the discharge of his functions as may be provided by rules.

(6) In subsections (1) to (3) "auditor" or "actuary" means an auditor, or actuary, who satisfies such requirements as to qualifications, experience and other matters (if any) as may be specified.

(7) "Specified" means specified in rules.

Information

Access to books etc.

341.—(1) An appointed auditor of, or an appointed actuary acting for, an authorised person—

(a) has a right of access at all times to the authorised person's books, accounts and vouchers; and

(b) is entitled to require from the authorised person's officers such information and explanations as he reasonably considers necessary for the performance of his duties as auditor or actuary.

(2) "Appointed" means appointed under or as a result of this Act.

Information given by auditor or actuary to the Authority.

342.—(1) This section applies to a person who is, or has been, an auditor of an authorised person appointed under or as a result of a statutory provision.

(2) This section also applies to a person who is, or has been, an actuary acting for an authorised person and appointed under or as a result of a statutory provision.

(3) An auditor or actuary does not contravene any duty to which he is subject merely because he gives to the Authority—

(a) information on a matter of which he has, or had, become aware in his capacity as auditor of, or actuary acting for, the authorised person, or

(b) his opinion on such a matter,

if he is acting in good faith and he reasonably believes that the information or opinion is relevant to any functions of the Authority.

(4) Subsection (3) applies whether or not the auditor or actuary is responding to a request from the Authority.

(5) The Treasury may make regulations prescribing circumstances in which an auditor or actuary must communicate matters to the Authority as mentioned in subsection (3).

(6) It is the duty of an auditor or actuary to whom any such regulations apply to communicate a matter to the Authority in the circumstances prescribed by the regulations.

(7) The matters to be communicated to the Authority in accordance with the regulations may include matters relating to persons other than the authorised person concerned.

Information given by auditor or actuary to the Authority: persons with close links.

343.—(1) This section applies to a person who—

(a) is, or has been, an auditor of an authorised person appointed under or as a result of a statutory provision; and

(b) is, or has been, an auditor of a person ("CL") who has close links with the authorised person.

(2) This section also applies to a person who—

(a) is, or has been, an actuary acting for an authorised person and appointed under or as a result of a statutory provision; and

(b) is, or has been, an actuary acting for a person ("CL") who has close links with the authorised person.

(3) An auditor or actuary does not contravene any duty to which he is subject merely because he gives to the Authority—

(a) information on a matter concerning the authorised person of which he has, or had, become aware in his capacity as auditor of, or actuary acting for, CL, or

(b) his opinion on such a matter,

if he is acting in good faith and he reasonably believes that the information or opinion is relevant to any functions of the Authority.

(4) Subsection (3) applies whether or not the auditor or actuary is responding to a request from the Authority.

(5) The Treasury may make regulations prescribing circumstances in which an auditor or actuary must communicate matters to the Authority as mentioned in subsection (3).

(6) It is the duty of an auditor or actuary to whom any such regulations apply to communicate a matter to the Authority in the circumstances prescribed by the regulations.

(7) The matters to be communicated to the Authority in accordance with the regulations may include matters relating to persons other than the authorised person concerned.

(8) CL has close links with the authorised person concerned ("A") if CL is—

(a) a parent undertaking of A;

(b) a subsidiary undertaking of A;

(c) a parent undertaking of a subsidiary undertaking of A; or

(d) a subsidiary undertaking of a parent undertaking of A.

(9) "Subsidiary undertaking" includes all the instances mentioned in Article 1(1) and (2) of the Seventh Company Law Directive in which an entity may be a subsidiary of an undertaking.

Duty of auditor or actuary resigning etc. to give notice.

344.—(1) This section applies to an auditor or actuary to whom section 342 applies.

(2) He must without delay notify the Authority if he—

(a) is removed from office by an authorised person;

(b) resigns before the expiry of his term of office with such a person; or

(c) is not re-appointed by such a person.

(3) If he ceases to be an auditor of, or actuary acting for, such a person, he must without delay notify the Authority—

(a) of any matter connected with his so ceasing which he thinks ought to be drawn to the Authority's attention; or

(b) that there is no such matter.

Disqualification

345.—(1) If it appears to the Authority that an auditor or actuary to whom section 342 applies has failed to comply with a duty imposed on him under this Act, it may disqualify him from being the auditor of, or (as the case may be) from acting as an actuary for, any authorised person or any particular class of authorised person. Disqualification.

(2) If the Authority proposes to disqualify a person under this section it must give him a warning notice.

(3) If it decides to disqualify him it must give him a decision notice.

(4) The Authority may remove any disqualification imposed under this section if satisfied that the disqualified person will in future comply with the duty in question.

(5) A person who has been disqualified under this section may refer the matter to the Tribunal.

Offence

346.—(1) An authorised person who knowingly or recklessly gives an appointed auditor or actuary information which is false or misleading in a material particular is guilty of an offence and liable— Provision of false or misleading information to auditor or actuary.

(a) on summary conviction, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

(2) Subsection (1) applies equally to an officer, controller or manager of an authorised person.

(3) "Appointed" means appointed under or as a result of this Act.

Part XXIII

Public Record, Disclosure of Information and Co-operation

The public record

347.—(1) The Authority must maintain a record of every— The record of authorised persons etc.

(a) person who appears to the Authority to be an authorised person;

(b) authorised unit trust scheme;

(c) authorised open-ended investment company;

(d) recognised scheme;

(e) recognised investment exchange;

(f) recognised clearing house;

(g) individual to whom a prohibition order relates;

(h) approved person; and

(i) person falling within such other class (if any) as the Authority may determine.

(2) The record must include such information as the Authority considers appropriate and at least the following information—

(a) in the case of a person appearing to the Authority to be an authorised person—

(i) information as to the services which he holds himself out as able to provide; and

(ii) any address of which the Authority is aware at which a notice or other document may be served on him;

(b) in the case of an authorised unit trust scheme, the name and address of the manager and trustee of the scheme;

(c) in the case of an authorised open-ended investment company, the name and address of—

(i) the company;

(ii) if it has only one director, the director; and

(iii) its depositary (if any);

(d) in the case of a recognised scheme, the name and address of—

(i) the operator of the scheme; and

(ii) any representative of the operator in the United Kingdom;

(e) in the case of a recognised investment exchange or recognised clearing house, the name and address of the exchange or clearing house;

(f) in the case of an individual to whom a prohibition order relates—

(i) his name; and

(ii) details of the effect of the order;

(g) in the case of a person who is an approved person—

(i) his name;

(ii) the name of the relevant authorised person;

(iii) if the approved person is performing a controlled function under an arrangement with a contractor of the relevant authorised person, the name of the contractor.

(3) If it appears to the Authority that a person in respect of whom there is an entry in the record as a result of one of the paragraphs of subsection (1) has ceased to be a person to whom that paragraph applies, the Authority may remove the entry from the record.

(4) But if the Authority decides not to remove the entry, it must—

(a) make a note to that effect in the record; and

(b) state why it considers that the person has ceased to be a person to whom that paragraph applies.

(5) The Authority must—

(a) make the record available for inspection by members of the public in a legible form at such times and in such place or places as the Authority may determine; and

(b) provide a certified copy of the record, or any part of it, to any person who asks for it—

(i) on payment of the fee (if any) fixed by the Authority; and

(ii) in a form (either written or electronic) in which it is legible to the person asking for it.

(6) The Authority may—

(a) publish the record, or any part of it;

(b) exploit commercially the information contained in the record, or any part of that information.

(7) "Authorised unit trust scheme", "authorised open-ended investment company" and "recognised scheme" have the same meaning as in Part XVII, and associated expressions are to be read accordingly.

(8) "Approved person" means a person in relation to whom the Authority has given its approval under section 59 and "controlled function" and "arrangement" have the same meaning as in that section.

(9) "Relevant authorised person" has the meaning given in section 66.

Disclosure of information

Restrictions on disclosure of confidential information by Authority etc.

348.—(1) Confidential information must not be disclosed by a primary recipient, or by any person obtaining the information directly or indirectly from a primary recipient, without the consent of—

(a) the person from whom the primary recipient obtained the information; and

(b) if different, the person to whom it relates.

(2) In this Part "confidential information" means information which—

(a) relates to the business or other affairs of any person;

(b) was received by the primary recipient for the purposes of, or in the discharge of, any functions of the Authority, the competent authority for the purposes of Part VI or the Secretary of State under any provision made by or under this Act; and

(c) is not prevented from being confidential information by subsection (4).

(3) It is immaterial for the purposes of subsection (2) whether or not the information was received—

(a) by virtue of a requirement to provide it imposed by or under this Act;

(b) for other purposes as well as purposes mentioned in that subsection.

(4) Information is not confidential information if—

(a) it has been made available to the public by virtue of being disclosed in any circumstances in which, or for any purposes for which, disclosure is not precluded by this section; or

(b) it is in the form of a summary or collection of information so framed that it is not possible to ascertain from it information relating to any particular person.

(5) Each of the following is a primary recipient for the purposes of this Part—

(a) the Authority;

(b) any person exercising functions conferred by Part VI on the competent authority;

(c) the Secretary of State;

(d) a person appointed to make a report under section 166;

(e) any person who is or has been employed by a person mentioned in paragraphs (a) to (c);

(f) any auditor or expert instructed by a person mentioned in those paragraphs.

(6) In subsection (5)(f) "expert" includes—

(a) a competent person appointed by the competent authority under section 97;

(b) a competent person appointed by the Authority or the Secretary of State to conduct an investigation under Part XI;

(c) any body or person appointed under paragraph 6 of Schedule 1 to perform a function on behalf of the Authority.

Exceptions from section 348.

349.—(1) Section 348 does not prevent a disclosure of confidential information which is—

(a) made for the purpose of facilitating the carrying out of a public function; and

(b) permitted by regulations made by the Treasury under this section.

(2) The regulations may, in particular, make provision permitting the disclosure of confidential information or of confidential information of a prescribed kind—

(a) by prescribed recipients, or recipients of a prescribed description, to any person for the purpose of enabling or assisting the recipient to discharge prescribed public functions;

(b) by prescribed recipients, or recipients of a prescribed description, to prescribed persons, or persons of prescribed descriptions, for the purpose of enabling or assisting those persons to discharge prescribed public functions;

(c) by the Authority to the Treasury or the Secretary of State for any purpose;

(d) by any recipient if the disclosure is with a view to or in connection with prescribed proceedings.

(3) The regulations may also include provision—

(a) making any permission to disclose confidential information subject to conditions (which may relate to the obtaining of consents or any other matter);

(b) restricting the uses to which confidential information disclosed under the regulations may be put.

(4) In relation to confidential information, each of the following is a "recipient"—

(a) a primary recipient;

(b) a person obtaining the information directly or indirectly from a primary recipient.

(5) "Public functions" includes—

(a) functions conferred by or in accordance with any provision contained in any enactment or subordinate legislation;

(b) functions conferred by or in accordance with any provision contained in the Community Treaties or any Community instrument;

(c) similar functions conferred on persons by or under provisions having effect as part of the law of a country or territory outside the United Kingdom;

(d) functions exercisable in relation to prescribed disciplinary proceedings.

(6) "Enactment" includes—

(a) an Act of the Scottish Parliament;

(b) Northern Ireland legislation.

(7) "Subordinate legislation" has the meaning given in the Interpretation Act 1978 and also includes an instrument made under an Act of the Scottish Parliament or under Northern Ireland legislation. 1978 c. 30.

Disclosure of information by the Inland Revenue.

350.—(1) No obligation as to secrecy imposed by statute or otherwise prevents the disclosure of Revenue information to—

(a) the Authority, or

(b) the Secretary of State,

if the disclosure is made for the purpose of assisting in the investigation of a matter under section 168 or with a view to the appointment of an investigator under that section.

(2) A disclosure may only be made under subsection (1) by or under the authority of the Commissioners of Inland Revenue.

(3) Section 348 does not apply to Revenue information.

(4) Information obtained as a result of subsection (1) may not be used except—

(a) for the purpose of deciding whether to appoint an investigator under section 168;

(b) in the conduct of an investigation under section 168;

(c) in criminal proceedings brought against a person under this Act or the Criminal Justice Act 1993 as a result of an investigation under section 168; 1993 c. 36.

(d) for the purpose of taking action under this Act against a person as a result of an investigation under section 168;

(e) in proceedings before the Tribunal as a result of action taken as mentioned in paragraph (d).

(5) Information obtained as a result of subsection (1) may not be disclosed except—

(a) by or under the authority of the Commissioners of Inland Revenue;

(b) in proceedings mentioned in subsection (4)(c) or (e) or with a view to their institution.

(6) Subsection (5) does not prevent the disclosure of information obtained as a result of subsection (1) to a person to whom it could have been disclosed under subsection (1).

(7) "Revenue information" means information held by a person which it would be an offence under section 182 of the Finance Act 1989 for him to disclose.

1989 c. 26.

Competition information.

351.—(1) A person is guilty of an offence if he has competition information (whether or not it was obtained by him) and improperly discloses it—

(a) if it relates to the affairs of an individual, during that individual's lifetime;

(b) if it relates to any particular business of a body, while that business continues to be carried on.

(2) For the purposes of subsection (1) a disclosure is improper unless it is made—

(a) with the consent of the person from whom it was obtained and, if different—

(i) the individual to whose affairs the information relates, or

(ii) the person for the time being carrying on the business to which the information relates;

(b) to facilitate the performance by a person mentioned in the first column of the table set out in Part I of Schedule 19 of a function mentioned in the second column of that table;

(c) in pursuance of a Community obligation;

(d) for the purpose of criminal proceedings in any part of the United Kingdom;

(e) in connection with the investigation of any criminal offence triable in the United Kingdom or any part of the United Kingdom;

(f) with a view to the institution of, or otherwise for the purposes of, civil proceedings brought under or in connection with—

(i) a competition provision; or

(ii) a specified enactment.

(3) A person guilty of an offence under this section is liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or to a fine or to both.

(4) Section 348 does not apply to competition information.

(5) "Competition information" means information which—

(a) relates to the affairs of a particular individual or body;

(b) is not otherwise in the public domain; and

(c) was obtained under or by virtue of a competition provision.

(6) "Competition provision" means any provision of—

(a) an order made under section 95;

(b) Chapter III of Part X; or

(c) Chapter II of Part XVIII.

(7) "Specified enactment" means an enactment specified in Part II of Schedule 19.

Offences.

352.—(1) A person who discloses information in contravention of section 348 or 350(5) is guilty of an offence.

(2) A person guilty of an offence under subsection (1) is liable—

(a) on summary conviction, to imprisonment for a term not exceeding three months or a fine not exceeding the statutory maximum, or both;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both.

(3) A person is guilty of an offence if, in contravention of any provision of regulations made under section 349, he uses information which has been disclosed to him in accordance with the regulations.

(4) A person is guilty of an offence if, in contravention of subsection (4) of section 350, he uses information which has been disclosed to him in accordance with that section.

(5) A person guilty of an offence under subsection (3) or (4) is liable on summary conviction to imprisonment for a term not exceeding three months or a fine not exceeding level 5 on the standard scale, or both.

(6) In proceedings for an offence under this section it is a defence for the accused to prove—

(a) that he did not know and had no reason to suspect that the information was confidential information or that it had been disclosed in accordance with section 350;

(b) that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.

Removal of other restrictions on disclosure.

353.—(1) The Treasury may make regulations permitting the disclosure of any information, or of information of a prescribed kind—

(a) by prescribed persons for the purpose of assisting or enabling them to discharge prescribed functions under this Act or any rules or regulations made under it;

(b) by prescribed persons, or persons of a prescribed description, to the Authority for the purpose of assisting or enabling the Authority to discharge prescribed functions.

(2) Regulations under this section may not make any provision in relation to the disclosure of confidential information by primary recipients or by any person obtaining confidential information directly or indirectly from a primary recipient.

(3) If a person discloses any information as permitted by regulations under this section the disclosure is not to be taken as a contravention of any duty to which he is subject.

Co-operation

Authority's duty to co-operate with others.

354.—(1) The Authority must take such steps as it considers appropriate to co-operate with other persons (whether in the United Kingdom or elsewhere) who have functions—

(a) similar to those of the Authority; or

(b) in relation to the prevention or detection of financial crime.

(2) Co-operation may include the sharing of information which the Authority is not prevented from disclosing.

(3) "Financial crime" has the same meaning as in section 6.

PART XXIV

INSOLVENCY

Interpretation

Interpretation of this Part.

1985 c. 66.

1986 c. 45.

S.I. 1989/2405 (N.I. 19).

355.—(1) In this Part—

"the 1985 Act" means the Bankruptcy (Scotland) Act 1985;

"the 1986 Act" means the Insolvency Act 1986;

"the 1989 Order" means the Insolvency (Northern Ireland) Order 1989;

"body" means a body of persons—

(a) over which the court has jurisdiction under any provision of, or made under, the 1986 Act (or the 1989 Order); but

(b) which is not a building society, a friendly society or an industrial and provident society; and

"court" means—

(a) the court having jurisdiction for the purposes of the 1985 Act or the 1986 Act; or

(b) in Northern Ireland, the High Court.

(2) In this Part "insurer" has such meaning as may be specified in an order made by the Treasury.

Voluntary arrangements

Authority's powers to participate in proceedings: company voluntary arrangements.

356.—(1) This section applies if a voluntary arrangement has been approved under Part I of the 1986 Act (or Part II of the 1989 Order) in respect of a company or insolvent partnership which is an authorised person.

(2) The Authority may make an application to the court in relation to the company or insolvent partnership under section 6 of the 1986 Act (or Article 19 of the 1989 Order).

(3) If a person other than the Authority makes an application to the court in relation to the company or insolvent partnership under either of those provisions, the Authority is entitled to be heard at any hearing relating to the application.

Authority's powers to participate in proceedings: individual voluntary arrangements.

357.—(1) The Authority is entitled to be heard on an application by an individual who is an authorised person under section 253 of the 1986 Act (or Article 227 of the 1989 Order).

(2) Subsections (3) to (6) apply if such an order is made on the application of such a person.

(3) A person appointed for the purpose by the Authority is entitled to attend any meeting of creditors of the debtor summoned under section 257 of the 1986 Act (or Article 231 of the 1989 Order).

(4) Notice of the result of a meeting so summoned is to be given to the Authority by the chairman of the meeting.

(5) The Authority may apply to the court—

(a) under section 262 of the 1986 Act (or Article 236 of the 1989 Order); or

(b) under section 263 of the 1986 Act (or Article 237 of the 1989 Order).

(6) If a person other than the Authority makes an application to the court under any provision mentioned in subsection (5), the Authority is entitled to be heard at any hearing relating to the application.

Authority's powers to participate in proceedings: trust deeds for creditors in Scotland.

358.—(1) This section applies where a trust deed has been granted by or on behalf of a debtor who is an authorised person.

(2) The trustee must, as soon as practicable after he becomes aware that the debtor is an authorised person, send to the Authority—

(a) in every case, a copy of the trust deed;

(b) where any other document or information is sent to every creditor known to the trustee in pursuance of paragraph 5(1)(c) of Schedule 5 to the 1985 Act, a copy of such document or information.

(3) Paragraph 7 of that Schedule applies to the Authority as if it were a qualified creditor who has not been sent a copy of the notice as mentioned in paragraph 5(1)(c) of the Schedule.

(4) The Authority must be given the same notice as the creditors of any meeting of creditors held in relation to the trust deed.

(5) A person appointed for the purpose by the Authority is entitled to attend and participate in (but not to vote at) any such meeting of creditors as if the Authority were a creditor under the deed.

(6) This section does not affect any right the Authority has as a creditor of a debtor who is an authorised person.

(7) Expressions used in this section and in the 1985 Act have the same meaning in this section as in that Act.

Administration orders

Petitions.

359.—(1) The Authority may present a petition to the court under section 9 of the 1986 Act (or Article 22 of the 1989 Order) in relation to a company or insolvent partnership which—

(a) is, or has been, an authorised person;

(b) is, or has been, an appointed representative; or

(c) is carrying on, or has carried on, a regulated activity in contravention of the general prohibition.

(2) Subsection (3) applies in relation to a petition presented by the Authority by virtue of this section.

(3) If the company or partnership is in default on an obligation to pay a sum due and payable under an agreement, it is to be treated for the purpose of section 8(1)(a) of the 1986 Act (or Article 21(1)(a) of the 1989 Order) as unable to pay its debts.

(4) "Agreement" means an agreement the making or performance of which constitutes or is part of a regulated activity carried on by the company or partnership.

(5) "Company" means—

(a) a company to which section 8 of the 1986 Act applies; or

(b) in relation to Northern Ireland, a company to which Article 21 of the 1989 Order applies.

Insurers.

360.—(1) The Treasury may by order provide that such provisions of Part II of the 1986 Act (or Part III of the 1989 Order) as may be specified are to apply in relation to insurers with such modifications as may be specified.

(2) An order under this section—

(a) may provide that such provisions of this Part as may be specified are to apply in relation to the administration of insurers in accordance with the order with such modifications as may be specified; and

(b) requires the consent of the Secretary of State.

(3) "Specified" means specified in the order.

Administrator's duty to report to Authority.

361.—(1) If—

(a) an administration order is in force in relation to a company or partnership by virtue of a petition presented by a person other than the Authority, and

(b) it appears to the administrator that the company or partnership is carrying on, or has carried on, a regulated activity in contravention of the general prohibition,

the administrator must report the matter to the Authority without delay.

(2) "An administration order" means an administration order under Part II of the 1986 Act (or Part III of the 1989 Order).

Authority's powers to participate in proceedings.

362.—(1) This section applies if a person other than the Authority presents a petition to the court under section 9 of the 1986 Act (or Article 22 of the 1989 Order) in relation to a company or partnership which—

(a) is, or has been, an authorised person;

(b) is, or has been, an appointed representative; or

(c) is carrying on, or has carried on, a regulated activity in contravention of the general prohibition.

(2) The Authority is entitled to be heard—

(a) at the hearing of the petition; and

(b) at any other hearing of the court in relation to the company or partnership under Part II of the 1986 Act (or Part III of the 1989 Order).

(3) Any notice or other document required to be sent to a creditor of the company or partnership must also be sent to the Authority.

(4) The Authority may apply to the court under section 27 of the 1986 Act (or Article 39 of the 1989 Order); and on such an application, section 27(1)(a) (or Article 39(1)(a)) has effect with the omission of the words "(including at least himself)".

(5) A person appointed for the purpose by the Authority is entitled—

(a) to attend any meeting of creditors of the company or partnership summoned under any enactment;

(b) to attend any meeting of a committee established under section 26 of the 1986 Act (or Article 38 of the 1989 Order); and

(c) to make representations as to any matter for decision at such a meeting.

(6) If, during the course of the administration of a company, a compromise or arrangement is proposed between the company and its creditors, or any class of them, the Authority may apply to the court under section 425 of the Companies Act 1985 (or Article 418 of the Companies (Northern Ireland) Order 1986). 1985 c. 6. S.I. 1986/1032 (N.I. 6).

Receivership

Authority's powers to participate in proceedings.

363.—(1) This section applies if a receiver has been appointed in relation to a company which—

(a) is, or has been, an authorised person;

(b) is, or has been, an appointed representative; or

(c) is carrying on, or has carried on, a regulated activity in contravention of the general prohibition.

(2) The Authority is entitled to be heard on an application made under section 35 or 63 of the 1986 Act (or Article 45 of the 1989 Order).

(3) The Authority is entitled to make an application under section 41(1)(a) or 69(1)(a) of the 1986 Act (or Article 51(1)(a) of the 1989 Order).

(4) A report under section 48(1) or 67(1) of the 1986 Act (or Article 58(1) of the 1989 Order) must be sent by the person making it to the Authority.

(5) A person appointed for the purpose by the Authority is entitled—

(a) to attend any meeting of creditors of the company summoned under any enactment;

(b) to attend any meeting of a committee established under section 49 or 68 of the 1986 Act (or Article 59 of the 1989 Order); and

(c) to make representations as to any matter for decision at such a meeting.

Receiver's duty to report to Authority.

364. If—

(a) a receiver has been appointed in relation to a company, and

(b) it appears to the receiver that the company is carrying on, or has carried on, a regulated activity in contravention of the general prohibition,

the receiver must report the matter to the Authority without delay.

Voluntary winding up

Authority's powers to participate in proceedings.

365.—(1) This section applies in relation to a company which—

(a) is being wound up voluntarily;

(b) is an authorised person; and

(c) is not an insurer effecting or carrying out contracts of long-term insurance.

(2) The Authority may apply to the court under section 112 of the 1986 Act (or Article 98 of the 1989 Order) in respect of the company.

(3) The Authority is entitled to be heard at any hearing of the court in relation to the voluntary winding up of the company.

(4) Any notice or other document required to be sent to a creditor of the company must also be sent to the Authority.

(5) A person appointed for the purpose by the Authority is entitled—

(a) to attend any meeting of creditors of the company summoned under any enactment;

(b) to attend any meeting of a committee established under section 101 of the 1986 Act (or Article 87 of the 1989 Order); and

(c) to make representations as to any matter for decision at such a meeting.

(6) The voluntary winding up of the company does not bar the right of the Authority to have it wound up by the court.

(7) If, during the course of the winding up of the company, a compromise or arrangement is proposed between the company and its creditors, or any class of them, the Authority may apply to the court under section 425 of the Companies Act 1985 (or Article 418 of the Companies (Northern Ireland) Order 1986).

1985 c. 6.
S.I. 1986/1032 (N.I. 6).

Insurers effecting or carrying out long-term contracts or insurance.

366.—(1) An insurer effecting or carrying out contracts of long-term insurance may not be wound up voluntarily without the consent of the Authority.

(2) If notice of a general meeting of such an insurer is given, specifying the intention to propose a resolution for voluntary winding up of the insurer, a director of the insurer must notify the Authority as soon as practicable after he becomes aware of it.

(3) A person who fails to comply with subsection (2) is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.

(4) The following provisions do not apply in relation to a winding-up resolution—

(a) sections 378(3) and 381A of the Companies Act 1985 ("the 1985 Act"); and

(b) Articles 386(3) and 389A of the Companies (Northern Ireland) Order 1986 ("the 1986 Order"). S.I. 1986/1032 (N.I. 6).

(5) A copy of a winding-up resolution forwarded to the registrar of companies in accordance with section 380 of the 1985 Act (or Article 388 of the 1986 Order) must be accompanied by a certificate issued by the Authority stating that it consents to the voluntary winding up of the insurer.

(6) If subsection (5) is complied with, the voluntary winding up is to be treated as having commenced at the time the resolution was passed.

(7) If subsection (5) is not complied with, the resolution has no effect.

(8) "Winding-up resolution" means a resolution for voluntary winding up of an insurer effecting or carrying out contracts of long-term insurance.

Winding up by the court

Winding-up petitions.

367.—(1) The Authority may present a petition to the court for the winding up of a body which—

(a) is, or has been, an authorised person;

(b) is, or has been, an appointed representative; or

(c) is carrying on, or has carried on, a regulated activity in contravention of the general prohibition.

(2) In subsection (1) "body" includes any partnership.

(3) On such a petition, the court may wind up the body if—

(a) the body is unable to pay its debts within the meaning of section 123 or 221 of the 1986 Act (or Article 103 or 185 of the 1989 Order); or

(b) the court is of the opinion that it is just and equitable that it should be wound up.

(4) If a body is in default on an obligation to pay a sum due and payable under an agreement, it is to be treated for the purpose of subsection (3)(a) as unable to pay its debts.

(5) "Agreement" means an agreement the making or performance of which constitutes or is part of a regulated activity carried on by the body concerned.

(6) Subsection (7) applies if a petition is presented under subsection (1) for the winding up of a partnership—

(a) on the ground mentioned in subsection (3)(b); or

(b) in Scotland, on a ground mentioned in subsection (3)(a) or (b).

(7) The court has jurisdiction, and the 1986 Act (or the 1989 Order) has effect, as if the partnership were an unregistered company as defined by section 220 of that Act (or Article 184 of that Order).

Winding-up petitions: EEA and Treaty firms.

368. The Authority may not present a petition to the court under section 367 for the winding up of—

(a) an EEA firm which qualifies for authorisation under Schedule 3, or

(b) a Treaty firm which qualifies for authorisation under Schedule 4,

unless it has been asked to do so by the home state regulator of the firm concerned.

Insurers: service of petition etc. on Authority.

369.—(1) If a person other than the Authority presents a petition for the winding up of an authorised person with permission to effect or carry out contracts of insurance, the petitioner must serve a copy of the petition on the Authority.

(2) If a person other than the Authority applies to have a provisional liquidator appointed under section 135 of the 1986 Act (or Article 115 of the 1989 Order) in respect of an authorised person with permission to effect or carry out contracts of insurance, the applicant must serve a copy of the application on the Authority.

Liquidator's duty to report to Authority.

370. If—

(a) a company is being wound up voluntarily or a body is being wound up on a petition presented by a person other than the Authority, and

(b) it appears to the liquidator that the company or body is carrying on, or has carried on, a regulated activity in contravention of the general prohibition,

the liquidator must report the matter to the Authority without delay.

Authority's powers to participate in proceedings.

371.—(1) This section applies if a person other than the Authority presents a petition for the winding up of a body which—

(a) is, or has been, an authorised person;

(b) is, or has been, an appointed representative; or

(c) is carrying on, or has carried on, a regulated activity in contravention of the general prohibition.

(2) The Authority is entitled to be heard—

(a) at the hearing of the petition; and

(b) at any other hearing of the court in relation to the body under or by virtue of Part IV or V of the 1986 Act (or Part V or VI of the 1989 Order).

(3) Any notice or other document required to be sent to a creditor of the body must also be sent to the Authority.

(4) A person appointed for the purpose by the Authority is entitled—

(a) to attend any meeting of creditors of the body;

(b) to attend any meeting of a committee established for the purposes of Part IV or V of the 1986 Act under section 101 of that Act or under section 141 or 142 of that Act;

(c) to attend any meeting of a committee established for the purposes of Part V or VI of the 1989 Order under Article 87 of that Order or under Article 120 of that Order; and

(d) to make representations as to any matter for decision at such a meeting.

(5) If, during the course of the winding up of a company, a compromise or arrangement is proposed between the company and its creditors, or

any class of them, the Authority may apply to the court under section 425 of the Companies Act 1985 (or Article 418 of the Companies (Northern Ireland) Order 1986). 1985 c. 6. S.I. 1986/1032 (N.I. 6).

Bankruptcy

372.—(1) The Authority may present a petition to the court— Petitions.

(a) under section 264 of the 1986 Act (or Article 238 of the 1989 Order) for a bankruptcy order to be made against an individual; or

(b) under section 5 of the 1985 Act for the sequestration of the estate of an individual.

(2) But such a petition may be presented only on the ground that—

(a) the individual appears to be unable to pay a regulated activity debt; or

(b) the individual appears to have no reasonable prospect of being able to pay a regulated activity debt.

(3) An individual appears to be unable to pay a regulated activity debt if he is in default on an obligation to pay a sum due and payable under an agreement.

(4) An individual appears to have no reasonable prospect of being able to pay a regulated activity debt if—

(a) the Authority has served on him a demand requiring him to establish to the satisfaction of the Authority that there is a reasonable prospect that he will be able to pay a sum payable under an agreement when it falls due;

(b) at least three weeks have elapsed since the demand was served; and

(c) the demand has been neither complied with nor set aside in accordance with rules.

(5) A demand made under subsection (4)(a) is to be treated for the purposes of the 1986 Act (or the 1989 Order) as if it were a statutory demand under section 268 of that Act (or Article 242 of that Order).

(6) For the purposes of a petition presented in accordance with subsection (1)(b)—

(a) the Authority is to be treated as a qualified creditor; and

(b) a ground mentioned in subsection (2) constitutes apparent insolvency.

(7) “Individual” means an individual—

(a) who is, or has been, an authorised person; or

(b) who is carrying on, or has carried on, a regulated activity in contravention of the general prohibition.

(8) “Agreement” means an agreement the making or performance of which constitutes or is part of a regulated activity carried on by the individual concerned.

(9) “Rules” means—

(a) in England and Wales, rules made under section 412 of the 1986 Act;

(b) in Scotland, rules made by order by the Treasury, after consultation with the Scottish Ministers, for the purposes of this section; and

(c) in Northern Ireland, rules made under Article 359 of the 1989 Order.

Insolvency practitioner's duty to report to Authority.

373.—(1) If—

(a) a bankruptcy order or sequestration award is in force in relation to an individual by virtue of a petition presented by a person other than the Authority, and

(b) it appears to the insolvency practitioner that the individual is carrying on, or has carried on, a regulated activity in contravention of the general prohibition,

the insolvency practitioner must report the matter to the Authority without delay.

(2) "Bankruptcy order" means a bankruptcy order under Part IX of the 1986 Act (or Part IX of the 1989 Order).

(3) "Sequestration award" means an award of sequestration under section 12 of the 1985 Act.

(4) "Individual" includes an entity mentioned in section 374(1)(c).

Authority's powers to participate in proceedings.

374.—(1) This section applies if a person other than the Authority presents a petition to the court—

(a) under section 264 of the 1986 Act (or Article 238 of the 1989 Order) for a bankruptcy order to be made against an individual;

(b) under section 5 of the 1985 Act for the sequestration of the estate of an individual; or

(c) under section 6 of the 1985 Act for the sequestration of the estate belonging to or held for or jointly by the members of an entity mentioned in subsection (1) of that section.

(2) The Authority is entitled to be heard—

(a) at the hearing of the petition; and

(b) at any other hearing in relation to the individual or entity under—

(i) Part IX of the 1986 Act;

(ii) Part IX of the 1989 Order; or

(iii) the 1985 Act.

(3) A copy of the report prepared under section 274 of the 1986 Act (or Article 248 of the 1989 Order) must also be sent to the Authority.

(4) A person appointed for the purpose by the Authority is entitled—

(a) to attend any meeting of creditors of the individual or entity;

(b) to attend any meeting of a committee established under section 301 of the 1986 Act (or Article 274 of the 1989 Order);

(c) to attend any meeting of commissioners held under paragraph 17 or 18 of Schedule 6 to the 1985 Act; and

(d) to make representations as to any matter for decision at such a meeting.

(5) "Individual" means an individual who—

(a) is, or has been, an authorised person; or

(b) is carrying on, or has carried on, a regulated activity in contravention of the general prohibition.

(6) "Entity" means an entity which—

(a) is, or has been, an authorised person; or

(b) is carrying on, or has carried on, a regulated activity in contravention of the general prohibition.

Provisions against debt avoidance

Authority's right to apply for an order.

375.—(1) The Authority may apply for an order under section 423 of the 1986 Act (or Article 367 of the 1989 Order) in relation to a debtor if—

(a) at the time the transaction at an undervalue was entered into, the debtor was carrying on a regulated activity (whether or not in contravention of the general prohibition); and

(b) a victim of the transaction is or was party to an agreement entered into with the debtor, the making or performance of which constituted or was part of a regulated activity carried on by the debtor.

(2) An application made under this section is to be treated as made on behalf of every victim of the transaction to whom subsection (1)(b) applies.

(3) Expressions which are given a meaning in Part XVI of the 1986 Act (or Article 367, 368 or 369 of the 1989 Order) have the same meaning when used in this section.

Supplemental provisions concerning insurers

Continuation of contracts of long-term insurance where insurer in liquidation.

376.—(1) This section applies in relation to the winding up of an insurer which effects or carries out contracts of long-term insurance.

(2) Unless the court otherwise orders, the liquidator must carry on the insurer's business so far as it consists of carrying out the insurer's contracts of long-term insurance with a view to its being transferred as a going concern to a person who may lawfully carry out those contracts.

(3) In carrying on the business, the liquidator—

(a) may agree to the variation of any contracts of insurance in existence when the winding up order is made; but

(b) must not effect any new contracts of insurance.

(4) If the liquidator is satisfied that the interests of the creditors in respect of liabilities of the insurer attributable to contracts of long-term insurance effected by it require the appointment of a special manager, he may apply to the court.

(5) On such an application, the court may appoint a special manager to act during such time as the court may direct.

(6) The special manager is to have such powers, including any of the powers of a receiver or manager, as the court may direct.

(7) Section 177(5) of the 1986 Act (or Article 151(5) of the 1989 Order) applies to a special manager appointed under subsection (5) as it applies to a special manager appointed under section 177 of the 1986 Act (or Article 151 of the 1989 Order).

(8) If the court thinks fit, it may reduce the value of one or more of the contracts of long-term insurance effected by the insurer.

(9) Any reduction is to be on such terms and subject to such conditions (if any) as the court thinks fit.

(10) The court may, on the application of an official, appoint an independent actuary to investigate the insurer's business so far as it consists of carrying out its contracts of long-term insurance and to report to the official—

(a) on the desirability or otherwise of that part of the insurer's business being continued; and

(b) on any reduction in the contracts of long-term insurance effected by the insurer that may be necessary for successful continuation of that part of the insurer's business.

(11) "Official" means—

(a) the liquidator;

(b) a special manager appointed under subsection (5); or

(c) the Authority.

(12) The liquidator may make an application in the name of the insurer and on its behalf under Part VII without obtaining the permission that would otherwise be required by section 167 of, and Schedule 4 to, the 1986 Act (or Article 142 of, and Schedule 2 to, the 1989 Order).

Reducing the value of contracts instead of winding up.

377.—(1) This section applies in relation to an insurer which has been proved to be unable to pay its debts.

(2) If the court thinks fit, it may reduce the value of one or more of the insurer's contracts instead of making a winding up order.

(3) Any reduction is to be on such terms and subject to such conditions (if any) as the court thinks fit.

Treatment of assets on winding up.

378.—(1) The Treasury may by regulations provide for the treatment of the assets of an insurer on its winding up.

(2) The regulations may, in particular, provide for—

(a) assets representing a particular part of the insurer's business to be available only for meeting liabilities attributable to that part of the insurer's business;

(b) separate general meetings of the creditors to be held in respect of liabilities attributable to a particular part of the insurer's business.

Winding-up rules.

379.—(1) Winding-up rules may include provision—

(a) for determining the amount of the liabilities of an insurer to policyholders of any class or description for the purpose of proof in a winding up; and

(b) generally for carrying into effect the provisions of this Part with respect to the winding up of insurers.

(2) Winding-up rules may, in particular, make provision for all or any of the following matters—

(a) the identification of assets and liabilities;

(b) the apportionment, between assets of different classes or descriptions, of—

(i) the costs, charges and expenses of the winding up; and

(ii) any debts of the insurer of a specified class or description;

(c) the determination of the amount of liabilities of a specified description;

(d) the application of assets for meeting liabilities of a specified description;

(e) the application of assets representing any excess of a specified description.

(3) "Specified" means specified in winding-up rules.

(4) "Winding-up rules" means rules made under section 411 of the 1986 Act (or Article 359 of the 1989 Order).

(5) Nothing in this section affects the power to make winding-up rules under the 1986 Act or the 1989 Order.

PART XXV

INJUNCTIONS AND RESTITUTION

Injunctions

Injunctions.

380.—(1) If, on the application of the Authority or the Secretary of State, the court is satisfied—

(a) that there is a reasonable likelihood that any person will contravene a relevant requirement, or

(b) that any person has contravened a relevant requirement and that there is a reasonable likelihood that the contravention will continue or be repeated,

the court may make an order restraining (or in Scotland an interdict prohibiting) the contravention.

(2) If on the application of the Authority or the Secretary of State the court is satisfied—

(a) that any person has contravened a relevant requirement, and

(b) that there are steps which could be taken for remedying the contravention,

the court may make an order requiring that person, and any other person who appears to have been knowingly concerned in the contravention, to take such steps as the court may direct to remedy it.

(3) If, on the application of the Authority or the Secretary of State, the court is satisfied that any person may have—

(a) contravened a relevant requirement, or

(b) been knowingly concerned in the contravention of such a requirement,

it may make an order restraining (or in Scotland an interdict prohibiting) him from disposing of, or otherwise dealing with, any assets of his which it is satisfied he is reasonably likely to dispose of or otherwise deal with.

(4) The jurisdiction conferred by this section is exercisable by the High Court and the Court of Session.

(5) In subsection (2), references to remedying a contravention include references to mitigating its effect.

(6) "Relevant requirement"—

(a) in relation to an application by the Authority, means a requirement—

(i) which is imposed by or under this Act; or

(ii) which is imposed by or under any other Act and whose contravention constitutes an offence which the Authority has power to prosecute under this Act;

(b) in relation to an application by the Secretary of State, means a requirement which is imposed by or under this Act and whose contravention constitutes an offence which the Secretary of State has power to prosecute under this Act.

(7) In the application of subsection (6) to Scotland—

(a) in paragraph (a)(ii) for "which the Authority has power to prosecute under this Act" substitute "mentioned in paragraph (a) or (b) of section 402(1)"; and

(b) in paragraph (b) omit "which the Secretary of State has power to prosecute under this Act".

Injunctions in cases of market abuse.

381.—(1) If, on the application of the Authority, the court is satisfied—

(a) that there is a reasonable likelihood that any person will engage in market abuse, or

(b) that any person is or has engaged in market abuse and that there is a reasonable likelihood that the market abuse will continue or be repeated,

the court may make an order restraining (or in Scotland an interdict prohibiting) the market abuse.

(2) If on the application of the Authority the court is satisfied—

(a) that any person is or has engaged in market abuse, and

(b) that there are steps which could be taken for remedying the market abuse,

the court may make an order requiring him to take such steps as the court may direct to remedy it.

(3) Subsection (4) applies if, on the application of the Authority, the court is satisfied that any person—

(a) may be engaged in market abuse; or

(b) may have been engaged in market abuse.

(4) The court make an order restraining (or in Scotland an interdict prohibiting) the person concerned from disposing of, or otherwise dealing with, any assets of his which it is satisfied that he is reasonably likely to dispose of, or otherwise deal with.

(5) The jurisdiction conferred by this section is exercisable by the High Court and the Court of Session.

(6) In subsection (2), references to remedying any market abuse include references to mitigating its effect.

Restitution orders

Restitution orders.

382.—(1) The court may, on the application of the Authority or the Secretary of State, make an order under subsection (2) if it is satisfied that a person has contravened a relevant requirement, or been knowingly concerned in the contravention of such a requirement, and—

(a) that profits have accrued to him as a result of the contravention; or

(b) that one or more persons have suffered loss or been otherwise adversely affected as a result of the contravention.

(2) The court may order the person concerned to pay to the Authority such sum as appears to the court to be just having regard—

(a) in a case within paragraph (a) of subsection (1), to the profits appearing to the court to have accrued;

(b) in a case within paragraph (b) of that subsection, to the extent of the loss or other adverse effect;

(c) in a case within both of those paragraphs, to the profits appearing to the court to have accrued and to the extent of the loss or other adverse effect.

(3) Any amount paid to the Authority in pursuance of an order under subsection (2) must be paid by it to such qualifying person or distributed by it among such qualifying persons as the court may direct.

(4) On an application under subsection (1) the court may require the person concerned to supply it with such accounts or other information as it may require for any one or more of the following purposes—

(a) establishing whether any and, if so, what profits have accrued to him as mentioned in paragraph (a) of that subsection;

(b) establishing whether any person or persons have suffered any loss or adverse effect as mentioned in paragraph (b) of that subsection and, if so, the extent of that loss or adverse effect; and

(c) determining how any amounts are to be paid or distributed under subsection (3).

(5) The court may require any accounts or other information supplied under subsection (4) to be verified in such manner as it may direct.

(6) The jurisdiction conferred by this section is exercisable by the High Court and the Court of Session.

(7) Nothing in this section affects the right of any person other than the Authority or the Secretary of State to bring proceedings in respect of the matters to which this section applies.

(8) "Qualifying person" means a person appearing to the court to be someone—

(a) to whom the profits mentioned in subsection (1)(a) are attributable; or

(b) who has suffered the loss or adverse effect mentioned in subsection (1)(b).

(9) "Relevant requirement"—

(a) in relation to an application by the Authority, means a requirement—

(i) which is imposed by or under this Act; or

(ii) which is imposed by or under any other Act and whose contravention constitutes an offence which the Authority has power to prosecute under this Act;

(b) in relation to an application by the Secretary of State, means a requirement which is imposed by or under this Act and whose contravention constitutes an offence which the Secretary of State has power to prosecute under this Act.

(10) In the application of subsection (9) to Scotland—

(a) in paragraph (a)(ii) for "which the Authority has power to prosecute under this Act" substitute "mentioned in paragraph (a) or (b) of section 402(1); and

(b) in paragraph (b) omit "which the Secretary of State has power to prosecute under this Act".

Restitution orders in cases of market abuse.

383.—(1) The court may, on the application of the Authority, make an order under subsection (4) if it is satisfied that a person ("the person concerned")—

(a) has engaged in market abuse, or

(b) by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by the person concerned, would amount to market abuse,

and the condition mentioned in subsection (2) is fulfilled.

(2) The condition is—

(a) that profits have accrued to the person concerned as a result; or

(b) that one or more persons have suffered loss or been otherwise adversely affected as a result.

(3) But the court may not make an order under subsection (4) if it is satisfied that—

(a) the person concerned believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1); or

(b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of subsection (1).

(4) The court may order the person concerned to pay to the Authority such sum as appears to the court to be just having regard—

(a) in a case within paragraph (a) of subsection (2), to the profits appearing to the court to have accrued;

(b) in a case within paragraph (b) of that subsection, to the extent of the loss or other adverse effect;

(c) in a case within both of those paragraphs, to the profits appearing to the court to have accrued and to the extent of the loss or other adverse effect.

(5) Any amount paid to the Authority in pursuance of an order under subsection (4) must be paid by it to such qualifying person or distributed by it among such qualifying persons as the court may direct.

(6) On an application under subsection (1) the court may require the person concerned to supply it with such accounts or other information as it may require for any one or more of the following purposes—

(a) establishing whether any and, if so, what profits have accrued to him as mentioned in subsection (2)(a);

(b) establishing whether any person or persons have suffered any loss or adverse effect as mentioned in subsection (2)(b) and, if so, the extent of that loss or adverse effect; and

(c) determining how any amounts are to be paid or distributed under subsection (5).

(7) The court may require any accounts or other information supplied under subsection (6) to be verified in such manner as it may direct.

(8) The jurisdiction conferred by this section is exercisable by the High Court and the Court of Session.

(9) Nothing in this section affects the right of any person other than the Authority to bring proceedings in respect of the matters to which this section applies.

(10) "Qualifying person" means a person appearing to the court to be someone—

(a) to whom the profits mentioned in paragraph (a) of subsection (2) are attributable; or

(b) who has suffered the loss or adverse effect mentioned in paragraph (b) of that subsection.

Restitution required by Authority

Power of Authority to require restitution.

384.—(1) The Authority may exercise the power in subsection (5) if it is satisfied that an authorised person ("the person concerned") has contravened a relevant requirement, or been knowingly concerned in the contravention of such a requirement, and—

(a) that profits have accrued to him as a result of the contravention; or

(b) that one or more persons have suffered loss or been otherwise adversely affected as a result of the contravention.

(2) The Authority may exercise the power in subsection (5) if it is satisfied that a person ("the person concerned")—

(a) has engaged in market abuse, or

(b) by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by the person concerned, would amount to market abuse,

and the condition mentioned in subsection (3) is fulfilled,

(3) The condition is—

(a) that profits have accrued to the person concerned as a result of the market abuse; or

(b) that one or more persons have suffered loss or been otherwise adversely affected as a result of the market abuse.

(4) But the Authority may not exercise that power as a result of subsection (2) if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that—

(a) the person concerned believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of that subsection; or

(b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.

(5) The power referred to in subsections (1) and (2) is a power to require the person concerned, in accordance with such arrangements as the Authority considers appropriate, to pay to the appropriate person or distribute among the appropriate persons such amount as appears to the Authority to be just having regard—

(a) in a case within paragraph (a) of subsection (1) or (3), to the profits appearing to the Authority to have accrued;

(b) in a case within paragraph (b) of subsection (1) or (3), to the extent of the loss or other adverse effect;

(c) in a case within paragraphs (a) and (b) of subsection (1) or (3), to the profits appearing to the Authority to have accrued and to the extent of the loss or other adverse effect.

(6) "Appropriate person" means a person appearing to the Authority to be someone—

(a) to whom the profits mentioned in paragraph (a) of subsection (1) or (3) are attributable; or

(b) who has suffered the loss or adverse effect mentioned in paragraph (b) of subsection (1) or (3).

(7) "Relevant requirement" means—

(a) a requirement imposed by or under this Act; and

(b) a requirement which is imposed by or under any other Act and whose contravention constitutes an offence in relation to which this Act confers power to prosecute on the Authority.

(8) In the application of subsection (7) to Scotland, in paragraph (b) for "in relation to which this Act confers power to prosecute on the Authority" substitute "mentioned in paragraph (a) or (b) of section 402(1)".

Warning notices.

385.—(1) If the Authority proposes to exercise the power under section 384(5) in relation to a person, it must give him a warning notice.

(2) A warning notice under this section must specify the amount which the Authority proposes to require the person concerned to pay or distribute as mentioned in section 384(5).

Decision notices.

386.—(1) If the Authority decides to exercise the power under section 384(5), it must give a decision notice to the person in relation to whom the power is exercised.

(2) The decision notice must—

(a) state the amount that he is to pay or distribute as mentioned in section 384(5);

(b) identify the person or persons to whom that amount is to be paid or among whom that amount is to be distributed; and

(c) state the arrangements in accordance with which the payment or distribution is to be made.

(3) If the Authority decides to exercise the power under section 384(5), the person in relation to whom it is exercised may refer the matter to the Tribunal.

PART XXVI

NOTICES

Warning notices

387.—(1) A warning notice must—

(a) state the action which the Authority proposes to take;

(b) be in writing;

(c) give reasons for the proposed action;

(d) state whether section 394 applies; and

(e) if that section applies, describe its effect and state whether any secondary material exists to which the person concerned must be allowed access under it.

(2) The warning notice must specify a reasonable period (which may not be less than 28 days) within which the person to whom it is given may make representations to the Authority.

(3) The Authority may extend the period specified in the notice.

(4) The Authority must then decide, within a reasonable period, whether to give the person concerned a decision notice.

Decision notices

388.—(1) A decision notice must—

(a) be in writing;

(b) give the Authority's reasons for the decision to take the action to which the notice relates;

(c) state whether section 394 applies;

(d) if that section applies, describe its effect and state whether any secondary material exists to which the person concerned must be allowed access under it; and

(e) give an indication of—

(i) any right to have the matter referred to the Tribunal which is given by this Act; and

(ii) the procedure on such a reference.

(2) If the decision notice was preceded by a warning notice, the action to which the decision notice relates must be action under the same Part as the action proposed in the warning notice.

(3) The Authority may, before it takes the action to which a decision notice ("the original notice") relates, give the person concerned a further decision notice which relates to different action in respect of the same matter.

(4) The Authority may give a further decision notice as a result of subsection (3) only if the person to whom the original notice was given consents.

(5) If the person to whom a decision notice is given under subsection (3) had the right to refer the matter to which the original decision notice related to the Tribunal, he has that right as respects the decision notice under subsection (3).

Conclusion of proceedings

Notices of discontinuance.

389.—(1) If the Authority decides not to take—

(a) the action proposed in a warning notice, or

(b) the action to which a decision notice relates,

it must give a notice of discontinuance to the person to whom the warning notice or decision notice was given.

(2) But subsection (1) does not apply if the discontinuance of the proceedings concerned results in the granting of an application made by the person to whom the warning or decision notice was given.

(3) A notice of discontinuance must identify the proceedings which are being discontinued.

Final notices.

390.—(1) If the Authority has given a person a decision notice and the matter was not referred to the Tribunal within the period mentioned in section 133(1), the Authority must, on taking the action to which the decision notice relates, give the person concerned and any person to whom the decision notice was copied a final notice.

(2) If the Authority has given a person a decision notice and the matter was referred to the Tribunal, the Authority must, on taking action in accordance with any directions given by—

(a) the Tribunal, or

(b) the court under section 137,

give that person and any person to whom the decision notice was copied a final notice.

(3) A final notice about a statement must—

(a) set out the terms of the statement;

(b) give details of the manner in which, and the date on which, the statement will be published.

(4) A final notice about an order must—

(a) set out the terms of the order;

(b) state the date from which the order has effect.

(5) A final notice about a penalty must—

(a) state the amount of the penalty;

(b) state the manner in which, and the period within which, the penalty is to be paid;

(c) give details of the way in which the penalty will be recovered if it is not paid by the date stated in the notice.

(6) A final notice about a requirement to make a payment or distribution in accordance with section 384(5) must state—

(a) the persons to whom,

(b) the manner in which, and

(c) the period within which,

it must be made.

(7) In any other case, the final notice must—

(a) give details of the action being taken;

(b) state the date on which the action is to be taken.

(8) The period stated under subsection (5)(b) or (6)(c) may not be less than 14 days beginning with the date on which the final notice is given.

(9) If all or any of the amount of a penalty payable under a final notice is outstanding at the end of the period stated under subsection (5)(b), the Authority may recover the outstanding amount as a debt due to it.

(10) If all or any of a required payment or distribution has not been made at the end of a period stated in a final notice under subsection (6)(c), the obligation to make the payment is enforceable, on the application of the Authority, by injunction or, in Scotland, by an order under section 45 of the Court of Session Act 1988. 1988 c. 36.

Publication

391.—(1) Neither the Authority nor a person to whom a warning notice or decision notice is given or copied may publish the notice or any details concerning it. Publication.

(2) A notice of discontinuance must state that, if the person to whom the notice is given consents, the Authority may publish such information as it considers appropriate about the matter to which the discontinued proceedings related.

(3) A copy of a notice of discontinuance must be accompanied by a statement that, if the person to whom the notice is copied consents, the Authority may publish such information as it considers appropriate about the matter to which the discontinued proceedings related, so far as relevant to that person.

(4) The Authority must publish such information about the matter to which a final notice relates as it considers appropriate.

(5) When a supervisory notice takes effect, the Authority must publish such information about the matter to which the notice relates as it considers appropriate.

(6) But the Authority may not publish information under this section if publication of it would, in its opinion, be unfair to the person with respect to whom the action was taken or prejudicial to the interests of consumers.

(7) Information is to be published under this section in such manner as the Authority considers appropriate.

(8) For the purposes of determining when a supervisory notice takes effect, a matter to which the notice relates is open to review if—

(a) the period during which any person may refer the matter to the Tribunal is still running;

(b) the matter has been referred to the Tribunal but has not been dealt with;

(c) the matter has been referred to the Tribunal and dealt with but the period during which an appeal may be brought against the Tribunal's decision is still running; or

(d) such an appeal has been brought but has not been determined.

(9) "Notice of discontinuance" means a notice given under section 389.

(10) "Supervisory notice" has the same meaning as in section 395.

(11) "Consumers" means persons who are consumers for the purposes of section 138.

Third party rights and access to evidence

Application of sections 393 and 394.

392. Sections 393 and 394 apply to—

(a) a warning notice given in accordance with section 54(1), 57(1), 63(3), 67(1), 88(4)(b), 89(2), 92(1), 126(1), 207(1), 255(1), 280(1), 331(1), 345(2) (whether as a result of subsection (1) of that section or section 249(1)) or 385(1);

(b) a decision notice given in accordance with section 54(2), 57(3), 63(4), 67(4), 88(6)(b), 89(3), 92(4), 127(1), 208(1), 255(2), 280(2), 331(3), 345(3) (whether as a result of subsection (1) of that section or section 249(1)) or 386(1).

Third party rights.

393.—(1) If any of the reasons contained in a warning notice to which this section applies relates to a matter which—

(a) identifies a person ("the third party") other than the person to whom the notice is given, and

(b) in the opinion of the Authority, is prejudicial to the third party,

a copy of the notice must be given to the third party.

(2) Subsection (1) does not require a copy to be given to the third party if the Authority—

(a) has given him a separate warning notice in relation to the same matter; or

(b) gives him such a notice at the same time as it gives the warning notice which identifies him.

(3) The notice copied to a third party under subsection (1) must specify a reasonable period (which may not be less than 28 days) within which he may make representations to the Authority.

(4) If any of the reasons contained in a decision notice to which this section applies relates to a matter which—

(a) identifies a person ("the third party") other than the person to whom the decision notice is given, and

(b) in the opinion of the Authority, is prejudicial to the third party,

a copy of the notice must be given to the third party.

(5) If the decision notice was preceded by a warning notice, a copy of the decision notice must (unless it has been given under subsection (4)) be given to each person to whom the warning notice was copied.

(6) Subsection (4) does not require a copy to be given to the third party if the Authority—

(a) has given him a separate decision notice in relation to the same matter; or

(b) gives him such a notice at the same time as it gives the decision notice which identifies him.

(7) Neither subsection (1) nor subsection (4) requires a copy of a notice to be given to a third party if the Authority considers it impracticable to do so.

(8) Subsections (9) to (11) apply if the person to whom a decision notice is given has a right to refer the matter to the Tribunal.

(9) A person to whom a copy of the notice is given under this section may refer to the Tribunal—

(a) the decision in question, so far as it is based on a reason of the kind mentioned in subsection (4); or

(b) any opinion expressed by the Authority in relation to him.

(10) The copy must be accompanied by an indication of the third party's right to make a reference under subsection (9) and of the procedure on such a reference.

(11) A person who alleges that a copy of the notice should have been given to him, but was not, may refer to the Tribunal the alleged failure and—

(a) the decision in question, so far as it is based on a reason of the kind mentioned in subsection (4); or

(b) any opinion expressed by the Authority in relation to him.

(12) Section 394 applies to a third party as it applies to the person to whom the notice to which this section applies was given, in so far as the material which the Authority must disclose under that section relates to the matter which identifies the third party.

(13) A copy of a notice given to a third party under this section must be accompanied by a description of the effect of section 394 as it applies to him.

(14) Any person to whom a warning notice or decision notice was copied under this section must be given a copy of a notice of discontinuance applicable to the proceedings to which the warning notice or decision notice related.

Access to Authority material.

394.—(1) If the Authority gives a person ("A") a notice to which this section applies, it must—

(a) allow him access to the material on which it relied in taking the decision which gave rise to the obligation to give the notice;

(b) allow him access to any secondary material which, in the opinion of the Authority, might undermine that decision.

(2) But the Authority does not have to allow A access to material under subsection (1) if the material is excluded material or it—

(a) relates to a case involving a person other than A; and

(b) was taken into account by the Authority in A's case only for purposes of comparison with other cases.

(3) The Authority may refuse A access to particular material which it would otherwise have to allow him access to if, in its opinion, allowing him access to the material—

(a) would not be in the public interest; or

(b) would not be fair, having regard to—

(i) the likely significance of the material to A in relation to the matter in respect of which he has been given a notice to which this section applies; and

(ii) the potential prejudice to the commercial interests of a person other than A which would be caused by the material's disclosure.

(4) If the Authority does not allow A access to material because it is excluded material consisting of a protected item, it must give A written notice of—

(a) the existence of the protected item; and

(b) the Authority's decision not to allow him access to it.

(5) If the Authority refuses under subsection (3) to allow A access to material, it must give him written notice of—

(a) the refusal; and

(b) the reasons for it.

(6) "Secondary material" means material, other than material falling within paragraph (a) of subsection (1) which—

(a) was considered by the Authority in reaching the decision mentioned in that paragraph; or

(b) was obtained by the Authority in connection with the matter to which the notice to which this section applies relates but which was not considered by it in reaching that decision.

(7) "Excluded material" means material which—

(a) has been intercepted in obedience to a warrant issued under any enactment relating to the interception of communications;

(b) indicates that such a warrant has been issued or that material has been intercepted in obedience to such a warrant; or

(c) is a protected item (as defined in section 413).

The Authority's procedures

395.—(1) The Authority must determine the procedure that it proposes to follow in relation to the giving of— The Authority's procedures.

(a) supervisory notices; and

(b) warning notices and decision notices.

(2) That procedure must be designed to secure, among other things, that the decision which gives rise to the obligation to give any such notice is taken by a person not directly involved in establishing the evidence on which that decision is based.

(3) But the procedure may permit a decision which gives rise to an obligation to give a supervisory notice to be taken by a person other than a person mentioned in subsection (2) if—

(a) the Authority considers that, in the particular case, it is necessary in order to protect the interests of consumers; and

(b) the person taking the decision is of a level of seniority laid down by the procedure.

(4) A level of seniority laid down by the procedure for the purposes of subsection (3)(b) must be appropriate to the importance of the decision.

(5) The Authority must issue a statement of the procedure.

(6) The statement must be published in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(7) The Authority may charge a reasonable fee for providing a person with a copy of the statement.

(8) The Authority must, without delay, give the Treasury a copy of any statement which it issues under this section.

(9) When giving a supervisory notice, or a warning notice or decision notice, the Authority must follow its stated procedure.

(10) If the Authority changes the procedure in a material way, it must publish a revised statement.

(11) The Authority's failure in a particular case to follow its procedure as set out in the latest published statement does not affect the validity of a notice given in that case.

(12) But subsection (11) does not prevent the Tribunal from taking into account any such failure in considering a matter referred to it.

(13) "Supervisory notice" means a notice given in accordance with section—

(a) 53(4), (7) or (8)(b);

(b) 78(2) or (5);

(c) 197(3), (6) or (7)(b);

(d) 259(3), (8) or (9)(b);

(e) 268(3), (7)(a) or (9)(a) (as a result of subsection (8)(b));

(f) 282(3), (6) or (7)(b);

(g) 321(2) or (5).

Statements under section 395: consultation.

396.—(1) Before issuing a statement of procedure under section 395, the Authority must publish a draft of the proposed statement in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(2) The draft must be accompanied by notice that representations about the proposal may be made to the Authority within a specified time.

(3) Before issuing the proposed statement of procedure, the Authority must have regard to any representations made to it in accordance with subsection (2).

(4) If the Authority issues the proposed statement of procedure it must publish an account, in general terms, of—

(a) the representations made to it in accordance with subsection (2); and

(b) its response to them.

(5) If the statement of procedure differs from the draft published under subsection (1) in a way which is, in the opinion of the Authority, significant, the Authority must (in addition to complying with subsection (4)) publish details of the difference.

(6) The Authority may charge a reasonable fee for providing a person with a copy of a draft published under subsection (1).

(7) This section also applies to a proposal to revise a statement of policy.

PART XXVII

OFFENCES

Miscellaneous offences

Misleading statements and practices.

397.—(1) This subsection applies to a person who—

(a) makes a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular;

(b) dishonestly conceals any material facts whether in connection with a statement, promise or forecast made by him or otherwise; or

(c) recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular.

(2) A person to whom subsection (1) applies is guilty of an offence if he makes the statement, promise or forecast or conceals the facts for the purpose of inducing, or is reckless as to whether it may induce, another person (whether or not the person to whom the statement, promise or forecast is made)—

(a) to enter or offer to enter into, or to refrain from entering or offering to enter into, a relevant agreement; or

(b) to exercise, or refrain from exercising, any rights conferred by a relevant investment.

(3) Any person who does any act or engages in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investments is guilty of an offence if he does so for the purpose of creating that impression and of thereby inducing another person to acquire, dispose of, subscribe for or underwrite those investments or to refrain from doing so or to exercise, or refrain from exercising, any rights conferred by those investments.

(4) In proceedings for an offence under subsection (2) brought against a person to whom subsection (1) applies as a result of paragraph (a) of that subsection, it is a defence for him to show that the statement, promise or forecast was made in conformity with price stabilising rules or control of information rules.

(5) In proceedings brought against any person for an offence under subsection (3) it is a defence for him to show—

(a) that he reasonably believed that his act or conduct would not create an impression that was false or misleading as to the matters mentioned in that subsection;

(b) that he acted or engaged in the conduct—

(i) for the purpose of stabilising the price of investments; and

(ii) in conformity with price stabilising rules; or

(c) that he acted or engaged in the conduct in conformity with control of information rules.

(6) Subsections (1) and (2) do not apply unless—

(a) the statement, promise or forecast is made in or from, or the facts are concealed in or from, the United Kingdom or arrangements are made in or from the United Kingdom for the statement, promise or forecast to be made or the facts to be concealed;

(b) the person on whom the inducement is intended to or may have effect is in the United Kingdom; or

(c) the agreement is or would be entered into or the rights are or would be exercised in the United Kingdom.

(7) Subsection (3) does not apply unless—

(a) the act is done, or the course of conduct is engaged in, in the United Kingdom; or

(b) the false or misleading impression is created there.

(8) A person guilty of an offence under this section is liable—

(a) on summary conviction, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both;

(b) on conviction on indictment, to imprisonment for a term not exceeding seven years or a fine, or both.

(9) "Relevant agreement" means an agreement—

(a) the entering into or performance of which by either party constitutes an activity of a specified kind or one which falls within a specified class of activity; and

(b) which relates to a relevant investment.

(10) "Relevant investment" means an investment of a specified kind or one which falls within a prescribed class of investment.

(11) Schedule 2 (except paragraphs 25 and 26) applies for the purposes of subsections (9) and (10) with references to section 22 being read as references to each of those subsections.

(12) Nothing in Schedule 2, as applied by subsection (11), limits the power conferred by subsection (9) or (10).

(13) "Investment" includes any asset, right or interest.

(14) "Specified" means specified in an order made by the Treasury.

Misleading the Authority: residual cases.

398.—(1) A person who, in purported compliance with any requirement imposed by or under this Act, knowingly or recklessly gives the Authority information which is false or misleading in a material particular is guilty of an offence.

(2) Subsection (1) applies only to a requirement in relation to which no other provision of this Act creates an offence in connection with the giving of information.

(3) A person guilty of an offence under this section is liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to a fine.

Misleading the Director General of Fair Trading. 1998 c. 41.

399. Section 44 of the Competition Act 1998 (offences connected with the provision of false or misleading information) applies in relation to any function of the Director General of Fair Trading under this Act as if it were a function under Part I of that Act.

Bodies corporate and partnerships

Offences by bodies corporate etc.

400.—(1) If an offence under this Act committed by a body corporate is shown—

(a) to have been committed with the consent or connivance of an officer, or

(b) to be attributable to any neglect on his part,

the officer as well as the body corporate is guilty of the offence and liable to be proceeded against and punished accordingly.

(2) If the affairs of a body corporate are managed by its members, subsection (1) applies in relation to the acts and defaults of a member in connection with his functions of management as if he were a director of the body.

(3) If an offence under this Act committed by a partnership is shown—

(a) to have been committed with the consent or connivance of a partner, or

(b) to be attributable to any neglect on his part,

the partner as well as the partnership is guilty of the offence and liable to be proceeded against and punished accordingly.

(4) In subsection (3) "partner" includes a person purporting to act as a partner.

(5) "Officer", in relation to a body corporate, means—

(a) a director, member of the committee of management, chief executive, manager, secretary or other similar officer of the body, or a person purporting to act in any such capacity; and

(b) an individual who is a controller of the body.

(6) If an offence under this Act committed by an unincorporated association (other than a partnership) is shown—

(a) to have been committed with the consent or connivance of an officer of the association or a member of its governing body, or

(b) to be attributable to any neglect on the part of such an officer or member,

that officer or member as well as the association is guilty of the offence and liable to be proceeded against and punished accordingly.

(7) Regulations may provide for the application of any provision of this section, with such modifications as the Treasury consider appropriate, to a body corporate or unincorporated association formed or recognised under the law of a territory outside the United Kingdom.

Institution of proceedings

Proceedings for offences.

401.—(1) In this section "offence" means an offence under this Act or subordinate legislation made under this Act.

(2) Proceedings for an offence may be instituted in England and Wales only—

(a) by the Authority or the Secretary of State; or

(b) by or with the consent of the Director of Public Prosecutions.

(3) Proceedings for an offence may be instituted in Northern Ireland only—

(a) by the Authority or the Secretary of State; or

(b) by or with the consent of the Director of Public Prosecutions for Northern Ireland.

(4) Except in Scotland, proceedings for an offence under section 203 may also be instituted by the Director General of Fair Trading.

(5) In exercising its power to institute proceedings for an offence, the Authority must comply with any conditions or restrictions imposed in writing by the Treasury.

(6) Conditions or restrictions may be imposed under subsection (5) in relation to—

(a) proceedings generally; or

(b) such proceedings, or categories of proceedings, as the Treasury may direct.

Power of the Authority to institute proceedings for certain other offences.

402.—(1) Except in Scotland, the Authority may institute proceedings for an offence under—

(a) Part V of the Criminal Justice Act 1993 (insider dealing); or

1993 c. 36.

(b) prescribed regulations relating to money laundering.

(2) In exercising its power to institute proceedings for any such offence, the Authority must comply with any conditions or restrictions imposed in writing by the Treasury.

(3) Conditions or restrictions may be imposed under subsection (2) in relation to—

(a) proceedings generally; or

(b) such proceedings, or categories of proceedings, as the Treasury may direct.

Jurisdiction and procedure in respect of offences.

403.—(1) A fine imposed on an unincorporated association on its conviction of an offence is to be paid out of the funds of the association.

(2) Proceedings for an offence alleged to have been committed by an unincorporated association must be brought in the name of the association (and not in that of any of its members).

(3) Rules of court relating to the service of documents are to have effect as if the association were a body corporate.

(4) In proceedings for an offence brought against an unincorporated association—

1925 c. 86.
1980 c. 43.

(a) section 33 of the Criminal Justice Act 1925 and Schedule 3 to the Magistrates' Courts Act 1980 (procedure) apply as they do in relation to a body corporate;

1995 c. 46.

(b) section 70 of the Criminal Procedure (Scotland) Act 1995 (procedure) applies as if the association were a body corporate;

1945 c. 15 (N.I.)
S.I. 1981/1675 (N.I. 26).

(c) section 18 of the Criminal Justice (Northern Ireland) Act 1945 and Schedule 4 to the Magistrates' Courts (Northern Ireland) Order 1981 (procedure) apply as they do in relation to a body corporate.

(5) Summary proceedings for an offence may be taken—

(a) against a body corporate or unincorporated association at any place at which it has a place of business;

(b) against an individual at any place where he is for the time being.

(6) Subsection (5) does not affect any jurisdiction exercisable apart from this section.

(7) "Offence" means an offence under this Act.

PART XXVIII

MISCELLANEOUS

Schemes for reviewing past business

Schemes for reviewing past business.

404.—(1) Subsection (2) applies if the Treasury are satisfied that there is evidence suggesting—

(a) that there has been a widespread or regular failure on the part of authorised persons to comply with rules relating to a particular kind of activity; and

(b) that, as a result, private persons have suffered (or will suffer) loss in respect of which authorised persons are (or will be) liable to make payments ("compensation payments").

(2) The Treasury may by order ("a scheme order") authorise the Authority to establish and operate a scheme for—

(a) determining the nature and extent of the failure;

(b) establishing the liability of authorised persons to make compensation payments; and

(c) determining the amounts payable by way of compensation payments.

(3) An authorised scheme must be made so as to comply with specified requirements.

(4) A scheme order may be made only if—

(a) the Authority has given the Treasury a report about the alleged failure and asked them to make a scheme order;

(b) the report contains details of the scheme which the Authority propose to make; and

(c) the Treasury are satisfied that the proposed scheme is an appropriate way of dealing with the failure.

(5) A scheme order may provide for specified provisions of or made under this Act to apply in relation to any provision of, or determination made under, the resulting authorised scheme subject to such modifications (if any) as may be specified.

(6) For the purposes of this Act, failure on the part of an authorised person to comply with any provision of an authorised scheme is to be treated (subject to any provision made by the scheme order concerned) as a failure on his part to comply with rules.

(7) The Treasury may prescribe circumstances in which loss suffered by a person ("A") acting in a fiduciary or other prescribed capacity is to be treated, for the purposes of an authorised scheme, as suffered by a private person in relation to whom A was acting in that capacity.

(8) This section applies whenever the failure in question occurred.

(9) "Authorised scheme" means a scheme authorised by a scheme order.

(10) "Private person" has such meaning as may be prescribed.

(11) "Specified" means specified in a scheme order.

Third countries

405.—(1) For the purpose of implementing a third country decision, the Treasury may direct the Authority to— Directions.

(a) refuse an application for permission under Part IV made by a body incorporated in, or formed under the law of, any part of the United Kingdom;

(b) defer its decision on such an application either indefinitely or for such period as may be specified in the direction;

(c) give a notice of objection to a person who has served a notice of control to the effect that he proposes to acquire a 50% stake in a UK authorised person; or

(d) give a notice of objection to a person who has acquired a 50% stake in a UK authorised person without having served the required notice of control.

(2) A direction may also be given in relation to—

(a) any person falling within a class specified in the direction;

(b) future applications, notices of control or acquisitions.

(3) The Treasury may revoke a direction at any time.

(4) But revocation does not affect anything done in accordance with the direction before it was revoked.

(5) "Third country decision" means a decision of the Council or the Commission under—

(a) Article 7(5) of the investment services directive;

(b) Article 9(4) of the second banking co-ordination directive;

(c) Article 29b(4) of the first non-life insurance directive; or

(d) Article 32b(4) of the first life insurance directive.

Interpretation of section 405.

406.—(1) For the purposes of section 405, a person ("the acquirer") acquires a 50% stake in a UK authorised person ("A") on first falling within any of the cases set out in subsection (2).

(2) The cases are where the acquirer—

(a) holds 50% or more of the shares in A;

(b) holds 50% or more of the shares in a parent undertaking ("P") of A;

(c) is entitled to exercise, or control the exercise of, 50% or more of the voting power in A; or

(d) is entitled to exercise, or control the exercise of, 50% or more of the voting power in P.

(3) In subsection (2) "the acquirer" means—

(a) the acquirer;

(b) any of the acquirer's associates; or

(c) the acquirer and any of his associates.

(4) "Associate", "shares" and "voting power" have the same meaning as in section 422.

Consequences of a direction under section 405.

407.—(1) If the Authority refuses an application for permission as a result of a direction under section 405(1)(a)—

(a) subsections (7) to (9) of section 52 do not apply in relation to the refusal; but

(b) the Authority must notify the applicant of the refusal and the reasons for it.

(2) If the Authority defers its decision on an application for permission as a result of a direction under section 405(1)(b)—

(a) the time limit for determining the application mentioned in section 52(1) or (2) stops running on the day of the deferral and starts running again (if at all) on the day the period specified in the direction (if any) ends or the day the direction is revoked; and

(b) the Authority must notify the applicant of the deferral and the reasons for it.

(3) If the Authority gives a notice of objection to a person as a result of a direction under section 405(1)(c) or (d)—

(a) sections 189 and 191 have effect as if the notice was a notice of objection within the meaning of Part XII; and

(b) the Authority must state in the notice the reasons for it.

EFTA firms.

408.—(1) If a third country decision has been taken, the Treasury may make a determination in relation to an EFTA firm which is a subsidiary undertaking of a parent undertaking which is governed by the law of the country to which the decision relates.

(2) "Determination" means a determination that the firm concerned does not qualify for authorisation under Schedule 3 even if it satisfies the conditions in paragraph 13 or 14 of that Schedule.

(3) A determination may also be made in relation to any firm falling within a class specified in the determination.

(4) The Treasury may withdraw a determination at any time.

(5) But withdrawal does not affect anything done in accordance with the determination before it was withdrawn.

(6) If the Treasury make a determination in respect of a particular firm, or withdraw such a determination, they must give written notice to that firm.

(7) The Treasury must publish notice of any determination (or the withdrawal of any determination)—

(a) in such a way as they think most suitable for bringing the determination (or withdrawal) to the attention of those likely to be affected by it; and

(b) on, or as soon as practicable after, the date of the determination (or withdrawal).

(8) "EFTA firm" means a firm, institution or undertaking which—

(a) is an EEA firm as a result of paragraph 5(a), (b) or (d) of Schedule 3; and

(b) is incorporated in, or formed under the law of, an EEA State which is not a member State.

(9) "Third country decision" has the same meaning as in section 405.

Gibraltar.

409.—(1) The Treasury may by order—

(a) modify Schedule 3 so as to provide for Gibraltar firms of a specified description to qualify for authorisation under that Schedule in specified circumstances;

(b) modify Schedule 3 so as to make provision in relation to the exercise by UK firms of rights under the law of Gibraltar which correspond to EEA rights;

(c) modify Schedule 4 so as to provide for Gibraltar firms of a specified description to qualify for authorisation under that Schedule in specified circumstances;

(d) modify section 264 so as to make provision in relation to collective investment schemes constituted under the law of Gibraltar;

(e) provide for the Authority to be able to give notice under section 264(2) on grounds relating to the law of Gibraltar;

(f) provide for this Act to apply to a Gibraltar recognised scheme as if the scheme were a scheme recognised under section 264.

(2) The fact that a firm may qualify for authorisation under Schedule 3 as a result of an order under subsection (1) does not prevent it from applying for a Part IV permission.

(3) "Gibraltar firm" means a firm which has its head office in Gibraltar or is otherwise connected with Gibraltar.

(4) "Gibraltar recognised scheme" means a collective investment scheme—

(a) constituted in an EEA State other than the United Kingdom, and

(b) recognised in Gibraltar under provisions which appear to the Treasury to give effect to the provisions of a relevant Community instrument.

(5) "Specified" means specified in the order.

(6) "UK firm" and "EEA right" have the same meaning as in Schedule 3.

International obligations

International obligations.

410.—(1) If it appears to the Treasury that any action proposed to be taken by a relevant person would be incompatible with Community obligations or any other international obligations of the United Kingdom, they may direct that person not to take that action.

(2) If it appears to the Treasury that any action which a relevant person has power to take is required for the purpose of implementing any such obligations, they may direct that person to take that action.

(3) A direction under this section—

(a) may include such supplemental or incidental requirements as the Treasury consider necessary or expedient; and

(b) is enforceable, on an application made by the Treasury, by injunction or, in Scotland, by an order for specific performance under section 45 of the Court of Session Act 1988.

1988 c. 36.

(4) "Relevant person" means—

(a) the Authority;

(b) any person exercising functions conferred by Part VI on the competent authority;

(c) any recognised investment exchange (other than one which is an overseas investment exchange);

(d) any recognised clearing house (other than one which is an overseas clearing house);

(e) a person included in the list maintained under section 301; or

(f) the scheme operator of the ombudsman scheme.

Tax treatment of levies and repayments

Tax treatment of levies and repayments.
1988 c. 1.

411.—(1) In the Income and Corporation Taxes Act 1988 ("the 1988 Act"), in section 76 (expenses of management: insurance companies), for subsections (7) and (7A) substitute—

"(7) For the purposes of this section any sums paid by a company by way of a levy shall be treated as part of its expenses of management.

(7A) "Levy" means—

(a) a payment required under rules made under section 136(2) of the Financial Services and Markets Act 2000 ("the Act of 2000");

(b) a levy imposed under the Financial Services Compensation Scheme;

(c) a payment required under rules made under section 234 of the Act of 2000;

(d) a payment required in accordance with the standard terms fixed under paragraph 18 of Schedule 17 to the Act of 2000."

(2) After section 76 of the 1988 Act insert—

"Levies and repayments under the Financial Services and Markets Act 2000.

76A.—(1) In computing the amount of the profits to be charged under Case I of Schedule D arising from a trade carried on by an authorised person (other than an investment company)—

(a) to the extent that it would not be deductible apart from this section, any sum expended by the authorised person in paying a levy may be deducted as an allowable expense;

(b) any payment which is made to the authorised person as a result of a repayment provision is to be treated as a trading receipt.

(2) "Levy" has the meaning given in section 76(7A).

(3) "Repayment provision" means any provision made by virtue of—

(a) section 136(7) of the Financial Services and Markets Act 2000 ("the Act of 2000");

(b) section 214(1)(e) of the Act of 2000.

(4) "Authorised person" has the same meaning as in the Act of 2000.

Levies and repayments

76B.—(1) For the purposes of section 75 any sums paid by an investment company—

under the Financial Services and Markets Act 2000: investment companies.

(a) by way of a levy, or

(b) as a result of an award of costs under costs rules,

shall be treated as part of its expenses of management.

(2) If a payment is made to an investment company as a result of a repayment provision, the company shall be charged to tax under Case VI of Schedule D on the amount of that payment.

(3) "Levy" has the meaning given in section 76(7A).

(4) "Costs rules" means—

(a) rules made under section 230 of the Financial Services and Markets Act 2000;

(b) provision relating to costs contained in the standard terms fixed under paragraph 18 of Schedule 17 to that Act.

(5) "Repayment provision" has the meaning given in section 76A(3)."

Gaming contracts

Gaming contracts.

412.—(1) No contract to which this section applies is void or unenforceable because of—

1845 c. 109. 1892 c. 9. S.I. 1985/1204 (N.I. 11).

(a) section 18 of the Gaming Act 1845, section 1 of the Gaming Act 1892 or Article 170 of the Betting, Gaming, Lotteries and Amusements (Northern Ireland) Order 1985; or

(b) any rule of the law of Scotland under which a contract by way of gaming or wagering is not legally enforceable.

(2) This section applies to a contract if—

(a) it is entered into by either or each party by way of business;

(b) the entering into or performance of it by either party constitutes an activity of a specified kind or one which falls within a specified class of activity; and

(c) it relates to an investment of a specified kind or one which falls within a specified class of investment.

(3) Part II of Schedule 2 applies for the purposes of subsection (2)(c), with the references to section 22 being read as references to that subsection.

(4) Nothing in Part II of Schedule 2, as applied by subsection (3), limits the power conferred by subsection (2)(c).

(5) "Investment" includes any asset, right or interest.

(6) "Specified" means specified in an order made by the Treasury.

Limitation on powers to require documents

413.—(1) A person may not be required under this Act to produce, disclose or permit the inspection of protected items. Protected items.

(2) "Protected items" means—

(a) communications between a professional legal adviser and his client or any person representing his client which fall within subsection (3);

(b) communications between a professional legal adviser, his client or any person representing his client and any other person which fall within subsection (3) (as a result of paragraph (b) of that subsection);

(c) items which—

(i) are enclosed with, or referred to in, such communications;

(ii) fall within subsection (3); and

(iii) are in the possession of a person entitled to possession of them.

(3) A communication or item falls within this subsection if it is made—

(a) in connection with the giving of legal advice to the client; or

(b) in connection with, or in contemplation of, legal proceedings and for the purposes of those proceedings.

(4) A communication or item is not a protected item if it is held with the intention of furthering a criminal purpose.

Service of notices

414.—(1) The Treasury may by regulations make provision with respect to the procedure to be followed, or rules to be applied, when a provision of or made under this Act requires a notice, direction or document of any kind to be given or authorises the imposition of a requirement. Service of notices.

(2) The regulations may, in particular, make provision—

(a) as to the manner in which a document must be given;

(b) as to the address to which a document must be sent;

(c) requiring, or allowing, a document to be sent electronically;

(d) for treating a document as having been given, or as having been received, on a date or at a time determined in accordance with the regulations;

(e) as to what must, or may, be done if the person to whom a document is required to be given is not an individual;

(f) as to what must, or may, be done if the intended recipient of a document is outside the United Kingdom.

(3) Subsection (1) applies however the obligation to give a document is expressed (and so, in particular, includes a provision which requires a document to be served or sent).

(4) Section 7 of the Interpretation Act 1978 (service of notice by post) has effect in relation to provisions made by or under this Act subject to any provision made by regulations under this section. 1978 c. 30.

Jurisdiction

Jurisdiction in civil proceedings.

415.—(1) Proceedings arising out of any act or omission (or proposed act or omission) of—

(a) the Authority,

(b) the competent authority for the purposes of Part VI,

(c) the scheme manager, or

(d) the scheme operator,

in the discharge or purported discharge of any of its functions under this Act may be brought before the High Court or the Court of Session.

(2) The jurisdiction conferred by subsection (1) is in addition to any other jurisdiction exercisable by those courts.

Removal of certain unnecessary provisions

Provisions relating to industrial assurance and certain other enactments.

416.—(1) The following enactments are to cease to have effect—

1923 c. 8.

1948 c. 39.

1977 c. 46.

S.I. 1979/1574 (N.I. 13).

(a) the Industrial Assurance Act 1923;

(b) the Industrial Assurance and Friendly Societies Act 1948;

(c) the Insurance Brokers (Registration) Act 1977.

(2) The Industrial Assurance (Northern Ireland) Order 1979 is revoked.

(3) The following bodies are to cease to exist—

(a) the Insurance Brokers Registration Council;

(b) the Policyholders Protection Board;

(c) the Deposit Protection Board;

(d) the Board of Banking Supervision.

(4) If the Treasury consider that, as a consequence of any provision of this section, it is appropriate to do so, they may by order make any provision of a kind that they could make under this Act (and in particular any provision of a kind mentioned in section 339) with respect to anything done by or under any provision of Part XXI.

(5) Subsection (4) is not to be read as affecting in any way any other power conferred on the Treasury by this Act.

PART XXIX

INTERPRETATION

Definitions.

417.—(1) In this Act—

"appointed representative" has the meaning given in section 39(2);

"auditors and actuaries rules" means rules made under section 340;

"authorisation offence" has the meaning given in section 23(2);

"authorised open-ended investment company" has the meaning given in section 237(3);

"authorised person" has the meaning given in section 31(2);

"the Authority" means the Financial Services Authority;

"body corporate" includes a body corporate constituted under the law of a country or territory outside the United Kingdom;

"chief executive"—

(a) in relation to a body corporate whose principal place of business is within the United Kingdom, means an employee of that body who, alone or jointly with one or more others, is responsible under the immediate authority of the directors, for the conduct of the whole of the business of that body; and

(b) in relation to a body corporate whose principal place of business is outside the United Kingdom, means the person who, alone or jointly with one or more others, is responsible for the conduct of its business within the United Kingdom;

"collective investment scheme" has the meaning given in section 235;

"the Commission" means the European Commission (except in provisions relating to the Competition Commission);

"the compensation scheme" has the meaning given in section 213(2);

"control of information rules" has the meaning given in section 147(1);

"director", in relation to a body corporate, includes—

(a) a person occupying in relation to it the position of a director (by whatever name called); and

(b) a person in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of that body are accustomed to act;

"documents" includes information recorded in any form and, in relation to information recorded otherwise than in legible form, references to its production include references to producing a copy of the information in legible form;

"exempt person", in relation to a regulated activity, means a person who is exempt from the general prohibition in relation to that activity as a result of an exemption order made under section 38(1) or as a result of section 39(1) or 285(2) or (3);

"financial promotion rules" means rules made under section 145;

"friendly society" means an incorporated or registered friendly society;

"general prohibition" has the meaning given in section 19(2);

"general rules" has the meaning given in section 138(2);

"incorporated friendly society" means a society incorporated under the Friendly Societies Act 1992; 1992 c. 40.

"industrial and provident society" means a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965 or the Industrial and Provident Societies Act (Northern Ireland) 1969; 1965 c. 12. 1969 c. 24. (N.I.)

"market abuse" has the meaning given in section 118;

"Minister of the Crown" has the same meaning as in the Ministers of the Crown Act 1975; 1975 c. 26.

"money laundering rules" means rules made under section 146;

"notice of control" has the meaning given in section 178(5);

"the ombudsman scheme" has the meaning given in section 225(3);

"open-ended investment company" has the meaning given in section 236;

"Part IV permission" has the meaning given in section 40(4);

"partnership" includes a partnership constituted under the law of a country or territory outside the United Kingdom;

"prescribed" (where not otherwise defined) means prescribed in regulations made by the Treasury;

"price stabilising rules" means rules made under section 144;

"private company" has the meaning given in section 1(3) of the Companies Act 1985 or in Article 12(3) of the Companies (Northern Ireland) Order 1986;

1985 c. 6.
S.I. 1986/1032 (N.I. 6).

"prohibition order" has the meaning given in section 56(2);

"recognised clearing house" and "recognised investment exchange" have the meaning given in section 285;

"registered friendly society" means a society which is—

(a) a friendly society within the meaning of section 7(1)(a) of the Friendly Societies Act 1974; and

1992 c. 40.

(b) registered within the meaning of that Act;

"regulated activity" has the meaning given in section 22;

"regulating provisions" has the meaning given in section 159(1);

"regulatory objectives" means the objectives mentioned in section 2;

"regulatory provisions" has the meaning given in section 302;

"rule" means a rule made by the Authority under this Act;

"rule-making instrument" has the meaning given in section 153;

"the scheme manager" has the meaning given in section 212(1);

"the scheme operator" has the meaning given in section 225(2);

"scheme particulars rules" has the meaning given in section 248(1);

"Seventh Company Law Directive" means the European Council Seventh Company Law Directive of 13 June 1983 on consolidated accounts (No. 83/349/EEC);

"threshold conditions", in relation to a regulated activity, has the meaning given in section 41;

"the Treaty" means the treaty establishing the European Community;

"trust scheme rules" has the meaning given in section 247(1);

"UK authorised person" has the meaning given in section 178(4); and

"unit trust scheme" has the meaning given in section 237.

(2) In the application of this Act to Scotland, references to a matter being actionable at the suit of a person are to be read as references to the matter being actionable at the instance of that person.

(3) For the purposes of any provision of this Act authorising or requiring a person to do anything within a specified number of days no account is to be taken of any day which is a public holiday in any part of the United Kingdom.

Carrying on regulated activities in the United Kingdom.

418.—(1) In the four cases described in this section, a person who—

(a) is carrying on a regulated activity, but

(b) would not otherwise be regarded as carrying it on in the United Kingdom,

is, for the purposes of this Act, to be regarded as carrying it on in the United Kingdom.

(2) The first case is where—

(a) his registered office (or if he does not have a registered office his head office) is in the United Kingdom;

(b) he is entitled to exercise rights under a single market directive as a UK firm; and

(c) he is carrying on in another EEA State a regulated activity to which that directive applies.

(3) The second case is where—

(a) his registered office (or if he does not have a registered office his head office) is in the United Kingdom;

(b) he is the manager of a scheme which is entitled to enjoy the rights conferred by an instrument which is a relevant Community instrument for the purposes of section 264; and

(c) persons in another EEA State are invited to become participants in the scheme.

(4) The third case is where—

(a) his registered office (or if he does not have a registered office his head office) is in the United Kingdom;

(b) the day-to-day management of the carrying on of the regulated activity is the responsibility of—

(i) his registered office (or head office); or

(ii) another establishment maintained by him in the United Kingdom.

(5) The fourth case is where—

(a) his head office is not in the United Kingdom; but

(b) the activity is carried on from an establishment maintained by him in the United Kingdom.

(6) For the purposes of subsections (2) to (5) it is irrelevant where the person with whom the activity is carried on is situated.

Carrying on regulated activities by way of business.

419.—(1) The Treasury may by order make provision—

(a) as to the circumstances in which a person who would otherwise not be regarded as carrying on a regulated activity by way of business is to be regarded as doing so;

(b) as to the circumstances in which a person who would otherwise be regarded as carrying on a regulated activity by way of business is to be regarded as not doing so.

(2) An order under subsection (1) may be made so as to apply—

(a) generally in relation to all regulated activities;

(b) in relation to a specified category of regulated activity; or

(c) in relation to a particular regulated activity.

(3) An order under subsection (1) may be made so as to apply—

(a) for the purposes of all provisions;

(b) for a specified group of provisions; or

(c) for a specified provision.

(4) "Provision" means a provision of, or made under, this Act.

(5) Nothing in this section is to be read as affecting the provisions of section 428(3).

Parent and subsidiary undertaking.

1985 c. 6.

S.I. 1986/1032 (N.I. 6).

420.—(1) In this Act, except in relation to an incorporated friendly society, "parent undertaking" and "subsidiary undertaking" have the same meaning as in Part VII of the Companies Act 1985 (or Part VIII of the Companies (Northern Ireland) Order 1986).

(2) But—

(a) "parent undertaking" also includes an individual who would be a parent undertaking for the purposes of those provisions if he were taken to be an undertaking (and "subsidiary undertaking" is to be read accordingly);

(b) "subsidiary undertaking" also includes, in relation to a body incorporated in or formed under the law of an EEA State other than the United Kingdom, an undertaking which is a subsidiary undertaking within the meaning of any rule of law in force in that State for purposes connected with implementation of the Seventh Company Law Directive (and "parent undertaking" is to be read accordingly).

1992 c. 40.

(3) In this Act "subsidiary undertaking", in relation to an incorporated friendly society, means a body corporate of which the society has control within the meaning of section 13(9)(a) or (aa) of the Friendly Societies Act 1992 (and "parent undertaking" is to be read accordingly).

Group.

421.—(1) In this Act "group", in relation to a person ("A"), means A and any person who is—

(a) a parent undertaking of A;

(b) a subsidiary undertaking of A;

(c) a subsidiary undertaking of a parent undertaking of A;

(d) a parent undertaking of a subsidiary undertaking of A;

(e) an undertaking in which A or an undertaking mentioned in paragraph (a), (b), (c) or (d) has a participating interest;

(f) if A or an undertaking mentioned in paragraph (a) or (d) is a building society, an associated undertaking of the society; or

(g) if A or an undertaking mentioned in paragraph (a) or (d) is an incorporated friendly society, a body corporate of which the society has joint control (within the meaning of section 13(9)(c) or (cc) of the Friendly Societies Act 1992).

(2) "Participating interest" has the same meaning as in Part VII of the Companies Act 1985 or Part VIII of the Companies (Northern Ireland) Order 1986; but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were taken to be an undertaking. 1985 c. 6. S.I. 1986/1032 (N.I. 6).

(3) "Associated undertaking" has the meaning given in section 119(1) of the Building Societies Act 1986. 1986 c. 53.

Controller.

422.—(1) In this Act "controller", in relation to an undertaking ("A"), means a person who falls within any of the cases in subsection (2).

(2) The cases are where the person—

(a) holds 10% or more of the shares in A;

(b) is able to exercise significant influence over the management of A by virtue of his shareholding in A;

(c) holds 10% or more of the shares in a parent undertaking ("P") of A;

(d) is able to exercise significant influence over the management of P by virtue of his shareholding in P;

(e) is entitled to exercise, or control the exercise of, 10% or more of the voting power in A;

(f) is able to exercise significant influence over the management of A by virtue of his voting power in A;

(g) is entitled to exercise, or control the exercise of, 10% or more of the voting power in P; or

(h) is able to exercise significant influence over the management of P by virtue of his voting power in P.

(3) In subsection (2) "the person" means—

(a) the person;

(b) any of the person's associates; or

(c) the person and any of his associates.

(4) "Associate", in relation to a person ("H") holding shares in an undertaking ("C") or entitled to exercise or control the exercise of voting power in relation to another undertaking ("D"), means—

(a) the spouse of H;

(b) a child or stepchild of H (if under 18);

(c) the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);

(d) an undertaking of which H is a director;

(e) a person who is an employee or partner of H;

(f) if H is an undertaking—

(i) a director of H;

(ii) a subsidiary undertaking of H;

(iii) a director or employee of such a subsidiary undertaking; and

(g) if H has with any other person an agreement or arrangement with respect to the acquisition, holding or disposal of shares or other interests in C or D or under which they undertake to act together in exercising their voting power in relation to C or D, that other person.

(5) "Settlement", in subsection (4)(c), includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation).

(6) "Shares"—

(a) in relation to an undertaking with a share capital, means allotted shares;

(b) in relation to an undertaking with capital but no share capital, means rights to share in the capital of the undertaking;

(c) in relation to an undertaking without capital, means interests—

(i) conferring any right to share in the profits, or liability to contribute to the losses, of the undertaking; or

(ii) giving rise to an obligation to contribute to the debts or expenses of the undertaking in the event of a winding up.

(7) "Voting power", in relation to an undertaking which does not have general meetings at which matters are decided by the exercise of voting rights, means the right under the constitution of the undertaking to direct the overall policy of the undertaking or alter the terms of its constitution.

Manager.

423.—(1) In this Act, except in relation to a unit trust scheme or a registered friendly society, "manager" means an employee who—

(a) under the immediate authority of his employer is responsible, either alone or jointly with one or more other persons, for the conduct of his employer's business; or

(b) under the immediate authority of his employer or of a person who is a manager by virtue of paragraph (a) exercises managerial functions or is responsible for maintaining accounts or other records of his employer.

(2) If the employer is not an individual, references in subsection (1) to the authority of the employer are references to the authority—

(a) in the case of a body corporate, of the directors;

(b) in the case of a partnership, of the partners; and

(c) in the case of an unincorporated association, of its officers or the members of its governing body.

(3) "Manager", in relation to a body corporate, means a person (other than an employee of the body) who is appointed by the body to manage any part of its business and includes an employee of the body corporate (other than the chief executive) who, under the immediate authority of a director or chief executive of the body corporate, exercises managerial functions or is responsible for maintaining accounts or other records of the body corporate.

Insurance.

424.—(1) In this Act, references to—

(a) contracts of insurance,

(b) reinsurance,

(c) contracts of long-term insurance,

(d) contracts of general insurance,

are to be read with section 22 and Schedule 2.

(2) In this Act "policy" and "policyholder", in relation to a contract of insurance, have such meaning as the Treasury may by order specify.

(3) The law applicable to a contract of insurance, the effecting of which constitutes the carrying on of a regulated activity, is to be determined, if it is of a prescribed description, in accordance with regulations made by the Treasury.

Expressions relating to authorisation elsewhere in the single market.

425.—(1) In this Act—

(a) "EEA authorisation", "EEA firm", "EEA right", "EEA State", "first life insurance directive", "first non-life insurance directive", "insurance directives", "investment services directive", "single market directives" and "second banking co-ordination directive" have the meaning given in Schedule 3; and

(b) "home state regulator", in relation to an EEA firm, has the meaning given in Schedule 3.

(2) In this Act—

(a) "home state authorisation" has the meaning given in Schedule 4;

(a) "Treaty firm" has the meaning given in Schedule 4; and

(c) "home state regulator", in relation to a Treaty firm, has the meaning given in Schedule 4.

PART XXX

SUPPLEMENTAL

Consequential and supplementary provision.

426.—(1) A Minister of the Crown may by order make such incidental, consequential, transitional or supplemental provision as he considers necessary or expedient for the general purposes, or any particular purpose, of this Act or in consequence of any provision made by or under this Act or for giving full effect to this Act or any such provision.

(2) An order under subsection (1) may, in particular, make provision—

(a) for enabling any person by whom any powers will become exercisable, on a date set by or under this Act, by virtue of any provision made by or under this Act to take before that date any steps which are necessary as a preliminary to the exercise of those powers;

(b) for applying (with or without modifications) or amending, repealing or revoking any provision of or made under an Act passed before this Act or in the same Session;

(c) dissolving any body corporate established by any Act passed, or instrument made, before the passing of this Act;

(d) for making savings, or additional savings, from the effect of any repeal or revocation made by or under this Act.

(3) Amendments made under this section are additional, and without prejudice, to those made by or under any other provision of this Act.

(4) No other provision of this Act restricts the powers conferred by this section.

Transitional provisions.

427.—(1) Subsections (2) and (3) apply to an order under section 426 which makes transitional provisions or savings.

(2) The order may, in particular—

(a) if it makes provision about the authorisation and permission of persons who before commencement were entitled to carry on any activities, also include provision for such persons not to be treated as having any authorisation or permission (whether on an application to the Authority or otherwise);

(b) make provision enabling the Authority to require persons of such descriptions as it may direct to re-apply for permissions having effect by virtue of the order;

(c) make provision for the continuation as rules of such provisions (including primary and subordinate legislation) as may be designated in accordance with the order by the Authority, including provision for the modification by the Authority of provisions designated;

(d) make provision about the effect of requirements imposed, liabilities incurred and any other things done before commencement, including provision for and about investigations, penalties and the taking or continuing of any other action in respect of contraventions;

(e) make provision for the continuation of disciplinary and other proceedings begun before commencement, including provision about the decisions available to bodies before which such proceedings take place and the effect of their decisions;

(f) make provision as regards the Authority's obligation to maintain a record under section 347 as respects persons in relation to whom provision is made by the order.

(3) The order may—

(a) confer functions on the Treasury, the Secretary of State, the Authority, the scheme manager, the scheme operator, members of the panel established under paragraph 4 of Schedule 17, the Competition Commission or the Director General of Fair Trading;

(b) confer jurisdiction on the Tribunal;

(c) provide for fees to be charged in connection with the carrying out of functions conferred under the order;

(d) modify, exclude or apply (with or without modifications) any primary or subordinate legislation (including any provision of, or made under, this Act).

(4) In subsection (2) "commencement" means the commencement of such provisions of this Act as may be specified by the order.

Regulations and orders.

428.—(1) Any power to make an order which is conferred on a Minister of the Crown by this Act and any power to make regulations which is conferred by this Act is exercisable by statutory instrument.

(2) The Lord Chancellor's power to make rules under section 132 is exercisable by statutory instrument.

(3) Any statutory instrument made under this Act may—

(a) contain such incidental, supplemental, consequential and transitional provision as the person making it considers appropriate; and

(b) make different provision for different cases.

Parliamentary control of statutory instruments.

429.—(1) No order is to be made under—

(a) section 144(4), 192(b) or (e), 236(5), 404 or 419, or

(b) paragraph 1 of Schedule 8,

unless a draft of the order has been laid before Parliament and approved by a resolution of each House.

(2) No regulations are to be made under section 262 unless a draft of the regulations has been laid before Parliament and approved by a resolution of each House.

(3) An order to which, if it is made, subsection (4) or (5) will apply is not to be made unless a draft of the order has been laid before Parliament and approved by a resolution of each House.

(4) This subsection applies to an order under section 21 if—

(a) it is the first order to be made, or to contain provisions made, under section 21(4);

(b) it varies an order made under section 21(4) so as to make section 21(1) apply in circumstances in which it did not previously apply;

(c) it is the first order to be made, or to contain provision made, under section 21(5);

(d) it varies a previous order made under section 21(5) so as to make section 21(1) apply in circumstances in which it did not, as a result of that previous order, apply;

(e) it is the first order to be made, or to contain provisions made, under section 21(9) or (10);

(f) it adds one or more activities to those that are controlled activities for the purposes of section 21; or

(g) it adds one or more investments to those which are controlled investments for the purposes of section 21.

(5) This subsection applies to an order under section 38 if—

(a) it is the first order to be made, or to contain provisions made, under that section; or

(b) it contains provisions restricting or removing an exemption provided by an earlier order made under that section.

(6) An order containing a provision to which, if the order is made, subsection (7) will apply is not to be made unless a draft of the order has been laid before Parliament and approved by a resolution of each House.

(7) This subsection applies to a provision contained in an order if—

(a) it is the first to be made in the exercise of the power conferred by subsection (1) of section 326 or it removes a body from those for the time being designated under that subsection; or

(b) it is the first to be made in the exercise of the power conferred by subsection (6) of section 327 or it adds a description of regulated activity or investment to those for the time being specified for the purposes of that subsection.

(8) Any other statutory instrument made under this Act, apart from one made under section 431(2) or to which paragraph 26 of Schedule 2 applies, shall be subject to annulment in pursuance of a resolution of either House of Parliament.

Extent.

430.—(1) This Act, except Chapter IV of Part XVII, extends to Northern Ireland.

(2) Except where Her Majesty by Order in Council provides otherwise, the extent of any amendment or repeal made by or under this Act is the same as the extent of the provision amended or repealed.

(3) Her Majesty may by Order in Council provide for any provision of or made under this Act relating to a matter which is the subject of other legislation which extends to any of the Channel Islands or the Isle of Man to extend there with such modifications (if any) as may be specified in the Order.

Commencement.

431.—(1) The following provisions come into force on the passing of this Act—

(a) this section;

(b) sections 428, 430 and 433;

(c) paragraphs 1 and 2 of Schedule 21.

(2) The other provisions of this Act come into force on such day as the Treasury may by order appoint; and different days may be appointed for different purposes.

Minor and consequential amendments, transitional provisions and repeals.

432.—(1) Schedule 20 makes minor and consequential amendments.

(2) Schedule 21 makes transitional provisions.

(3) The enactments set out in Schedule 22 are repealed.

Short title.

433. This Act may be cited as the Financial Services and Markets Act 2000.

SCHEDULES

SCHEDULE 1

Section 1.

THE FINANCIAL SERVICES AUTHORITY

PART I

GENERAL

Interpretation

1.—(1) In this Schedule—

"the 1985 Act" means the Companies Act 1985; 1985 c. 6.

"non-executive committee" means the committee maintained under paragraph 3;

"functions", in relation to the Authority, means functions conferred on the Authority by or under any provision of this Act.

(2) For the purposes of this Schedule, the following are the Authority's legislative functions—

(a) making rules;

(b) issuing codes under section 64 or 119;

(c) issuing statements under section 64, 69, 124 or 210;

(d) giving directions under section 316, 318 or 328;

(e) issuing general guidance (as defined by section 158(5)).

Constitution

2.—(1) The constitution of the Authority must continue to provide for the Authority to have—

(a) a chairman; and

(b) a governing body.

(2) The governing body must include the chairman.

(3) The chairman and other members of the governing body must be appointed, and be liable to removal from office, by the Treasury.

(4) The validity of any act of the Authority is not affected—

(a) by a vacancy in the office of chairman; or

(b) by a defect in the appointment of a person as a member of the governing body or as chairman.

Non-executive members of the governing body

3.—(1) The Authority must secure—

(a) that the majority of the members of its governing body are non-executive members; and

(b) that a committee of its governing body, consisting solely of the non-executive members, is set up and maintained for the purposes of discharging the functions conferred on the committee by this Schedule.

(2) The members of the non-executive committee are to be appointed by the Authority.

(3) The non-executive committee is to have a chairman appointed by the Treasury from among its members.

Functions of the non-executive committee

4.—(1) In this paragraph "the committee" means the non-executive committee.

(2) The non-executive functions are functions of the Authority but must be discharged by the committee.

(3) The non-executive functions are—

(a) keeping under review the question whether the Authority is, in discharging its functions in accordance with decisions of its governing body, using its resources in the most efficient and economic way;

(b) keeping under review the question whether the Authority's internal financial controls secure the proper conduct of its financial affairs; and

(c) determining the remuneration of—

(i) the chairman of the Authority's governing body; and

(ii) the executive members of that body.

(4) The function mentioned in sub-paragraph (3)(b) and those mentioned in sub-paragraph (3)(c) may be discharged on behalf of the committee by a sub-committee.

(5) Any sub-committee of the committee—

(a) must have as its chairman the chairman of the committee; but

(b) may include persons other than members of the committee.

(6) The committee must prepare a report on the discharge of its functions for inclusion in the Authority's annual report to the Treasury under paragraph 10.

(7) The committee's report must relate to the same period as that covered by the Authority's report.

Arrangements for discharging functions

5.—(1) The Authority may make arrangements for any of its functions to be discharged by a committee, sub-committee, officer or member of staff of the Authority.

(2) But in exercising its legislative functions, the Authority must act through its governing body.

(3) Sub-paragraph (1) does not apply to the non-executive functions.

Monitoring and enforcement

6.—(1) The Authority must maintain arrangements designed to enable it to determine whether persons on whom requirements are imposed by or under this Act are complying with them.

(2) Those arrangements may provide for functions to be performed on behalf of the Authority by any body or person who, in its opinion, is competent to perform them.

(3) The Authority must also maintain arrangements for enforcing the provisions of, or made under, this Act.

(4) Sub-paragraph (2) does not affect the Authority's duty under sub-paragraph (1).

Arrangements for the investigation of complaints

7.—(1) The Authority must—

(a) make arrangements ("the complaints scheme") for the investigation of complaints arising in connection with the exercise of, or failure to exercise, any of its functions (other than its legislative functions); and

(b) appoint an independent person ("the investigator") to be responsible for the conduct of investigations in accordance with the complaints scheme.

(2) The complaints scheme must be designed so that, as far as reasonably practicable, complaints are investigated quickly.

(3) The Treasury's approval is required for the appointment or dismissal of the investigator.

(4) The terms and conditions on which the investigator is appointed must be such as, in the opinion of the Authority, are reasonably designed to secure—

(a) that he will be free at all times to act independently of the Authority; and

(b) that complaints will be investigated under the complaints scheme without favouring the Authority.

(5) Before making the complaints scheme, the Authority must publish a draft of the proposed scheme in the way appearing to the Authority best calculated to bring it to the attention of the public.

(6) The draft must be accompanied by notice that representations about it may be made to the Authority within a specified time.

(7) Before making the proposed complaints scheme, the Authority must have regard to any representations made to it in accordance with sub-paragraph (6).

(8) If the Authority makes the proposed complaints scheme, it must publish an account, in general terms, of—

(a) the representations made to it in accordance with sub-paragraph (6); and

(b) its response to them.

(9) If the complaints scheme differs from the draft published under sub-paragraph (5) in a way which is, in the opinion of the Authority, significant the Authority must (in addition to complying with sub-paragraph (8)) publish details of the difference.

(10) The Authority must publish up-to-date details of the complaints scheme including, in particular, details of—

(a) the provision made under paragraph 8(5); and

(b) the powers which the investigator has to investigate a complaint.

(11) Those details must be published in the way appearing to the Authority to be best calculated to bring them to the attention of the public.

(12) The Authority must, without delay, give the Treasury a copy of any details published by it under this paragraph.

(13) The Authority may charge a reasonable fee for providing a person with a copy of—

(a) a draft published under sub-paragraph (5);

(b) details published under sub-paragraph (10).

(14) Sub-paragraphs (5) to (9) and (13)(a) also apply to a proposal to alter or replace the complaints scheme.

Investigation of complaints

8.—(1) The Authority is not obliged to investigate a complaint in accordance with the complaints scheme which it reasonably considers would be more appropriately dealt with in another way (for example by referring the matter to the Tribunal or by the institution of other legal proceedings).

(2) The complaints scheme must provide—

(a) for reference to the investigator of any complaint which the Authority is investigating; and

(b) for him—

(i) to have the means to conduct a full investigation of the complaint;

(ii) to report on the result of his investigation to the Authority and the complainant; and

(iii) to be able to publish his report (or any part of it) if he considers that it (or the part) ought to be brought to the attention of the public.

(3) If the Authority has decided not to investigate a complaint, it must notify the investigator.

(4) If the investigator considers that a complaint of which he has been notified under sub-paragraph (3) ought to be investigated, he may proceed as if the complaint had been referred to him under the complaints scheme.

(5) The complaints scheme must confer on the investigator the power to recommend, if he thinks it appropriate, that the Authority—

(a) makes a compensatory payment to the complainant,

(b) remedies the matter complained of,

or takes both of those steps.

(6) The complaints scheme must require the Authority, in a case where the investigator—

(a) has reported that a complaint is well-founded, or

(b) has criticised the Authority in his report,

to inform the investigator and the complainant of the steps which it proposes to take in response to the report.

(7) The investigator may require the Authority to publish the whole or a specified part of the response.

(8) The investigator may appoint a person to conduct the investigation on his behalf but subject to his direction.

(9) Neither an officer nor an employee of the Authority may be appointed under sub-paragraph (8).

(10) Sub-paragraph (2) is not to be taken as preventing the Authority from making arrangements for the initial investigation of a complaint to be conducted by the Authority.

Records

9. The Authority must maintain satisfactory arrangements for—

(a) recording decisions made in the exercise of its functions; and

(b) the safe-keeping of those records which it considers ought to be preserved.

Annual report

10.—(1) At least once a year the Authority must make a report to the Treasury on—

(a) the discharge of its functions;

(b) the extent to which, in its opinion, the regulatory objectives have been met;

(c) its consideration of the matters mentioned in section 2(3); and

(d) such other matters as the Treasury may from time to time direct.

(2) The report must be accompanied by—

(a) the report prepared by the non-executive committee under paragraph 4(6); and

(b) such other reports or information, prepared by such persons, as the Treasury may from time to time direct.

(3) The Treasury must lay before Parliament a copy of each report received by them under this paragraph.

(4) The Treasury may—

(a) require the Authority to comply with any provisions of the 1985 Act about accounts and their audit which would not otherwise apply to it; or

(b) direct that any such provision of that Act is to apply to the Authority with such modifications as are specified in the direction.

(5) Compliance with any requirement imposed under sub-paragraph (4)(a) or (b) is enforceable by injunction or, in Scotland, an order under section 45(b) of the Court of Session Act 1988. 1988 c. 36.

(6) Proceedings under sub-paragraph (5) may be brought only by the Treasury.

Annual public meeting

11.—(1) Not later than three months after making a report under paragraph 10, the Authority must hold a public meeting ("the annual meeting") for the purposes of enabling that report to be considered.

(2) The Authority must organise the annual meeting so as to allow—

(a) a general discussion of the contents of the report which is being considered; and

(b) a reasonable opportunity for those attending the meeting to put questions to the Authority about the way in which it discharged, or failed to discharge, its functions during the period to which the report relates.

(3) But otherwise the annual meeting is to be organised and conducted in such a way as the Authority considers appropriate.

(4) The Authority must give reasonable notice of its annual meeting.

(5) That notice must—

(a) give details of the time and place at which the meeting is to be held;

(b) set out the proposed agenda for the meeting;

(c) indicate the proposed duration of the meeting;

(d) give details of the Authority's arrangements for enabling persons to attend; and

(e) be published by the Authority in the way appearing to it to be most suitable for bringing the notice to the attention of the public.

(6) If the Authority proposes to alter any of the arrangements which have been included in the notice given under sub-paragraph (4) it must—

(a) give reasonable notice of the alteration; and

(b) publish that notice in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

Report of annual meeting

12. Not later than one month after its annual meeting, the Authority must publish a report of the proceedings of the meeting.

PART II

STATUS

13. In relation to any of its functions—

(a) the Authority is not to be regarded as acting on behalf of the Crown; and

(b) its members, officers and staff are not to be regarded as Crown servants.

Exemption from requirement of "limited" in Authority's name

14. The Authority is to continue to be exempt from the requirements of the 1985 Act relating to the use of "limited" as part of its name.

15. If the Secretary of State is satisfied that any action taken by the Authority makes it inappropriate for the exemption given by paragraph 14 to continue he may, after consulting the Treasury, give a direction removing it.

PART III

PENALTIES AND FEES

Penalties

16.—(1) In determining its policy with respect to the amounts of penalties to be imposed by it under this Act, the Authority must take no account of the expenses which it incurs, or expects to incur, in discharging its functions.

(2) The Authority must prepare and operate a scheme for ensuring that the amounts paid to the Authority by way of penalties imposed under this Act are applied for the benefit of authorised persons.

(3) The scheme may, in particular, make different provision with respect to different classes of authorised person.

(4) Up to date details of the scheme must be set out in a document ("the scheme details").

(5) The scheme details must be published by the Authority in the way appearing to it to be best calculated to bring them to the attention of the public.

(6) Before making the scheme, the Authority must publish a draft of the proposed scheme in the way appearing to the Authority to be best calculated to bring it to the attention of the public.

(7) The draft must be accompanied by notice that representations about the proposals may be made to the Authority within a specified time.

(8) Before making the scheme, the Authority must have regard to any representations made to it in accordance with sub-paragraph (7).

(9) If the Authority makes the proposed scheme, it must publish an account, in general terms, of—

(a) the representations made to it in accordance with sub-paragraph (7); and

(b) its response to them.

(10) If the scheme differs from the draft published under sub-paragraph (6) in a way which is, in the opinion of the Authority, significant the Authority must (in addition to complying with sub-paragraph (9)) publish details of the difference.

(11) The Authority must, without delay, give the Treasury a copy of any scheme details published by it.

(12) The Authority may charge a reasonable fee for providing a person with a copy of—

(a) a draft published under sub-paragraph (6);

(b) scheme details.

(13) Sub-paragraphs (6) to (10) and (12)(a) also apply to a proposal to alter or replace the complaints scheme.

Fees

17.—(1) The Authority may make rules providing for the payment to it of such fees, in connection with the discharge of any of its functions under or as a result of this Act, as it considers will (taking account of its expected income from fees and charges provided for by any other provision of this Act) enable it—

(a) to meet expenses incurred in carrying out its functions or for any incidental purpose;

(b) to repay the principal of, and pay any interest on, any money which it has borrowed and which has been used for the purpose of meeting expenses incurred in relation to its assumption of functions under this Act or the Bank of England Act 1998; and 1998 c. 11.

(c) to maintain adequate reserves.

(2) In fixing the amount of any fee which is to be payable to the Authority, no account is to be taken of any sums which the Authority receives, or expects to receive, by way of penalties imposed by it under this Act.

(3) Sub-paragraph (1)(b) applies whether expenses were incurred before or after the coming into force of this Act or the Bank of England Act 1998.

(4) Any fee which is owed to the Authority under any provision made by or under this Act may be recovered as a debt due to the Authority.

Services for which fees may not be charged

18. The power conferred by paragraph 17 may not be used to require—

(a) a fee to be paid in respect of the discharge of any of the Authority's functions under paragraphs 13, 14, 19 or 20 of Schedule 3; or

(b) a fee to be paid by any person whose application for approval under section 59 has been granted.

PART IV

MISCELLANEOUS

Exemption from liability in damages

19.—(1) Neither the Authority nor any person who is, or is acting as, a member, officer or member of staff of the Authority is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of the Authority's functions.

(2) Neither the investigator appointed under paragraph 7 nor a person appointed to conduct an investigation on his behalf under paragraph 8(8) is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of his functions in relation to the investigation of a complaint.

(3) Neither sub-paragraph (1) nor sub-paragraph (2) applies—

(a) if the act or omission is shown to have been in bad faith; or

(b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998.

1998 c. 42.

Disqualification for membership of House of Commons

1975 c. 24.

20. In Part III of Schedule 1 to the House of Commons Disqualification Act 1975 (disqualifying offices), insert at the appropriate place—

"Member of the governing body of the Financial Services Authority".

Disqualification for membership of Northern Ireland Assembly

1975 c. 25.

21. In Part III of Schedule 1 to the Northern Ireland Assembly Disqualification Act 1975 (disqualifying offices), insert at the appropriate place—

"Member of the governing body of the Financial Services Authority".

Section 22(2).

SCHEDULE 2

Regulated Activities

Part I

Regulated Activities

General

1. The matters with respect to which provision may be made under section 22(1) in respect of activities include, in particular, those described in general terms in this Part of this Schedule.

Dealing in investments

2.—(1) Buying, selling, subscribing for or underwriting investments or offering or agreeing to do so, either as a principal or as an agent.

(2) In the case of an investment which is a contract of insurance, that includes carrying out the contract.

Arranging deals in investments

3. Making, or offering or agreeing to make—

(a) arrangements with a view to another person buying, selling, subscribing for or underwriting a particular investment;

(b) arrangements with a view to a person who participates in the arrangements buying, selling, subscribing for or underwriting investments.

Deposit taking

4. Accepting deposits.

Safekeeping and administration of assets

5.—(1) Safeguarding and administering assets belonging to another which consist of or include investments or offering or agreeing to do so.

(2) Arranging for the safeguarding and administration of assets belonging to another, or offering or agreeing to do so.

Managing investments

6. Managing, or offering or agreeing to manage, assets belonging to another person where—

(a) the assets consist of or include investments; or

(b) the arrangements for their management are such that the assets may consist of or include investments at the discretion of the person managing or offering or agreeing to manage them.

Investment advice

7. Giving or offering or agreeing to give advice to persons on—

(a) buying, selling, subscribing for or underwriting an investment; or

(b) exercising any right conferred by an investment to acquire, dispose of, underwrite or convert an investment.

Establishing collective investment schemes

8. Establishing, operating or winding up a collective investment scheme, including acting as—

(a) trustee of a unit trust scheme;

(b) depositary of a collective investment scheme other than a unit trust scheme; or

(c) sole director of a body incorporated by virtue of regulations under section 262.

Using computer-based systems for giving investment instructions

9.—(1) Sending on behalf of another person instructions relating to an investment by means of a computer-based system which enables investments to be transferred without a written instrument.

(2) Offering or agreeing to send such instructions by such means on behalf of another person.

(3) Causing such instructions to be sent by such means on behalf of another person.

(4) Offering or agreeing to cause such instructions to be sent by such means on behalf of another person.

PART II

INVESTMENTS

General

10. The matters with respect to which provision may be made under section 22(1) in respect of investments include, in particular, those described in general terms in this Part of this Schedule.

Securities

11.—(1) Shares or stock in the share capital of a company.

(2) "Company" includes—

(a) any body corporate (wherever incorporated), and

(b) any unincorporated body constituted under the law of a country or territory outside the United Kingdom,

other than an open-ended investment company.

Instruments creating or acknowledging indebtedness

12. Any of the following—

(a) debentures;

(b) debenture stock;

(c) loan stock;

(d) bonds;

(e) certificates of deposit;

(f) any other instruments creating or acknowledging a present or future indebtedness.

Government and public securities

13.—(1) Loan stock, bonds and other instruments—

(a) creating or acknowledging indebtedness; and

(b) issued by or on behalf of a government, local authority or public authority.

(2) "Government, local authority or public authority" means—

(a) the government of the United Kingdom, of Northern Ireland, or of any country or territory outside the United Kingdom;

(b) a local authority in the United Kingdom or elsewhere;

(c) any international organisation the members of which include the United Kingdom or another member State.

Instruments giving entitlement to investments

14.—(1) Warrants or other instruments entitling the holder to subscribe for any investment.

(2) It is immaterial whether the investment is in existence or identifiable.

Certificates representing securities

15. Certificates or other instruments which confer contractual or property rights—

(a) in respect of any investment held by someone other than the person on whom the rights are conferred by the certificate or other instrument; and

(b) the transfer of which may be effected without requiring the consent of that person.

Units in collective investment schemes

16.—(1) Shares in or securities of an open-ended investment company.

(2) Any right to participate in a collective investment scheme.

Options

17. Options to acquire or dispose of property.

Futures

18. Rights under a contract for the sale of a commodity or property of any other description under which delivery is to be made at a future date.

Contracts for differences

19. Rights under—

(a) a contract for differences; or

(b) any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in—

(i) the value or price of property of any description; or

(ii) an index or other factor designated for that purpose in the contract.

Contracts of insurance

20. Rights under a contract of insurance, including rights under contracts falling within head C of Schedule 2 to the Friendly Societies Act 1992. 1992 c. 40.

Participation in Lloyd's syndicates

21.—(1) The underwriting capacity of a Lloyd's syndicate.

(2) A person's membership (or prospective membership) of a Lloyd's syndicate.

Deposits

22. Rights under any contract under which a sum of money (whether or not denominated in a currency) is paid on terms under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it.

Loans secured on land

23.—(1) Rights under any contract under which—

(a) one person provides another with credit; and

(b) the obligation of the borrower to repay is secured on land.

(2) "Credit" includes any cash loan or other financial accommodation.

(3) "Cash" includes money in any form.

Rights in investments

24. Any right or interest in anything which is an investment as a result of any other provision made under section 22(1).

PART III

SUPPLEMENTAL PROVISIONS

The order-making power

25.—(1) An order under section 22(1) may—

(a) provide for exemptions;

(b) confer powers on the Treasury or the Authority;

(c) authorise the making of regulations or other instruments by the Treasury for purposes of, or connected with, any relevant provision;

(d) authorise the making of rules or other instruments by the Authority for purposes of, or connected with, any relevant provision;

(e) make provision in respect of any information or document which, in the opinion of the Treasury or the Authority, is relevant for purposes of, or connected with, any relevant provision;

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(f) make such consequential, transitional or supplemental provision as the Treasury consider appropriate for purposes of, or connected with, any relevant provision.

(2) Provision made as a result of sub-paragraph (1)(f) may amend any primary or subordinate legislation, including any provision of, or made under, this Act.

(3) "Relevant provision" means any provision—

(a) of section 22 or this Schedule; or

(b) made under that section or this Schedule.

Parliamentary control

26.—(1) This paragraph applies to the first order made under section 22(1).

(2) This paragraph also applies to any subsequent order made under section 22(1) which contains a statement by the Treasury that, in their opinion, the effect (or one of the effects) of the proposed order would be that an activity which is not a regulated activity would become a regulated activity.

(3) An order to which this paragraph applies—

(a) must be laid before Parliament after being made; and

(b) ceases to have effect at the end of the relevant period unless before the end of that period the order is approved by a resolution of each House of Parliament (but without that affecting anything done under the order or the power to make a new order).

(4) "Relevant period" means a period of twenty-eight days beginning with the day on which the order is made.

(5) In calculating the relevant period no account is to be taken of any time during which Parliament is dissolved or prorogued or during which both Houses are adjourned for more than four days.

Interpretation

27.—(1) In this Schedule—

"buying" includes acquiring for valuable consideration;

"offering" includes inviting to treat;

"property" includes currency of the United Kingdom or any other country or territory; and

"selling" includes disposing for valuable consideration.

(2) In sub-paragraph (1) "disposing" includes—

(a) in the case of an investment consisting of rights under a contract—

(i) surrendering, assigning or converting those rights; or

(ii) assuming the corresponding liabilities under the contract;

(b) in the case of an investment consisting of rights under other arrangements, assuming the corresponding liabilities under the contract or arrangements;

(c) in the case of any other investment, issuing or creating the investment or granting the rights or interests of which it consists.

(3) In this Schedule references to an instrument include references to any record (whether or not in the form of a document).

SCHEDULE 3

Sections 31(1)(b) and 37.

EEA PASSPORT RIGHTS

PART I

DEFINED TERMS

The single market directives

1. "The single market directives" means—

(a) the first banking co-ordination directive;

(b) the second banking co-ordination directive;

(c) the insurance directives; and

(d) the investment services directive.

The banking co-ordination directives

2.—(1) "The first banking co-ordination directive" means the Council Directive of 12 December 1977 on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (No. 77/780/EEC).

(2) "The second banking co-ordination directive" means the Council Directive of 15 December 1989 on the co-ordination of laws, etc, relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC (No. 89/646/EEC).

The insurance directives

3.—(1) "The insurance directives" means the first, second and third non-life insurance directives and the first, second and third life insurance directives.

(2) "First non-life insurance directive" means the Council Directive of 24 July 1973 on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life assurance (No. 73/239/EEC).

(3) "Second non-life insurance directive" means the Council Directive of 22 June 1988 on the co-ordination of laws, etc, and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC (No. 88/357/EEC).

(4) "Third non-life insurance directive" means the Council Directive of 18 June 1992 on the co-ordination of laws, etc, and amending Directives 73/239/EEC and 88/357/EEC (No. 92/49/EEC).

(5) "First life insurance directive" means the Council Directive of 5 March 1979 on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance (No. 79/267/EEC).

(6) "Second life insurance directive" means the Council Directive of 8 November 1990 on the co-ordination of laws, etc, and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 79/267/EEC (No. 90/619/EEC).

(7) "Third life insurance directive" means the Council Directive of 10 November 1992 on the co-ordination of laws, etc, and amending Directives 79/267/EEC and 90/619/EEC (No. 92/96/EEC).

The investment services directive

4. "The investment services directive" means the Council Directive of 10 May 1993 on investment services in the securities field (No. 93/22/EEC).

EEA firm

5. "EEA firm" means any of the following if it does not have its head office in the United Kingdom—

(a) an investment firm (as defined in Article 1.2 of the investment services directive) which is authorised (within the meaning of Article 3) by its home state regulator;

(b) a credit institution (as defined in Article 1 of the first banking co-ordination directive) which is authorised (within the meaning of Article 1) by its home state regulator;

(c) a financial institution (as defined in Article 1 of the second banking co-ordination directive) which is a subsidiary of the kind mentioned in Article 18.2 and which fulfils the conditions in Article 18; or

(d) an undertaking pursuing the activity of direct insurance (within the meaning of Article 1 of the first life insurance directive or of the first non-life insurance directive) which has received authorisation under Article 6 from its home state regulator.

EEA authorisation

6. "EEA authorisation" means authorisation granted to an EEA firm by its home state regulator for the purpose of the relevant single market directive.

EEA right

7. "EEA right" means the entitlement of a person to establish a branch, or provide services, in an EEA State other than that in which he has his head office—

(a) in accordance with the Treaty as applied in the EEA; and

(b) subject to the conditions of the relevant single market directive.

EEA State

8. "EEA State" means a State which is a contracting party to the agreement on the European Economic Area signed at Oporto on 2 May 1992 as it has effect for the time being.

Home state regulator

9. "Home state regulator" means the competent authority (within the meaning of the relevant single market directive) of an EEA State (other than the United Kingdom) in relation to the EEA firm concerned.

UK firm

10. "UK firm" means a person whose head office is in the UK and who has an EEA right to carry on activity in an EEA State other than the United Kingdom.

Host state regulator

11. "Host state regulator" means the competent authority (within the meaning of the relevant single market directive) of an EEA State (other than the United Kingdom) in relation to a UK firm's exercise of EEA rights there.

PART II

EXERCISE OF PASSPORT RIGHTS BY EEA FIRMS

Firms qualifying for authorisation

12.—(1) Once an EEA firm which is seeking to establish a branch in the United Kingdom in exercise of an EEA right satisfies the establishment conditions, it qualifies for authorisation.

(2) Once an EEA firm which is seeking to provide services in the United Kingdom in exercise of an EEA right satisfies the service conditions, it qualifies for authorisation.

Establishment

13.—(1) The establishment conditions are that—

(a) the Authority has received notice ("a consent notice") from the firm's home state regulator that it has given the firm consent to establish a branch in the United Kingdom;

(b) the consent notice—

(i) is given in accordance with the relevant single market directive;

(ii) identifies the activities to which consent relates; and

(iii) includes such other information as may be prescribed; and

(c) the firm has been informed of the applicable provisions or two months have elapsed beginning with the date when the Authority received the consent notice.

(2) If the Authority has received a consent notice, it must—

(a) prepare for the firm's supervision;

(b) notify the firm of the applicable provisions (if any); and

(c) if the firm falls within paragraph 5(d), notify its home state regulator of the applicable provisions (if any).

(3) A notice under sub-paragraph (2)(b) or (c) must be given before the end of the period of two months beginning with the day on which the Authority received the consent notice.

(4) For the purposes of this paragraph—

"applicable provisions" means the host state rules with which the firm is required to comply when carrying on a permitted activity through a branch in the United Kingdom;

"host state rules" means rules—

(a) made in accordance with the relevant single market directive; and

(b) which are the responsibility of the United Kingdom (both as to implementation and as to supervision of compliance) in accordance with that directive; and

"permitted activity" means an activity identified in the consent notice.

Services

14.—(1) The service conditions are that—

(a) the firm has given its home state regulator notice of its intention to provide services in the United Kingdom ("a notice of intention");

(b) if the firm falls within paragraph 5(a) or (d), the Authority has received notice ("a regulator's notice") from the firm's home state regulator containing such information as may be prescribed; and

(c) if the firm falls within paragraph 5(d), its home state regulator has informed it that the regulator's notice has been sent to the Authority.

(2) If the Authority has received a regulator's notice or, where none is required by sub-paragraph (1), has been informed of the firm's intention to provide services in the United Kingdom, it must—

(a) prepare for the firm's supervision; and

(b) notify the firm of the applicable provisions (if any).

(3) A notice under sub-paragraph (2)(b) must be given before the end of the period of two months beginning on the day on which the Authority received the regulator's notice, or was informed of the firm's intention.

(4) For the purposes of this paragraph—

"applicable provisions" means the host state rules with which the firm is required to comply when carrying on a permitted activity by providing services in the United Kingdom;

"host state rules" means rules—

(a) made in accordance with the relevant single market directive; and

(b) which are the responsibility of the United Kingdom (both as to implementation and as to supervision of compliance) in accordance with that directive; and

"permitted activity" means an activity identified in—

(a) the regulator's notice; or

(b) where none is required by sub-paragraph (1), the notice of intention.

Grant of permission

15.—(1) On qualifying for authorisation as a result of paragraph 12, a firm has, in respect of each permitted activity which is a regulated activity, permission to carry it on through its United Kingdom branch (if it satisfies the establishment conditions) or by providing services in the United Kingdom (if it satisfies the service conditions).

(2) The permission is to be treated as being on terms equivalent to those appearing from the consent notice, regulator's notice or notice of intention.

1974 c. 39. (3) Sections 21, 39(1) and 147(1) of the Consumer Credit Act 1974 (business requiring a licence under that Act) do not apply in relation to the carrying on of a permitted activity which is Consumer Credit Act business by a firm which qualifies for authorisation as a result of paragraph 12, unless the Director General of Fair Trading has exercised the power conferred on him by section 203 in relation to the firm.

(4) "Consumer Credit Act business" has the same meaning as in section 203.

Effect of carrying on regulated activity when not qualified for authorisation

16.—(1) This paragraph applies to an EEA firm which is not qualified for authorisation under paragraph 12.

(2) Section 26 does not apply to an agreement entered into by the firm.

(3) Section 27 does not apply to an agreement in relation to which the firm is a third party for the purposes of that section.

(4) Section 29 does not apply to an agreement in relation to which the firm is the deposit-taker.

Continuing regulation of EEA firms

17. Regulations may—

(a) modify any provision of this Act which is an applicable provision (within the meaning of paragraph 13 or 14) in its application to an EEA firm qualifying for authorisation;

(b) make provision as to any change (or proposed change) of a prescribed kind relating to an EEA firm or to an activity that it carries on in the United Kingdom and as to the procedure to be followed in relation to such cases;

(c) provide that the Authority may treat an EEA firm's notification that it is to cease to carry on regulated activity in the United Kingdom as a request for cancellation of its qualification for authorisation under this Schedule.

Giving up right to authorisation

18. Regulations may provide that in prescribed circumstances an EEA firm falling within paragraph 5(c) may, on following the prescribed procedure—

(a) have its qualification for authorisation under this Schedule cancelled; and

(b) seek to become an authorised person by applying for a Part IV permission.

PART III

EXERCISE OF PASSPORT RIGHTS BY UK FIRMS

Establishment

19.—(1) A UK firm may not exercise an EEA right to establish a branch unless three conditions are satisfied.

(2) The first is that the firm has given the Authority, in the specified way, notice of its intention to establish a branch ("a notice of intention") which—

(a) identifies the activities which it seeks to carry on through the branch; and

(b) includes such other information as may be specified.

(3) The activities identified in a notice of intention may include activities which are not regulated activities.

(4) The second is that the Authority has given notice in specified terms ("a consent notice") to the host state regulator.

(5) The third is that—

(a) the host state regulator has notified the firm (or, where the EEA right in question derives from any of the insurance directives, the Authority) of the applicable provisions; or

(b) two months have elapsed beginning with the date on which the Authority gave the consent notice.

(6) If the firm's EEA right derives from the investment services directive or the second banking coordination directive and the first condition is satisfied, the Authority must give a consent notice to the host state regulator unless it has reason to doubt the adequacy of the firm's resources or its administrative structure.

(7) If the firm's EEA right derives from any of the insurance directives and the first condition is satisfied, the Authority must give a consent notice unless it has reason—

(a) to doubt the adequacy of the firm's resources or its administrative structure, or

(b) to question the reputation, qualifications or experience of the directors or managers of the firm or the person proposed as the branch's authorised agent for the purposes of those directives,

in relation to the business to be conducted through the proposed branch.

(8) If the Authority proposes to refuse to give a consent notice it must give the firm concerned a warning notice.

(9) If the firm's EEA right derives from any of the insurance directives and the host state regulator has notified it of the applicable provisions, the Authority must inform the firm of those provisions.

(10) Rules may specify the procedure to be followed by the Authority in exercising its functions under this paragraph.

(11) If the Authority gives a consent notice it must give written notice that it has done so to the firm concerned.

(12) If the Authority decides to refuse to give a consent notice—

(a) it must, within three months beginning with the date when it received the notice of intention, give the person who gave that notice a decision notice to that effect; and

(b) that person may refer the matter to the Tribunal.

(13) In this paragraph, "applicable provisions" means the host state rules with which the firm will be required to comply when conducting business through the proposed branch in the EEA State concerned.

(14) In sub-paragraph (13), "host state rules" means rules—

(a) made in accordance with the relevant single market directive; and

(b) which are the responsibility of the EEA State concerned (both as to implementation and as to supervision of compliance) in accordance with that directive.

(15) "Specified" means specified in rules.

Services

20.—(1) A UK firm may not exercise an EEA right to provide services unless the firm has given the Authority, in the specified way, notice of its intention to provide services ("a notice of intention") which—

(a) identifies the activities which it seeks to carry out by way of provision of services; and

(b) includes such other information as may be specified.

(2) The activities identified in a notice of intention may include activities which are not regulated activities.

(3) If the firm's EEA right derives from the investment services directive or a banking co-ordination directive, the Authority must, within one month of receiving a notice of intention, send a copy of it to the host state regulator.

(4) When the Authority sends the copy under sub-paragraph (3), it must give written notice to the firm concerned.

(5) If the firm concerned's EEA right derives from the investment services directive, it must not provide the services to which its notice of intention relates until it has received written notice from the Authority under sub-paragraph (4).

(6) "Specified" means specified in rules.

Offence relating to exercise of passport rights

21.—(1) If a UK firm which is not an authorised person contravenes the prohibition imposed by—

(a) sub-paragraph (1) of paragraph 19, or

(b) sub-paragraph (1) or (5) of paragraph 20,

it is guilty of an offence.

(2) A firm guilty of an offence under sub-paragraph (1) is liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum; or

(b) on conviction on indictment, to a fine.

(3) In proceedings for an offence under sub-paragraph (1), it is a defence for the firm to show that it took all reasonable precautions and exercised all due diligence to avoid committing the offence.

Continuing regulation of UK firms

22.—(1) Regulations may make such provision as the Treasury consider appropriate in relation to a UK firm's exercise of EEA rights, and may in particular provide for the application (with or without modification) of any provision of, or made under, this Act in relation to an activity of a UK firm.

(2) Regulations may—

(a) make provision as to any change (or proposed change) of a prescribed kind relating to a UK firm or to an activity that it carries on and as to the procedure to be followed in relation to such cases;

(b) make provision with respect to the consequences of the firm's failure to comply with a provision of the regulations.

(3) Where a provision of the kind mentioned in sub-paragraph (2) requires the Authority's consent to a change (or proposed change)—

(a) consent may be refused only on prescribed grounds; and

(b) if the Authority decides to refuse consent, the firm concerned may refer the matter to the Tribunal.

23.—(1) Sub-paragraph (2) applies if a UK firm—

(a) has a Part IV permission; and

(b) is exercising an EEA right to carry on any Consumer Credit Act business in an EEA State other than the United Kingdom.

(2) The Authority may exercise its power under section 45 in respect of the firm if the Director of Fair Trading has informed the Authority that—

(a) the firm,

(b) any of the firm's employees, agents or associates (whether past or present), or

(c) if the firm is a body corporate, a controller of the firm or an associate of such a controller,

has done any of the things specified in paragraphs (a) to (d) of section 25(2) of the Consumer Credit Act 1974. 1974 c. 39.

(3) "Associate", "Consumer Credit Act business" and "controller" have the same meaning as in section 203.

24.—(1) Sub-paragraph (2) applies if a UK firm—

(a) is not required to have a Part IV permission in relation to the business which it is carrying on; and

(b) is exercising the right conferred by Article 18.2 of the second banking co-ordination directive to carry on that business in an EEA State other than the United Kingdom.

(2) If requested to do so by the host state regulator in the EEA State in which the UK firm's business is being carried on, the Authority may impose any requirement in relation to the firm which it could impose if—

(a) the firm had a Part IV permission in relation to the business which it is carrying on; and

(b) the Authority was entitled to exercise its power under that Part to vary that permission.

Section 31(1)(c).

SCHEDULE 4

TREATY RIGHTS

Definitions

1. In this Schedule—

"consumers" means persons who are consumers for the purposes of section 138;

"Treaty firm" means a person—

(a) whose head office is situated in an EEA State (its "home state") other than the United Kingdom; and

(b) which is recognised under the law of that State as its national; and

"home state regulator", in relation to a Treaty firm, means the competent authority of the firm's home state for the purpose of its home state authorisation (as to which see paragraph 3(1)(a)).

Firms qualifying for authorisation

2. Once a Treaty firm which is seeking to carry on a regulated activity satisfies the conditions set out in paragraph 3(1), it qualifies for authorisation.

Exercise of Treaty rights

3.—(1) The conditions are that—

(a) the firm has received authorisation ("home state authorisation") under the law of its home state to carry on the regulated activity in question ("the permitted activity");

(b) the relevant provisions of the law of the firm's home state—

(i) afford equivalent protection; or

(ii) satisfy the conditions laid down by a Community instrument for the co-ordination or approximation of laws, regulations or administrative provisions of member States relating to the carrying on of that activity; and

(c) the firm has no EEA right to carry on that activity in the manner in which it is seeking to carry it on.

(2) A firm is not to be regarded as having home state authorisation unless its home state regulator has so informed the Authority in writing.

(3) Provisions afford equivalent protection if, in relation to the firm's carrying on of the permitted activity, they afford consumers protection which is at least equivalent to that afforded by or under this Act in relation to that activity.

(4) A certificate issued by the Treasury that the provisions of the law of a particular EEA State afford equivalent protection in relation to the activities specified in the certificate is conclusive evidence of that fact.

Permission

4.—(1) On qualifying for authorisation under this Schedule, a Treaty firm has permission to carry on each permitted activity through its United Kingdom branch or by providing services in the United Kingdom.

(2) The permission is to be treated as being on terms equivalent to those to which the firm's home state authorisation is subject.

(3) If, on qualifying for authorisation under this Schedule, a firm has a Part IV permission which includes permission to carry on a permitted activity, the Authority must give a direction cancelling the permission so far as it relates to that activity.

(4) The Authority need not give a direction under sub-paragraph (3) if it considers that there are good reasons for not doing so.

Notice to Authority

5.—(1) Sub-paragraph (2) applies to a Treaty firm which—

(a) qualifies for authorisation under this Schedule, but

(b) is not carrying on in the United Kingdom the regulated activity, or any of the regulated activities, which it has permission to carry on there.

(2) At least seven days before it begins to carry on such a regulated activity, the firm must give the Authority written notice of its intention to do so.

(3) If a Treaty firm to which sub-paragraph (2) applies has given notice under that sub-paragraph, it need not give such a notice if it again becomes a firm to which that sub-paragraph applies.

(4) Subsections (1), (3) and (6) of section 51 apply to a notice under sub-paragraph (2) as they apply to an application for a Part IV permission.

Offences

6.—(1) A person who contravenes paragraph 5(2) is guilty of an offence.

(2) In proceedings against a person for an offence under sub-paragraph (1) it is a defence for him to show that he took all reasonable precautions and exercised all due diligence to avoid committing the offence.

(3) A person is guilty of an offence if in, or in connection with, a notice given by him under paragraph 5(2) he—

(a) provides information which he knows to be false or misleading in a material particular; or

(b) recklessly provides information which is false or misleading in a material particular.

(4) A person guilty of an offence under this paragraph is liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to a fine.

Section 36.

SCHEDULE 5

PERSONS CONCERNED IN COLLECTIVE INVESTMENT SCHEMES

Authorisation

1.—(1) A person who for the time being is an operator, trustee or depositary of a recognised collective investment scheme is an authorised person.

(2) "Recognised" means recognised by virtue of section 264.

(3) An authorised open-ended investment company is an authorised person.

Permission

2.—(1) A person authorised as a result of paragraph 1(1) has permission to carry on, so far as it is a regulated activity—

(a) any activity, appropriate to the capacity in which he acts in relation to the scheme, of the kind described in paragraph 8 of Schedule 2;

(b) any activity in connection with, or for the purposes of, the scheme.

(2) A person authorised as a result of paragraph 1(3) has permission to carry on, so far as it is a regulated activity—

(a) the operation of the scheme;

(b) any activity in connection with, or for the purposes of, the operation of the scheme.

Section 41.

SCHEDULE 6

THRESHOLD CONDITIONS

PART I

PART IV PERMISSION

Legal status

1.—(1) If the regulated activity concerned is the effecting or carrying out of contracts of insurance the authorised person must be a body corporate, a registered friendly society or a member of Lloyd's.

(2) If the person concerned appears to the Authority to be seeking to carry on, or to be carrying on, a regulated activity constituting accepting deposits, it must be—

(a) a body corporate; or

(b) a partnership.

Location of offices

2.—(1) If the person concerned is a body corporate constituted under the law of any part of the United Kingdom—

(a) its head office, and

(b) if it has a registered office, that office,

must be in the United Kingdom.

(2) If the person concerned has its head office in the United Kingdom but is not a body corporate, it must carry on business in the United Kingdom.

Close links

3.—(1) If the person concerned (“A”) has close links with another person (“CL”) the Authority must be satisfied—

(a) that those links are not likely to prevent the Authority’s effective supervision of A; and

(b) if it appears to the Authority that CL is subject to the laws, regulations or administrative provisions of a territory which is not an EEA State (“the foreign provisions”), that neither the foreign provisions, nor any deficiency in their enforcement, would prevent the Authority’s effective supervision of A.

(2) A has close links with CL if—

(a) CL is a parent undertaking of A;

(b) CL is a subsidiary undertaking of A;

(c) CL is a parent undertaking of a subsidiary undertaking of A;

(d) CL is a subsidiary undertaking of a parent undertaking of A;

(e) CL owns or controls 20% or more of the voting rights or capital of A; or

(f) A owns or controls 20% or more of the voting rights or capital of CL.

(3) “Subsidiary undertaking” includes all the instances mentioned in Article 1(1) and (2) of the Seventh Company Law Directive in which an entity may be a subsidiary of an undertaking.

Adequate resources

4.—(1) The resources of the person concerned must, in the opinion of the Authority, be adequate in relation to the regulated activities that he seeks to carry on, or carries on.

(2) In reaching that opinion, the Authority may—

(a) take into account the person’s membership of a group and any effect which that membership may have; and

(b) have regard to—

(i) the provision he makes and, if he is a member of a group, which other members of the group make in respect of liabilities (including contingent and future liabilities); and

(ii) the means by which he manages and, if he is a member of a group, which other members of the group manage the incidence of risk in connection with his business.

Suitability

5. The person concerned must satisfy the Authority that he is a fit and proper person having regard to all the circumstances, including—

(a) his connection with any person;

(b) the nature of any regulated activity that he carries on or seeks to carry on; and

(c) the need to ensure that his affairs are conducted soundly and prudently.

PART II

AUTHORISATION

Authorisation under Schedule 3

6. In relation to an EEA firm qualifying for authorisation under Schedule 3, the conditions set out in paragraphs 1 and 3 to 5 apply, so far as relevant, to—

(a) an application for permission under Part IV;

(b) exercise of the Authority's own-initiative power under section 45 in relation to a Part IV permission.

Authorisation under Schedule 4

7. In relation to a person who qualifies for authorisation under Schedule 4, the conditions set out in paragraphs 1 and 3 to 5 apply, so far as relevant, to—

(a) an application for an additional permission;

(b) the exercise of the Authority's own-initiative power under section 45 in relation to additional permission.

PART III

ADDITIONAL CONDITIONS

8.—(1) If this paragraph applies to the person concerned, he must, for the purposes of such provisions of this Act as may be specified, satisfy specified additional conditions.

(2) This paragraph applies to a person who—

(a) has his head office outside the EEA; and

(b) appears to the Authority to be seeking to carry on a regulated activity relating to insurance business.

(3) "Specified" means specified in, or in accordance with, an order made by the Treasury.

9. The Treasury may by order—

(a) vary or remove any of the conditions set out in Parts I and II;

(b) add to those conditions.

Section 72(2).

SCHEDULE 7

THE AUTHORITY AS COMPETENT AUTHORITY FOR PART VI

General

1. This Act applies in relation to the Authority when it is exercising functions under Part VI as the competent authority subject to the following modifications.

The Authority's general functions

2. In section 2—

(a) subsection (4)(a) does not apply to listing rules;

(b) subsection (4)(c) does not apply to general guidance given in relation to Part VI; and

(c) subsection (4)(d) does not apply to functions under Part VI.

Duty to consult

3. Section 8 does not apply.

Rules

4.—(1) Sections 149, 153, 154 and 156 do not apply.

(2) Section 155 has effect as if—

(a) the reference in subsection (2)(c) to the general duties of the Authority under section 2 were a reference to its duty under section 73; and

(b) section 99 were included in the provisions referred to in subsection (9).

Statements of policy

5.—(1) Paragraph 5 of Schedule 1 has effect as if the requirement to act through the Authority's governing body applied also to the exercise of its functions of publishing statements under section 93.

(2) Paragraph 1 of Schedule 1 has effect as if section 93 were included in the provisions referred to in sub-paragraph (2)(d).

Penalties

6. Paragraph 16 of Schedule 1 does not apply in relation to penalties under Part VI (for which separate provision is made by section 100).

Fees

7. Paragraph 17 of Schedule 1 does not apply in relation to fees payable under Part VI (for which separate provision is made by section 99).

Exemption from liability in damages

8. Schedule 1 has effect as if—

(a) sub-paragraph (1) of paragraph 19 were omitted (similar provision being made in relation to the competent authority by section 102); and

(b) for the words from the beginning to "(a)" in sub-paragraph (3) of that paragraph, there were substituted "Sub-paragraph (2) does not apply".

SCHEDULE 8

Section 72(3).

TRANSFER OF FUNCTIONS UNDER PART VI

The power to transfer

1.—(1) The Treasury may by order provide for any function conferred on the competent authority which is exercisable for the time being by a particular person to be transferred so as to be exercisable by another person.

(2) An order may be made under this paragraph only if—

(a) the person from whom the relevant functions are to be transferred has agreed in writing that the order should be made;

(b) the Treasury are satisfied that the manner in which, or efficiency with which, the functions are discharged would be significantly improved if they were transferred to the transferee; or

(c) the Treasury are satisfied that it is otherwise in the public interest that the order should be made.

Supplemental

2.—(1) An order under this Schedule does not affect anything previously done by any person ("the previous authority") in the exercise of functions which are transferred by the order to another person ("the new authority").

(2) Such an order may, in particular, include provision—

(a) modifying or excluding any provision of Part VI, IX or XXVI in its application to any such functions;

(b) for reviews similar to that made, in relation to the Authority, by section 12;

(c) imposing on the new authority requirements similar to those imposed, in relation to the Authority, by sections 152, 155 and 354;

(d) as to the giving of guidance by the new authority;

(e) for the delegation by the new authority of the exercise of functions under Part VI and as to the consequences of delegation;

(f) for the transfer of any property, rights or liabilities relating to any such functions from the previous authority to the new authority;

(g) for the carrying on and completion by the new authority of anything in the process of being done by the previous authority when the order takes effect;

(h) for the substitution of the new authority for the previous authority in any instrument, contract or legal proceedings;

(i) for the transfer of persons employed by the previous authority to the new authority and as to the terms on which they are to transfer;

(j) making such amendments to any primary or subordinate legislation (including any provision of, or made under, this Act) as the Treasury consider appropriate in consequence of the transfer of functions effected by the order.

(3) Nothing in this paragraph is to be taken as restricting the powers conferred by section 428.

3. If the Treasury have made an order under paragraph 1 ("the transfer order") they may, by a separate order made under this paragraph, make any provision of a kind that could have been included in the transfer order.

Section 87(5).

SCHEDULE 9

NON-LISTING PROSPECTUSES

General application of Part VI

1. The provisions of Part VI apply in relation to a non-listing prospectus as they apply in relation to listing particulars but with the modifications made by this Schedule.

References to listing particulars

2.—(1) Any reference to listing particulars is to be read as a reference to a prospectus.

(2) Any reference to supplementary listing particulars is to be read as a reference to a supplementary prospectus.

General duty of disclosure

3.—(1) In section 80(1), for "section 79" substitute "section 87".

(2) In section 80(2), omit "as a condition of the admission of the securities to the official list".

Supplementary prospectuses

4. In section 81(1), for "section 79 and before the commencement of dealings in the securities concerned following their admission to the official list" substitute "section 87 and before the end of the period during which the offer to which the prospectus relates remains open".

Exemption from liability for compensation

5.—(1) In paragraphs 1(3) and 2(3) of Schedule 10, for paragraph (d) substitute—

"(d) the securities were acquired after such a lapse of time that he ought in the circumstances to be reasonably excused and, if the securities are dealt in on an approved exchange, he continued in that belief until after the commencement of dealings in the securities on that exchange."

(2) After paragraph 8 of that Schedule, insert—

"Meaning of "approved exchange"

9. "Approved exchange" has such meaning as may be prescribed."

Advertisements

6. In section 98(1), for "If listing particulars are, or are to be, published in connection with an application for listing," substitute "If a prospectus is, or is to be, published in connection with an application for approval, then, until the end of the period during which the offer to which the prospectus relates remains open,".

Fees

7. Listing rules made under section 99 may require the payment of fees to the competent authority in respect of a prospectus submitted for approval under section 87.

SCHEDULE 10

Section 90(2) and (5).

COMPENSATION: EXEMPTIONS

Statements believed to be true

1.—(1) In this paragraph "statement" means—

(a) any untrue or misleading statement in listing particulars; or

(b) the omission from listing particulars of any matter required to be included by section 80 or 81.

(2) A person does not incur any liability under section 90(1) for loss caused by a statement if he satisfies the court that, at the time when the listing particulars were submitted to the competent authority, he reasonably believed (having made such enquiries, if any, as were reasonable) that—

(a) the statement was true and not misleading, or

(b) the matter whose omission caused the loss was properly omitted,

and that one or more of the conditions set out in sub-paragraph (3) are satisfied.

(3) The conditions are that—

(a) he continued in his belief until the time when the securities in question were acquired;

(b) they were acquired before it was reasonably practicable to bring a correction to the attention of persons likely to acquire them;

(c) before the securities were acquired, he had taken all such steps as it was reasonable for him to have taken to secure that a correction was brought to the attention of those persons;

(d) he continued in his belief until after the commencement of dealings in the securities following their admission to the official list and they were acquired after such a lapse of time that he ought in the circumstances to be reasonably excused.

Statements by experts

2.—(1) In this paragraph "statement" means a statement included in listing particulars which—

(a) purports to be made by, or on the authority of, another person as an expert; and

(b) is stated to be included in the listing particulars with that other person's consent.

(2) A person does not incur any liability under section 90(1) for loss in respect of any securities caused by a statement if he satisfies the court that, at the time when the listing particulars were submitted to the competent authority, he reasonably believed that the other person—

(a) was competent to make or authorise the statement, and

(b) had consented to its inclusion in the form and context in which it was included,

and that one or more of the conditions set out in sub-paragraph (3) are satisfied.

(3) The conditions are that—

(a) he continued in his belief until the time when the securities were acquired;

(b) they were acquired before it was reasonably practicable to bring the fact that the expert was not competent, or had not consented, to the attention of persons likely to acquire the securities in question;

(c) before the securities were acquired he had taken all such steps as it was reasonable for him to have taken to secure that that fact was brought to the attention of those persons;

(d) he continued in his belief until after the commencement of dealings in the securities following their admission to the official list and they were acquired after such a lapse of time that he ought in the circumstances to be reasonably excused.

Corrections of statements

3.—(1) In this paragraph "statement" has the same meaning as in paragraph 1.

(2) A person does not incur liability under section 90(1) for loss caused by a statement if he satisfies the court—

(a) that before the securities in question were acquired, a correction had been published in a manner calculated to bring it to the attention of persons likely to acquire the securities; or

(b) that he took all such steps as it was reasonable for him to take to secure such publication and reasonably believed that it had taken place before the securities were acquired.

(3) Nothing in this paragraph is to be taken as affecting paragraph 1.

Corrections of statements by experts

4.—(1) In this paragraph "statement" has the same meaning as in paragraph 2.

(2) A person does not incur liability under section 90(1) for loss caused by a statement if he satisfies the court—

(a) that before the securities in question were acquired, the fact that the expert was not competent or had not consented had been published in a manner calculated to bring it to the attention of persons likely to acquire the securities; or

(b) that he took all such steps as it was reasonable for him to take to secure such publication and reasonably believed that it had taken place before the securities were acquired.

(3) Nothing in this paragraph is to be taken as affecting paragraph 2.

Official statements

5. A person does not incur any liability under section 90(1) for loss resulting from—

(a) a statement made by an official person which is included in the listing particulars, or

(b) a statement contained in a public official document which is included in the listing particulars,

if he satisfies the court that the statement is accurately and fairly reproduced.

False or misleading information known about

6. A person does not incur any liability under section 90(1) or (4) if he satisfies the court that the person suffering the loss acquired the securities in question with knowledge—

(a) that the statement was false or misleading,

(b) of the omitted matter, or

(c) of the change or new matter,

as the case may be.

Belief that supplementary listing particulars not called for

7. A person does not incur any liability under section 90(4) if he satisfies the court that he reasonably believed that the change or new matter in question was not such as to call for supplementary listing particulars.

Meaning of "expert"

8. "Expert" includes any engineer, valuer, accountant or other person whose profession, qualifications or experience give authority to a statement made by him.

Section 103(6).

SCHEDULE 11

OFFERS OF SECURITIES

The general rule

1.—(1) A person offers securities to the public in the United Kingdom if—

(a) to the extent that the offer is made to persons in the United Kingdom, it is made to the public; and

(b) the offer is not an exempt offer.

(2) For this purpose, an offer which is made to any section of the public, whether selected—

(a) as members or debenture holders of a body corporate,

(b) as clients of the person making the offer, or

(c) in any other manner,

is to be regarded as made to the public.

Exempt offers

2.—(1) For the purposes of this Schedule, an offer of securities is an "exempt offer" if, to the extent that the offer is made to persons in the United Kingdom—

(a) the condition specified in any of paragraphs 3 to 24 is satisfied in relation to the offer; or

(b) the condition specified in one relevant paragraph is satisfied in relation to part, but not the whole, of the offer and, in relation to each other part of the offer, the condition specified in a different relevant paragraph is satisfied.

(2) The relevant paragraphs are 3 to 8, 12 to 18 and 21.

Offers for business purposes

3. The securities are offered to persons—

(a) whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses, or

(b) who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses,

or are otherwise offered to persons in the context of their trades, professions or occupations.

Offers to limited numbers

4.—(1) The securities are offered to no more than fifty persons.

(2) In determining whether this condition is satisfied, the offer is to be taken together with any other offer of the same securities which was—

(a) made by the same person;

(b) open at any time within the period of 12 months ending with the date on which the offer is first made; and

(c) not an offer to the public in the United Kingdom by virtue of this condition being satisfied.

(3) For the purposes of this paragraph—

(a) the making of an offer of securities to trustees or members of a partnership in their capacity as such, or

(b) the making of such an offer to any other two or more persons jointly,

is to be treated as the making of an offer to a single person.

Clubs and associations

5. The securities are offered to the members of a club or association (whether or not incorporated) and the members can reasonably be regarded as having a common interest with each other and with the club or association in the affairs of the club or association and in what is to be done with the proceeds of the offer.

Restricted circles

6.—(1) The securities are offered to a restricted circle of persons whom the offeror reasonably believes to be sufficiently knowledgeable to understand the risks involved in accepting the offer.

(2) In determining whether a person is sufficiently knowledgeable to understand the risks involved in accepting an offer of securities, any information supplied by the person making the offer is to be disregarded, apart from information about—

(a) the issuer of the securities; or

(b) if the securities confer the right to acquire other securities, the issuer of those other securities.

Underwriting agreements

7. The securities are offered in connection with a genuine invitation to enter into an underwriting agreement with respect to them.

Offers to public authorities

8.—(1) The securities are offered to a public authority.

(2) "Public authority" means—

(a) the government of the United Kingdom;

(b) the government of any country or territory outside the United Kingdom;

(c) a local authority in the United Kingdom or elsewhere;

(d) any international organisation the members of which include the United Kingdom or another EEA State; and

(e) such other bodies, if any, as may be specified.

Maximum consideration

9.—(1) The total consideration payable for the securities cannot exceed 40,000 euros (or an equivalent amount).

(2) In determining whether this condition is satisfied, the offer is to be taken together with any other offer of the same securities which was—

(a) made by the same person;

(b) open at any time within the period of 12 months ending with the date on which the offer is first made; and

(c) not an offer to the public in the United Kingdom by virtue of this condition being satisfied.

(3) An amount (in relation to an amount denominated in euros) is an "equivalent amount" if it is an amount of equal value, calculated at the latest

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practicable date before (but in any event not more than 3 days before) the date on which the offer is first made, denominated wholly or partly in another currency or unit of account.

Minimum consideration

10.—(1) The minimum consideration which may be paid by any person for securities acquired by him pursuant to the offer is at least 40,000 euros (or an equivalent amount).

(2) Paragraph 9(3) also applies for the purposes of this paragraph.

Securities denominated in euros

11.—(1) The securities are denominated in amounts of at least 40,000 euros (or an equivalent amount).

(2) Paragraph 9(3) also applies for the purposes of this paragraph.

Takeovers

12.—(1) The securities are offered in connection with a takeover offer.

(2) "Takeover offer" means—

(a) an offer to acquire shares in a body incorporated in the United Kingdom which is a takeover offer within the meaning of the takeover provisions (or would be such an offer if those provisions applied in relation to any body corporate);

(b) an offer to acquire all or substantially all of the shares, or of the shares of a particular class, in a body incorporated outside the United Kingdom; or

(c) an offer made to all the holders of shares, or of shares of a particular class, in a body corporate to acquire a specified proportion of those shares.

(3) "The takeover provisions" means—

1985 c. 6. (a) Part XIIIA of the Companies Act 1985; or

S.I. 1986/1032 (N.I. 6). (b) in relation to Northern Ireland, Part XIVA of the Companies (Northern Ireland) Order 1986.

(4) For the purposes of sub-paragraph (2)(b), any shares which the offeror or any associate of his holds or has contracted to acquire are to be disregarded.

(5) For the purposes of sub-paragraph (2)(c), the following are not to be regarded as holders of the shares in question—

(a) the offeror;

(b) any associate of the offeror; and

(c) any person whose shares the offeror or any associate of the offeror has contracted to acquire.

(6) "Associate" has the same meaning as in—

(a) section 430E of the Companies Act 1985; or

(b) in relation to Northern Ireland, Article 423E of the Companies (Northern Ireland) Order 1986.

Mergers

13. The securities are offered in connection with a merger (within the meaning of Council Directive No. 78/855/EEC).

Free shares

14.—(1) The securities are shares and are offered free of charge to any or all of the holders of shares in the issuer.

(2) "Holders of shares" means the persons who at the close of business on a date—

(a) specified in the offer, and

(b) falling within the period of 60 days ending with the date on which the offer is first made,

were holders of such shares.

Exchange of shares

15. The securities—

(a) are shares, or investments of a specified kind relating to shares, in a body corporate, and

(b) are offered in exchange for shares in the same body corporate,

and the offer cannot result in any increase in the issued share capital of the body corporate.

Qualifying persons

16.—(1) The securities are issued by a body corporate and are offered—

(a) by the issuer, by a body corporate connected with the issuer or by a relevant trustee;

(b) only to qualifying persons; and

(c) on terms that a contract to acquire any such securities may be entered into only by the qualifying person to whom they were offered or, if the terms of the offer so permit, any qualifying person.

(2) A person is a "qualifying person", in relation to an issuer, if he is a genuine employee or former employee of the issuer or of another body corporate in the same group or the wife, husband, widow, widower or child or stepchild under the age of eighteen of such an employee or former employee.

(3) In relation to an issuer of securities, "connected with" has such meaning as may be prescribed.

(4) "Group" and "relevant trustee" have such meaning as may be prescribed.

Convertible securities

17.—(1) The securities result from the conversion of convertible securities and listing particulars (or a prospectus) relating to the convertible securities were (or was) published in the United Kingdom under or by virtue of Part VI or such other provisions applying in the United Kingdom as may be specified.

(2) "Convertible securities" means securities of a specified kind which can be converted into, or exchanged for, or which confer rights to acquire, other securities.

(3) "Conversion" means conversion into or exchange for, or the exercise of rights conferred by the securities to acquire, other securities.

Charities

18. The securities are issued by—

(a) a charity within the meaning of—

(i) section 96(1) of the Charities Act 1993, or 1993 c. 10.

(ii) section 35 of the Charities Act (Northern Ireland) 1964, 1964 c. 33 (N.I.)

1990 c. 40.

(b) a recognised body within the meaning of section 1(7) of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990,

(c) a housing association within the meaning of—

1985 c. 68.

(i) section 5(1) of the Housing Act 1985,

1985 c. 69

(ii) section 1 of the Housing Associations Act 1985, or

S.I. 1992/1725 (N.I. 10).

(iii) Article 3 of the Housing (Northern Ireland) Order 1992,

(d) an industrial or provident society registered in accordance with—

1965 c. 12.

(i) section 1(2)(b) of the Industrial and Provident Societies Act 1965, or

1969 c. 24 (N.I.).

(ii) section 1(2)(b) of the Industrial and Provident Societies Act 1969, or

(e) a non-profit making association or body, recognised by the country or territory in which it is established, with objectives similar to those of a body falling within any of paragraphs (a) to (c),

and the proceeds of the offer will be used for the purposes of the issuer's objectives.

Building societies etc.

19. The securities offered are shares which are issued by, or ownership of which entitles the holder to membership of or to obtain the benefit of services provided by—

(a) a building society incorporated under the law of, or of any part of, the United Kingdom;

(b) any body incorporated under the law of, or of any part of, the United Kingdom relating to industrial and provident societies or credit unions; or

(c) a body of a similar nature established in another EEA State.

Euro-securities

20.—(1) The securities offered are Euro-securities and no advertisement relating to the offer is issued in the United Kingdom, or is caused to be so issued—

(a) by the issuer of the Euro-securities;

(b) by any credit institution or other financial institution through which the Euro-securities may be acquired pursuant to the offer; or

(c) by any body corporate which is a member of the same group as the issuer or any of those institutions.

(2) But sub-paragraph (1) does not apply to an advertisement of a prescribed kind.

(3) "Euro-securities" means investments which—

(a) are to be underwritten and distributed by a syndicate at least two of the members of which have their registered offices in different countries or territories;

(b) are to be offered on a significant scale in one or more countries or territories, other than the country or territory in which the issuer has its registered office; and

(c) may be acquired pursuant to the offer only through a credit institution or other financial institution.

(4) "Credit institution" means a credit institution as defined in Article 1 of Council Directive No 77/780/EEC.

(5) "Financial institution" means a financial institution as defined in Article 1 of Council Directive No 89/646/EEC.

(6) "Underwritten" means underwritten by whatever means, including by acquisition or subscription, with a view to resale.

Same class securities

21. The securities are of the same class, and were issued at the same time, as securities in respect of which a prospectus has been published under or by virtue of—

(a) Part VI;

(b) Part III of the Companies Act 1985; or 1985 c. 6.

(c) such other provisions applying in the United Kingdom as may be specified.

Short date securities

22. The securities are investments of a specified kind with a maturity of less than one year from their date of issue.

Government and public securities

23.—(1) The securities are investments of a specified kind creating or acknowledging indebtedness issued by or on behalf of a public authority.

(2) "Public authority" means—

(a) the government of the United Kingdom;

(b) the government of any country or territory outside the United Kingdom;

(c) a local authority in the United Kingdom or elsewhere;

(d) any international organisation the members of which include the United Kingdom or another EEA State; and

(e) such other bodies, if any, as may be specified.

Non-transferable securities

24. The securities are not transferable.

General definitions

25. For the purposes of this Schedule—

"shares" has such meaning as may be specified; and

"specified" means specified in an order made by the Treasury.

SCHEDULE 12

Sections 111(2) and 115.

TRANSFER SCHEMES: CERTIFICATES

PART I

INSURANCE BUSINESS TRANSFER SCHEMES

1.—(1) For the purposes of section 111(2) the appropriate certificates, in relation to an insurance business transfer scheme, are—

(a) a certificate under paragraph 2;

(b) if sub-paragraph (2) applies, a certificate under paragraph 3;

(c) if sub-paragraph (3) applies, a certificate under paragraph 4;

(d) if sub-paragraph (4) applies, a certificate under paragraph 5.

(2) This sub-paragraph applies if—

(a) the authorised person concerned is a UK authorised person which has received authorisation under Article 6 of the first life insurance directive or of the first non-life insurance directive from the Authority; and

(b) the establishment from which the business is to be transferred under the proposed insurance business transfer scheme is in an EEA State other than the United Kingdom.

(3) This sub-paragraph applies if—

(a) the authorised person concerned has received authorisation under Article 6 of the first life insurance directive from the Authority;

(b) the proposed transfer relates to business which consists of the effecting or carrying out of contracts of long-term insurance; and

(c) as regards any policy which is included in the proposed transfer and which evidences a contract of insurance (other than reinsurance), an EEA State other than the United Kingdom is the State of the commitment.

(4) This sub-paragraph applies if—

(a) the authorised person concerned has received authorisation under Article 6 of the first non-life insurance directive from the Authority;

(b) the business to which the proposed insurance business transfer scheme relates is business which consists of the effecting or carrying out of contracts of general insurance; and

(c) as regards any policy which is included in the proposed transfer and which evidences a contract of insurance (other than reinsurance), the risk is situated in an EEA State other than the United Kingdom.

Certificates as to margin of solvency

2.—(1) A certificate under this paragraph is to be given—

(a) by the relevant authority; or

(b) in a case in which there is no relevant authority, by the Authority.

(2) A certificate given under sub-paragraph (1)(a) is one certifying that, taking the proposed transfer into account—

(a) the transferee possesses, or will possess before the scheme takes effect, the necessary margin of solvency; or

(b) there is no necessary margin of solvency applicable to the transferee.

(3) A certificate under sub-paragraph (1)(b) is one certifying that the Authority has received from the authority which it considers to be the authority responsible for supervising persons who effect or carry out contracts of insurance in the place to which the business is to be transferred that, taking the proposed transfer into account—

(a) the transferee possesses or will possess before the scheme takes effect the margin of solvency required under the law applicable in that place; or

(b) there is no such margin of solvency applicable to the transferee .

(4) "Necessary margin of solvency" means the margin of solvency required in relation to the transferee, taking the proposed transfer into account, under the law which it is the responsibility of the relevant authority to apply.

(5) "Margin of solvency" means the excess of the value of the assets of the transferee over the amount of its liabilities.

(6) "Relevant authority" means—

(a) if the transferee is an EEA firm falling within paragraph 5(d) of Schedule 3, its home state regulator;

(b) if the transferee is a Swiss general insurer, the authority responsible in Switzerland for supervising persons who effect or carry out contracts of insurance;

(c) if the transferee is an authorised person not falling within paragraph (a) or (b), the Authority.

(7) In sub-paragraph (6), any reference to a transferee of a particular description includes a reference to a transferee who will be of that description if the proposed scheme takes effect.

(8) "Swiss general insurer" means a body—

(a) whose head office is in Switzerland;

(b) which has permission to carry on regulated activities consisting of the effecting and carrying out of contracts of general insurance; and

(c) whose permission is not restricted to the effecting or carrying out of contracts of reinsurance.

Certificates as to consent

3. A certificate under this paragraph is one given by the Authority and certifying that the host State regulator has been notified of the proposed scheme and that—

(a) that regulator has responded to the notification; or

(b) that it has not responded but the period of three months beginning with the notification has elapsed.

Certificates as to long-term business

4. A certificate under this paragraph is one given by the Authority and certifying that the authority responsible for supervising persons who effect or carry out contracts of insurance in the State of the commitment has been notified of the proposed scheme and that—

(a) that authority has consented to the proposed scheme; or

(b) the period of three months beginning with the notification has elapsed and that authority has not refused its consent.

Certificates as to general business

5. A certificate under this paragraph is one given by the Authority and certifying that the authority responsible for supervising persons who effect or carry out contracts of insurance in the EEA State in which the risk is situated has been notified of the proposed scheme and that—

(a) that authority has consented to the proposed scheme; or

(b) the period of three months beginning with the notification has elapsed and that authority has not refused its consent.

Interpretation of Part I

6.—(1) "State of the commitment", in relation to a commitment entered into at any date, means—

(a) if the policyholder is an individual, the State in which he had his habitual residence at that date;

(b) if the policyholder is not an individual, the State in which the establishment of the policyholder to which the commitment relates was situated at that date.

(2) "Commitment" means a commitment represented by contracts of insurance of a prescribed class.

(3) References to the EEA State in which a risk is situated are—

(a) if the insurance relates to a building or to a building and its contents (so far as the contents are covered by the same policy), to the EEA State in which the building is situated;

(b) if the insurance relates to a vehicle of any type, to the EEA State of registration;

(c) in the case of policies of a duration of four months or less covering travel or holiday risks (whatever the class concerned), to the EEA State in which the policyholder took out the policy;

(d) in a case not covered by paragraphs (a) to (c)—

(i) if the policyholder is an individual, to the EEA State in which he has his habitual residence at the date when the contract is entered into; and

(ii) otherwise, to the EEA State in which the establishment of the policyholder to which the policy relates is situated at that date.

PART II

BANKING BUSINESS TRANSFER SCHEMES

7.—(1) For the purposes of section 111(2) the appropriate certificates, in relation to a banking business transfer scheme, are—

(a) a certificate under paragraph 8; and

(b) if sub-paragraph (2) applies, a certificate under paragraph 9.

(2) This sub-paragraph applies if the authorised person concerned or the transferee is an EEA firm falling within paragraph 5(b) of Schedule 3.

Certificates as to financial resources

8.—(1) A certificate under this paragraph is one given by the relevant authority and certifying that, taking the proposed transfer into account, the transferee possesses, or will possess before the scheme takes effect, adequate financial resources.

(2) "Relevant authority" means—

(a) if the transferee is a person with a Part IV permission or with permission under Schedule 4, the Authority;

(b) if the transferee is an EEA firm falling within paragraph 5(b) of Schedule 3, its home state regulator;

(c) if the transferee does not fall within paragraph (a) or (b), the authority responsible for the supervision of the transferee's business in the place in which the transferee has its head office.

(3) In sub-paragraph (2), any reference to a transferee of a particular description of person includes a reference to a transferee who will be of that description if the proposed banking business transfer scheme takes effect.

Certificates as to consent of home state regulator

9. A certificate under this paragraph is one given by the Authority and certifying that the home State regulator of the authorised person concerned or of the transferee has been notified of the proposed scheme and that—

(a) the home State regulator has responded to the notification; or

(b) the period of three months beginning with the notification has elapsed.

PART III

INSURANCE BUSINESS TRANSFERS EFFECTED OUTSIDE THE UNITED KINGDOM

10.—(1) This paragraph applies to a proposal to execute under provisions corresponding to Part VII in a country or territory other than the United Kingdom an instrument transferring all the rights and obligations of the transferor under general or long-term insurance policies, or under such descriptions of such policies as may be specified in the instrument, to the transferee if any of the conditions in sub-paragraphs (2), (3) or (4) is met in relation to it.

(2) The transferor is an EEA firm falling within paragraph 5(d) of Schedule 3 and the transferee is an authorised person whose margin of solvency is supervised by the Authority.

(3) The transferor is a company authorised in an EEA State other than the United Kingdom under Article 27 of the first life insurance directive, or Article 23 of the first non-life insurance directive and the transferee is a UK authorised person which has received authorisation under Article 6 of either of those directives.

(4) The transferor is a Swiss general insurer and the transferee is a UK authorised person which has received authorisation under Article 6 of the first life insurance directive or the first non-life insurance directive.

(5) In relation to a proposed transfer to which this paragraph applies, the Authority may, if it is satisfied that the transferee possesses the necessary margin of solvency, issue a certificate to that effect.

(6) "Necessary margin of solvency" means the margin of solvency which the transferee, taking the proposed transfer into account, is required by the Authority to maintain.

(7) "Swiss general insurer" has the same meaning as in paragraph 2.

(8) "General policy" means a policy evidencing a contract which, if it had been effected by the transferee, would have constituted the carrying on of a regulated activity consisting of the effecting of contracts of general insurance.

(9) "Long-term policy" means a policy evidencing a contract which, if it had been effected by the transferee, would have constituted the carrying on of a regulated activity consisting of the effecting of contracts of long-term insurance.

SCHEDULE 13

Section 132(4).

THE FINANCIAL SERVICES AND MARKETS TRIBUNAL

PART I

GENERAL

Interpretation

1. In this Schedule—

"panel of chairmen" means the panel established under paragraph 3(1);

"lay panel" means the panel established under paragraph 3(4);

"rules" means rules made by the Lord Chancellor under section 132.

PART II

THE TRIBUNAL

President

2.—(1) The Lord Chancellor must appoint one of the members of the panel of chairmen to preside over the discharge of the Tribunal's functions.

(2) The member so appointed is to be known as the President of the Financial Services and Markets Tribunal (but is referred to in this Act as "the President").

(3) The Lord Chancellor may appoint one of the members of the panel of chairmen to be Deputy President.

(4) The Deputy President is to have such functions in relation to the Tribunal as the President may assign to him.

(5) The Lord Chancellor may not appoint a person to be the President or Deputy President unless that person—

(a) has a ten year general qualification within the meaning of section 71 of the Courts and Legal Services Act 1990; 1990 c. 41.

(b) is an advocate or solicitor in Scotland of at least ten years' standing; or

(c) is—

(i) a member of the Bar of Northern Ireland of at least ten years' standing; or

(ii) a solicitor of the Supreme Court of Northern Ireland of at least ten years' standing.

(6) If the President (or Deputy President) ceases to be a member of the panel of chairmen, he also ceases to be the President (or Deputy President).

(7) The functions of the President may, if he is absent or is otherwise unable to act, be discharged—

(a) by the Deputy President; or

(b) if there is no Deputy President or he too is absent or otherwise unable to act, by a person appointed for that purpose from the panel of chairmen by the Lord Chancellor.

Panels

3.—(1) The Lord Chancellor must appoint a panel of persons for the purposes of serving as chairmen of the Tribunal.

(2) A person is qualified for membership of the panel of chairmen if—

(a) he has a seven year general qualification within the meaning of section 71 of the Courts and Legal Services Act 1990;

(b) he is an advocate or solicitor in Scotland of at least seven years' standing; or

(c) he is—

(i) a member of the Bar of Northern Ireland of at least seven years' standing; or

(ii) a solicitor of the Supreme Court of Northern Ireland of at least seven years' standing.

(3) The panel of chairmen must include at least one member who is a person of the kind mentioned in sub-paragraph (2)(b).

(4) The Lord Chancellor must also appoint a panel of persons who appear to him to be qualified by experience or otherwise to deal with matters of the kind that may be referred to the Tribunal.

Terms of office etc

4.—(1) Subject to the provisions of this Schedule, each member of the panel of chairmen and the lay panel is to hold and vacate office in accordance with the terms of his appointment.

(2) The Lord Chancellor may remove a member of either panel (including the President) on the ground of incapacity or misbehaviour.

(3) A member of either panel—

(a) may at any time resign office by notice in writing to the Lord Chancellor;

(b) is eligible for re-appointment if he ceases to hold office.

Remuneration and expenses

5. The Lord Chancellor may pay to any person, in respect of his service—

(a) as a member of the Tribunal (including service as the President or Deputy President), or

(b) as a person appointed under paragraph 7(4),

such remuneration and allowances as he may determine.

Staff

6.—(1) The Lord Chancellor may appoint such staff for the Tribunal as he may determine.

(2) The remuneration of the Tribunal's staff is to be defrayed by the Lord Chancellor.

(3) Such expenses of the Tribunal as the Lord Chancellor may determine are to be defrayed by the Lord Chancellor.

PART III

CONSTITUTION OF TRIBUNAL

7.—(1) On a reference to the Tribunal, the persons to act as members of the Tribunal for the purposes of the reference are to be selected from the panel of chairmen or the lay panel in accordance with arrangements made by the President for the purposes of this paragraph ("the standing arrangements").

(2) The standing arrangements must provide for at least one member to be selected from the panel of chairmen.

(3) If while a reference is being dealt with, a person serving as member of the Tribunal in respect of the reference becomes unable to act, the reference may be dealt with by—

(a) the other members selected in respect of that reference; or

(b) if it is being dealt with by a single member, such other member of the panel of chairmen as may be selected in accordance with the standing arrangements for the purposes of the reference.

(4) If it appears to the Tribunal that a matter before it involves a question of fact of special difficulty, it may appoint one or more experts to provide assistance.

PART IV

TRIBUNAL PROCEDURE

8. For the purpose of dealing with references, or any matter preliminary or incidental to a reference, the Tribunal must sit at such times and in such place or places as the Lord Chancellor may direct.

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9. Rules made by the Lord Chancellor under section 132 may, in particular, include provision—

(a) as to the manner in which references are to be instituted;

(b) for the holding of hearings in private in such circumstances as may be specified in the rules;

(c) as to the persons who may appear on behalf of the parties;

(d) for a member of the panel of chairmen to hear and determine interlocutory matters arising on a reference;

(e) for the suspension of decisions of the Authority which have taken effect;

(f) as to the withdrawal of references;

(g) as to the registration, publication and proof of decisions and orders.

Practice directions

10. The President of the Tribunal may give directions as to the practice and procedure to be followed by the Tribunal in relation to references to it.

Evidence

11.—(1) The Tribunal may by summons require any person to attend, at such time and place as is specified in the summons, to give evidence or to produce any document in his custody or under his control which the Tribunal considers it necessary to examine.

(2) The Tribunal may—

(a) take evidence on oath and for that purpose administer oaths; or

(b) instead of administering an oath, require the person examined to make and subscribe a declaration of the truth of the matters in respect of which he is examined.

(3) A person who without reasonable excuse—

(a) refuses or fails—

(i) to attend following the issue of a summons by the Tribunal, or

(ii) to give evidence, or

(b) alters, suppresses, conceals or destroys, or refuses to produce a document which he may be required to produce for the purposes of proceedings before the Tribunal,

is guilty of an offence.

(4) A person guilty of an offence under sub-paragraph (3)(a) is liable on summary conviction to a fine not exceeding the statutory maximum.

(5) A person guilty of an offence under sub-paragraph (3)(b) is liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum;

(b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine or both.

Decisions of Tribunal

12.—(1) A decision of the Tribunal may be taken by a majority.

(2) The decision must—

(a) state whether it was unanimous or taken by a majority;

(b) be recorded in a document which—

(i) contains a statement of the reasons for the decision; and

(ii) is signed and dated by the member of the panel of chairmen dealing with the reference.

(3) The Tribunal must—

(a) inform each party of its decision; and

(b) as soon as reasonably practicable, send to each party and, if different, to any authorised person concerned, a copy of the document mentioned in sub-paragraph (2).

(4) The Tribunal must send the Treasury a copy of its decision.

Costs

13.—(1) If the Tribunal considers that a party to any proceedings on a reference has acted vexatiously, frivolously or unreasonably it may order that party to pay to another party to the proceedings the whole or part of the costs or expenses incurred by the other party in connection with the proceedings.

(2) If, in any proceedings on a reference, the Tribunal considers that a decision of the Authority which is the subject of the reference was unreasonable it may order the Authority to pay to another party to the proceedings the whole or part of the costs or expenses incurred by the other party in connection with the proceedings.

SCHEDULE 14

Section 162.

ROLE OF THE COMPETITION COMMISSION

Provision of information by Treasury

1.—(1) The Treasury's powers under this paragraph are to be exercised only for the purpose of assisting the Commission in carrying out an investigation under section 162.

(2) The Treasury may give to the Commission—

(a) any information in their possession which relates to matters falling within the scope of the investigation; and

(b) other assistance in relation to any such matters.

(3) In carrying out an investigation under section 162, the Commission must have regard to any information given to it under this paragraph.

Consideration of matters arising on a report

2. In considering any matter arising from a report made by the Director under section 160, the Commission must have regard to—

(a) any representations made to it in connection with the matter by any person appearing to the Commission to have a substantial interest in the matter; and

(b) any cost benefit analysis prepared by the Authority (at any time) in connection with the regulatory provision or practice, or any of the regulatory provisions or practices, which are the subject of the report.

Applied provisions

3.—(1) The provisions mentioned in sub-paragraph (2) are to apply in relation to the functions of the Commission under section 162 as they apply in relation to the functions of the Commission in relation to a reference to the Commission under the Fair Trading Act 1973. 1973 c. 41.

(2) The provisions are—

(a) section 82(2), (3) and (4) of the Fair Trading Act 1973 (general provisions about reports);

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(b) section 85 of that Act (attendance of witnesses and production of documents);

(c) section 93B of that Act (false or misleading information);

1980 c. 21. (d) section 24 of the Competition Act 1980 (modifications of provisions about the performance of the Commission's functions);

1998 c. 41. (d) Part II of Schedule 7 to the Competition Act 1998 (performance by the Commission of its general functions).

(3) But the reference in paragraph 15(7)(b) in Schedule 7 to the 1998 Act to section 75(5) of that Act is to be read as a reference to the power of the Commission to decide not to make a report in accordance with section 162(2).

Publication of reports

4.—(1) If the Commission makes a report under section 162, it must publish it in such a way as appears to it to be best calculated to bring it to the attention of the public.

(2) Before publishing the report the Commission must, so far as practicable, exclude any matter which relates to the private affairs of a particular individual the publication of which, in the opinion of the Commission, would or might seriously and prejudicially affect his interests.

(3) Before publishing the report the Commission must, so far as practicable, also exclude any matter which relates to the affairs of a particular body the publication of which, in the opinion of the Commission, would or might seriously and prejudicially affect its interests.

(4) Sub-paragraphs (2) and (3) do not apply in relation to copies of a report which the Commission is required to send under section 162(10).

Sections 165(11) and 171(4).

SCHEDULE 15

INFORMATION AND INVESTIGATIONS: CONNECTED PERSONS

PART I

RULES FOR SPECIFIC BODIES

Corporate bodies

1. If the authorised person ("BC") is a body corporate, a person who is or has been—

(a) an officer or manager of BC or of a parent undertaking of BC;

(b) an employee of BC;

(c) an agent of BC or of a parent undertaking of BC.

Partnerships

2. If the authorised person ("PP") is a partnership, a person who is or has been a member, manager, employee or agent of PP.

Unincorporated associations

3. If the authorised person ("UA") is an unincorporated association of persons which is neither a partnership nor an unincorporated friendly society, a person who is or has been an officer, manager, employee or agent of UA.

Friendly societies

4.—(1) If the authorised person ("FS") is a friendly society, a person who is or has been an officer, manager or employee of FS.

(2) In relation to FS, "officer" and "manager" have the same meaning as in section 119(1) of the Friendly Societies Act 1992. 1992 c. 40.

Building societies

5.—(1) If the authorised person ("BS") is a building society, a person who is or has been an officer or employee of BS.

(2) In relation to BS, "officer" has the same meaning as it has in section 119(1) of the Building Societies Act 1986. 1986 c. 53.

Individuals

6. If the authorised person ("IP") is an individual, a person who is or has been an employee or agent of IP.

Application to sections 171 and 172

7. For the purposes of sections 171 and 172, if the person under investigation is not an authorised person the references in this Part of this Schedule to an authorised person are to be taken to be references to the person under investigation.

PART II

ADDITIONAL RULES

8. A person who is, or at the relevant time was, the partner, manager, employee, agent, appointed representative, banker, auditor, actuary or solicitor of—

(a) the person under investigation ("A");

(b) a parent undertaking of A;

(c) a subsidiary undertaking of A;

(d) a subsidiary undertaking of a parent undertaking of A; or

(e) a parent undertaking of a subsidiary undertaking of A.

SCHEDULE 16

Section 203(8).

PROHIBITIONS AND RESTRICTIONS IMPOSED BY DIRECTOR GENERAL OF FAIR TRADING

Preliminary

1. In this Schedule—

"appeal period" has the same meaning as in the Consumer Credit Act 1974; 1974 c. 39.

"prohibition" means a consumer credit prohibition under section 203;

"restriction" means a restriction under section 204.

Notice of prohibition or restriction

2.—(1) This paragraph applies if the Director proposes, in relation to a firm—

(a) to impose a prohibition;

(b) to impose a restriction; or

(c) to vary a restriction otherwise than with the agreement of the firm.

(2) The Director must by notice—

(a) inform the firm of his proposal, stating his reasons; and

(b) invite the firm to submit representations in accordance with paragraph 4.

(3) If he imposes the prohibition or restriction or varies the restriction, the Director may give directions authorising the firm to carry into effect agreements made before the coming into force of the prohibition, restriction or variation.

(4) A prohibition, restriction or variation is not to come into force before the end of the appeal period.

(5) If the Director imposes a prohibition or restriction or varies a restriction, he must serve a copy of the prohibition, restriction or variation—

(a) on the Authority; and

(b) on the firm's home state regulator.

Application to revoke prohibition or restriction

3.—(1) This paragraph applies if the Director proposes to refuse an application made by a firm for the revocation of a prohibition or restriction.

(2) The Director must by notice—

(a) inform the firm of the proposed refusal, stating his reasons; and

(b) invite the firm to submit representations in accordance with paragraph 4.

Representations to Director

4.—(1) If this paragraph applies to an invitation to submit representations, the Director must invite the firm, within 21 days after the notice containing the invitation is given to it or such longer period as he may allow—

(a) to submit its representations in writing to him; and

(b) to give notice to him, if the firm thinks fit, that it wishes to make representations orally.

(2) If notice is given under sub-paragraph (1)(b), the Director must arrange for the oral representations to be heard.

(3) The Director must give the firm notice of his determination.

Appeals

1974 c. 39. 5. Section 41 of the Consumer Credit Act 1974 (appeals to the Secretary of State) has effect as if—

(a) the following determinations were mentioned in column 1 of the table set out at the end of that section—

(i) imposition of a prohibition or restriction or the variation of a restriction; and

(ii) refusal of an application for the revocation of a prohibition or restriction; and

(b) the firm concerned were mentioned in column 2 of that table in relation to those determinations.

SCHEDULE 17

Section 225(4).

THE OMBUDSMAN SCHEME

PART I

GENERAL

Interpretation

1. In this Schedule—

"ombudsman" means a person who is a member of the panel; and

"the panel" means the panel established under paragraph 4.

PART II

THE SCHEME OPERATOR

Establishment by the Authority

2.—(1) The Authority must establish a body corporate to exercise the functions conferred on the scheme operator by or under this Act.

(2) The Authority must take such steps as are necessary to ensure that the scheme operator is, at all times, capable of exercising those functions.

Constitution

3.—(1) The constitution of the scheme operator must provide for it to have—

(a) a chairman; and

(b) a board (which must include the chairman) whose members are the scheme operator's directors.

(2) The chairman and other members of the board must be persons appointed, and liable to removal from office, by the Authority (acting, in the case of the chairman, with the approval of the Treasury).

(3) But the terms of their appointment (and in particular those governing removal from office) must be such as to secure their independence from the Authority in the operation of the scheme.

(4) The function of making voluntary jurisdiction rules under section 227 and the functions conferred by paragraphs 4, 5, 7, 9 or 14 may be exercised only by the board.

(5) The validity of any act of the scheme operator is unaffected by—

(a) a vacancy in the office of chairman; or

(b) a defect in the appointment of a person as chairman or as a member of the board.

The panel of ombudsmen

4.—(1) The scheme operator must appoint and maintain a panel of persons, appearing to it to have appropriate qualifications and experience, to act as ombudsmen for the purposes of the scheme.

(2) A person's appointment to the panel is to be on such terms (including terms as to the duration and termination of his appointment and as to remuneration) as the scheme operator considers—

(a) consistent with the independence of the person appointed; and

(b) otherwise appropriate.

The Chief Ombudsman

5.—(1) The scheme operator must appoint one member of the panel to act as Chief Ombudsman.

(2) The Chief Ombudsman is to be appointed on such terms (including terms as to the duration and termination of his appointment) as the scheme operator considers appropriate.

Status

6.—(1) The scheme operator is not to be regarded as exercising functions on behalf of the Crown.

(2) The scheme operator's board members, officers and staff are not to be regarded as Crown servants.

(3) Appointment as Chief Ombudsman or to the panel or as a deputy ombudsman does not confer the status of Crown servant.

Annual reports

7.—(1) At least once a year—

(a) the scheme operator must make a report to the Authority on the discharge of its functions; and

(b) the Chief Ombudsman must make a report to the Authority on the discharge of his functions.

(2) Each report must distinguish between functions in relation to the scheme's compulsory jurisdiction and functions in relation to its voluntary jurisdiction.

(3) Each report must also comply with any requirements specified in rules made by the Authority.

(4) The scheme operator must publish each report in the way it considers appropriate.

Guidance

8. The scheme operator may publish guidance consisting of such information and advice as it considers appropriate and may charge for it or distribute it free of charge.

Budget

9.—(1) The scheme operator must, before the start of each of its financial years, adopt an annual budget which has been approved by the Authority.

(2) The scheme operator may, with the approval of the Authority, vary the budget for a financial year at any time after its adoption.

(3) The annual budget must include an indication of—

(a) the distribution of resources deployed in the operation of the scheme, and

(b) the amounts of income of the scheme operator arising or expected to arise from the operation of the scheme,

distinguishing between the scheme's compulsory and voluntary jurisdiction.

Exemption from liability in damages

10.—(1) No person is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of any functions under this Act in relation to the compulsory jurisdiction.

(2) Sub-paragraph (1) does not apply—

(a) if the act or omission is shown to have been in bad faith; or

(b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998. 1998 c. 42.

Privilege

11. For the purposes of the law relating to defamation, proceedings in relation to a complaint which is subject to the compulsory jurisdiction are to be treated as if they were proceedings before a court.

PART III

THE COMPULSORY JURISDICTION

Introduction

12. This Part of this Schedule applies only in relation to the compulsory jurisdiction.

Authority's procedural rules

13.—(1) The Authority must make rules providing that a complaint is not to be entertained unless the complainant has referred it under the ombudsman scheme before the applicable time limit (determined in accordance with the rules) has expired.

(2) The rules may provide that an ombudsman may extend that time limit in specified circumstances.

(3) The Authority may make rules providing that a complaint is not to be entertained (except in specified circumstances) if the complainant has not previously communicated its substance to the respondent and given him a reasonable opportunity to deal with it.

(4) The Authority may make rules requiring an authorised person who may become subject to the compulsory jurisdiction as a respondent to establish such procedures as the Authority considers appropriate for the resolution of complaints which—

(a) may be referred to the scheme; and

(b) arise out of activity to which the Authority's powers under Part X do not apply.

The scheme operator's rules

14.—(1) The scheme operator must make rules, to be known as "scheme rules", which are to set out the procedure for reference of complaints and for their investigation, consideration and determination by an ombudsman.

(2) Scheme rules may, among other things—

(a) specify matters which are to be taken into account in determining whether an act or omission was fair and reasonable;

(b) provide that a complaint may, in specified circumstances, be dismissed without consideration of its merits;

(c) provide for the reference of a complaint, in specified circumstances and with the consent of the complainant, to another body with a view to its being determined by that body instead of by an ombudsman;

(d) make provision as to the evidence which may be required or admitted, the extent to which it should be oral or written and the consequences of a person's failure to produce any information or document which he has been required (under section 231 or otherwise) to produce;

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(e) allow an ombudsman to fix time limits for any aspect of the proceedings and to extend a time limit;

(f) provide for certain things in relation to the reference, investigation or consideration (but not determination) of a complaint to be done by a member of the scheme operator's staff instead of by an ombudsman;

(g) make different provision in relation to different kinds of complaint.

(3) The circumstances specified under sub-paragraph (2)(b) may include the following—

(a) the ombudsman considers the complaint frivolous or vexatious;

(b) legal proceedings have been brought concerning the subject-matter of the complaint and the ombudsman considers that the complaint is best dealt with in those proceedings; or

(c) the ombudsman is satisfied that there are other compelling reasons why it is inappropriate for the complaint to be dealt with under the ombudsman scheme.

(4) If the scheme operator proposes to make any scheme rules it must publish a draft of the proposed rules in the way appearing to it to be best calculated to bring them to the attention of persons appearing to it to be likely to be affected.

(5) The draft must be accompanied by a statement that representations about the proposals may be made to the scheme operator within a time specified in the statement.

(6) Before making the proposed scheme rules, the scheme operator must have regard to any representations made to it under sub-paragraph (5).

(7) The consent of the Authority is required before any scheme rules may be made.

Fees

15.—(1) Scheme rules may require a respondent to pay to the scheme operator such fees as may be specified in the rules.

(2) The rules may, among other things—

(a) provide for the scheme operator to reduce or waive a fee in a particular case;

(b) set different fees for different stages of the proceedings on a complaint;

(c) provide for fees to be refunded in specified circumstances;

(d) make different provision for different kinds of complaint.

Enforcement of money awards

16. A money award, including interest, which has been registered in accordance with scheme rules may—

(a) if a county court so orders in England and Wales, be recovered by execution issued from the county court (or otherwise) as if it were payable under an order of that court;

(b) be enforced in Northern Ireland as a money judgment under the Judgments Enforcement (Northern Ireland) Order 1981;

S.I. 1981/226 (N.I.6).

(c) be enforced in Scotland by the sheriff, as if it were a judgment or order of the sheriff and whether or not the sheriff could himself have granted such judgment or order.

PART IV

THE VOLUNTARY JURISDICTION

Introduction

17. This Part of this Schedule applies only in relation to the voluntary jurisdiction.

Terms of reference to the scheme

18.—(1) Complaints are to be dealt with and determined under the voluntary jurisdiction on standard terms fixed by the scheme operator with the approval of the Authority.

(2) Different standard terms may be fixed with respect to different matters or in relation to different cases.

(3) The standard terms may, in particular—

(a) require the making of payments to the scheme operator by participants in the scheme of such amounts, and at such times, as may be determined by the scheme operator;

(b) make provision as to the award of costs on the determination of a complaint.

(4) The scheme operator may not vary any of the standard terms or add or remove terms without the approval of the Authority.

(5) The standard terms may include provision to the effect that (unless acting in bad faith) none of the following is to be liable in damages for anything done or omitted in the discharge or purported discharge of functions in connection with the voluntary jurisdiction—

(a) the scheme operator;

(b) any member of its governing body;

(c) any member of its staff;

(d) any person acting as an ombudsman for the purposes of the scheme.

Delegation by and to other schemes

19.—(1) The scheme operator may make arrangements with a relevant body—

(a) for the exercise by that body of any part of the voluntary jurisdiction of the ombudsman scheme on behalf of the scheme; or

(b) for the exercise by the scheme of any function of that body as if it were part of the voluntary jurisdiction of the scheme.

(2) A "relevant body" is one which the scheme operator is satisfied—

(a) is responsible for the operation of a broadly comparable scheme (whether or not established by statute) for the resolution of disputes; and

(b) in the case of arrangements under sub-paragraph (1)(a), will exercise the jurisdiction in question in a way compatible with the requirements imposed by or under this Act in relation to complaints of the kind concerned.

(3) Such arrangements require the approval of the Authority.

Voluntary jurisdiction rules: procedure

20.—(1) If the scheme operator makes voluntary jurisdiction rules, it must give a copy to the Authority without delay.

(2) If the scheme operator revokes any such rules, it must give written notice to the Authority without delay.

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(3) The power to make voluntary jurisdiction rules is exercisable in writing.

(4) Immediately after making voluntary jurisdiction rules, the scheme operator must arrange for them to be printed and made available to the public.

(5) The scheme operator may charge a reasonable fee for providing a person with a copy of any voluntary jurisdiction rules.

Verification of the rules

21.—(1) The production of a printed copy of voluntary jurisdiction rules purporting to be made by the scheme operator—

(a) on which is endorsed a certificate signed by a member of the scheme operator's staff authorised by the scheme operator for that purpose, and

(b) which contains the required statements,

is evidence (or in Scotland sufficient evidence) of the facts stated in the certificate.

(2) The required statements are—

(a) that the rules were made by the scheme operator;

(b) that the copy is a true copy of the rules; and

(c) that on a specified date the rules were made available to the public in accordance with paragraph 20(4).

(3) A certificate purporting to be signed as mentioned in sub-paragraph (1) is to be taken to have been duly signed unless the contrary is shown.

Consultation

22.—(1) If the scheme operator proposes to make voluntary jurisdiction rules, it must publish a draft of the proposed rules in the way appearing to it to be best calculated to bring them to the attention of the public.

(2) The draft must be accompanied by—

(a) an explanation of the proposed rules; and

(b) a statement that representations about the proposals may be made to the scheme operator within a specified time.

(3) Before making any voluntary jurisdiction rules, the scheme operator must have regard to any representations made to it in accordance with sub-paragraph (2)(b).

(4) If voluntary jurisdiction rules made by the scheme operator differ from the draft published under sub-paragraph (1) in a way which the scheme operator considers significant, the scheme operator must publish a statement of the difference.

Sections 334, 336 and 338.

SCHEDULE 18

MUTUALS

PART I

FRIENDLY SOCIETIES

The Friendly Societies Act 1974 (c.46)

1. Omit sections 4 (provision for separate registration areas) and 10 (societies registered in one registration area carrying on business in another).

2. In section 7 (societies which may be registered), in subsection (2)(b), for "in the central registration area or in Scotland" substitute "in the United Kingdom, the Channel Islands or the Isle of Man".

3. In section 11 (additional registration requirements for societies with branches), omit "and where any such society has branches in more than one registration area, section 10 above shall apply to that society".

4. In section 99(4) (punishment of fraud etc and recovery of property misapplied), omit "in the central registration area".

The Friendly Societies Act 1992 (c.40)

5. Omit sections 31 to 36A (authorisation of friendly societies business).

6. In section 37 (restrictions on combinations of business), omit subsections (1), (1A) and (7A) to (9).

7. Omit sections 38 to 43 (restrictions on business of certain authorised societies).

8. Omit sections 44 to 50 (regulation of friendly societies business).

PART II

FRIENDLY SOCIETIES: SUBSIDIARIES AND CONTROLLED BODIES

Interpretation

9. In this Part of this Schedule—

"the 1992 Act" means the Friendly Societies Act 1992; and 1992 c. 40.

"section 13" means section 13 of that Act.

Qualifying bodies

10.—(1) Subsections (2) to (5) of section 13 (incorporated friendly societies allowed to form or acquire control or joint control only of qualifying bodies) cease to have effect.

(2) As a result, omit—

(a) subsections (8) and (11) of that section, and

(b) Schedule 7 to the 1992 Act (activities which may be carried on by a subsidiary of, or body jointly controlled by, an incorporated friendly society).

Bodies controlled by societies

11. In section 13(9) (defined terms), after paragraph (a) insert—

"(aa) an incorporated friendly society also has control of a body corporate if the body corporate is itself a body controlled in one of the ways mentioned in paragraph (a)(i), (ii) or (iii) by a body corporate of which the society has control;".

Joint control by societies

12. In section 13(9), after paragraph (c) insert—

"(cc) an incorporated friendly society also has joint control of a body corporate if—

(i) a subsidiary of the society has joint control of the body corporate in a way mentioned in paragraph (c)(i), (ii) or (iii);

(ii) a body corporate of which the society has joint control has joint control of the body corporate in such a way; or

(iii) the body corporate is controlled in a way mentioned in paragraph (a)(i), (ii) or (iii) by a body corporate of which the society has joint control;".

Acquisition of joint control

13. In section 13(9), in the words following paragraph (d), after "paragraph (c)" insert "or (cc)".

Amendment of Schedule 8 to the 1992 Act

14.—(1) Schedule 8 to the 1992 Act (provisions supplementing section 13) is amended as follows.

(2) Omit paragraph 3(2).

(3) After paragraph 3 insert—

"3A.—(1) A body is to be treated for the purposes of section 13(9) as having the right to appoint to a directorship if—

(a) a person's appointment to the directorship follows necessarily from his appointment as an officer of that body; or

(b) the directorship is held by the body itself.

(2) A body ("B") and some other person ("P") together are to be treated, for the purposes of section 13(9), as having the right to appoint to a directorship if—

(a) P is a body corporate which has directors and a person's appointment to the directorship follows necessarily from his appointment both as an officer of B and a director of P;

(b) P is a body corporate which does not have directors and a person's appointment to the directorship follows necessarily from his appointment both as an officer of B and as a member of P's managing body; or

(c) the directorship is held jointly by B and P.

(3) For the purposes of section 13(9), a right to appoint (or remove) which is exercisable only with the consent or agreement of another person must be left out of account unless no other person has a right to appoint (or remove) in relation to that directorship.

(4) Nothing in this paragraph is to be read as restricting the effect of section 13(9)."

(4) In paragraph 9 (exercise of certain rights under instruction by, or in the interests of, incorporated friendly society) insert at the end "or in the interests of any body over which the society has joint control".

Consequential amendments

15.—(1) Section 52 of the 1992 Act is amended as follows.

(2) In subsection (2), omit paragraph (d).

(3) In subsection (3), for "(4) below" substitute "(2)".

(4) For subsection (4) substitute—

"(4) A court may not make an order under subsection (5) unless it is satisfied that one or more of the conditions mentioned in subsection (2) are satisfied.

(5) In subsection (5), omit the words from "or, where" to the end.

References in other enactments

16. References in any provision of, or made under, any enactment to subsidiaries of, or bodies jointly controlled by, an incorporated friendly society are to be read as including references to bodies which are such subsidiaries or bodies as a result of any provision of this Part of this Schedule.

PART III

BUILDING SOCIETIES

The Building Societies Act 1986 (c.53)

17. Omit section 9 (initial authorisation to raise funds and borrow money).

18. Omit Schedule 3 (supplementary provisions about authorisation).

PART IV

INDUSTRIAL AND PROVIDENT SOCIETIES

The Industrial and Provident Societies Act 1965 (c.12)

19. Omit section 8 (provision for separate registration areas for Scotland and for England, Wales and the Channel Islands).

20. Omit section 70 (scale of fees to be paid in respect of transactions and inspection of documents).

PART V

CREDIT UNIONS

The Credit Unions Act 1979 (c.34)

21. In section 6 (minimum and maximum number of members), omit subsections (2) to (6).

22. In section 11 (loans), omit subsections (2) and (6).

23. Omit sections 11B (loans approved by credit unions), 11C (grant of certificates of approval) and 11D (withdrawal of certificates of approval).

24. In section 12, omit subsections (4) and (5).

25. In section 14, omit subsections (2), (3), (5) and (6).

26. In section 28 (offences), omit subsection (2).

Section 351.

SCHEDULE 19

Competition Information

Part I

Persons and functions for the purposes of section 351

1. The Table set out after this paragraph has effect for the purposes of section 351(3)(b).

Table

Person	*Function*
1. The Commission.	Any function of the Commission under Community law relating to competition.
2. The Comptroller and Auditor General.	Any function of his.
3. A Minister of the Crown.	Any function of his under a specified enactment.
4. Director General of Telecommunications.	Any function of his under a specified enactment.
5. Director General of Gas Supply	Any function of his under a specified enactment
6. The Director General of Gas for Northern Ireland.	Any function of his under a specified enactment.
7. The Director General of Electricity Supply.	Any function of his under a specified enactment.
8. The Director General of Electricity Supply for Northern Ireland.	Any function of his under a specified enactment.
9. The Director General of Water Services.	Any function of his under a specified enactment.
10. The Civil Aviation Authority.	Any function of that authority under a specified enactment.
11. The Rail Regulator.	Any function of his under a specified enactment.
12. The Director General of Fair Trading.	Any function of his under a specified enactment.
13. The Competition Commission.	Any function of the Competition Commission under a specified enactment.
14. The Authority.	Any function of the Authority under a specified enactment.
15. A person of a description specified in an order made by the Treasury.	Any function of his which is specified in the order.

Part II

The enactments

1973 c. 41. 1. The Fair Trading Act 1973

1974 c. 39. 2. The Consumer Credit Act 1974

1979 c. 38. 3. The Estate Agents Act 1979

1980 c. 21. 4. The Competition Act 1980

1984 c. 12. 5. The Telecommunications Act 1984

6. The Airports Act 1986 1986 c. 31.

7. The Gas Act 1986 1986 c. 45.

8. The Control of Misleading Advertisements Regulations 1988 S.I. 1988/915.

9. The Electricity Act 1989 1989 c. 29.

10. The Broadcasting Act 1990 1990 c. 42.

11. The Water Industry Act 1991 1991 c. 56.

12. The Electricity (Northern Ireland) Order 1992 S.I. 1992/231 (N.I. 1).

13. The Railways Act 1993 1993 c. 43.

14. Part IV of the Airports (Northern Ireland) Order 1994 S.I. 1994/426 (N.I. 1).

15. The Gas (Northern Ireland) Order 1996 S.I. 1996/275 (N.I. 2).

16. The EC Competition (Articles 88 and 89) Enforcement Regulations 1996 S.I. 1996/2199.

17. The Unfair Terms in Consumer Contracts Regulations 1999 S.I. 1999/2083.

18. This Act.

19. An enactment specified for the purposes of this paragraph in an order made by the Treasury.

SCHEDULE 20

Section 432(1).

MINOR AND CONSEQUENTIAL AMENDMENTS

The House of Commons Disqualification Act 1975 (c. 24)

1. In Part III of Schedule 1 to the House of Commons Disqualification Act 1975 (disqualifying offices)—

(a) omit—

"Any member of the Financial Services Tribunal in receipt of remuneration"; and

(b) at the appropriate place, insert—

"Any member, in receipt of remuneration, of a panel of persons who may be selected to act as members of the Financial Services and Markets Tribunal".

The Northern Ireland Assembly Disqualification Act 1975 (c. 25)

2. In Part III of Schedule 1 to the Northern Ireland Assembly Disqualification Act 1975 (disqualifying offices)—

(a) omit—

"Any member of the Financial Services Tribunal in receipt of remuneration"; and

(b) at the appropriate place, insert—

"Any member, in receipt of remuneration, of a panel of persons who may be selected to act as members of the Financial Services and Markets Tribunal".

The Civil Jurisdiction and Judgments Act 1982 (c. 27)

3. In paragraph 10 of Schedule 5 to the Civil Jurisdiction and Judgments Act 1982 (proceedings excluded from the operation of Schedule 4 to that Act), for "section 188 of the Financial Services Act 1986" substitute "section 415 of the Financial Services and Markets Act 2000".

The Income and Corporation Taxes Act 1988 (c. 1)

4.—(1) The Income and Corporation Taxes Act 1988 is amended as follows.

(2) In section 76 (expenses of management: insurance companies), in subsection (8), omit the definitions of—

"the 1986 Act";

"authorised person";

"investment business";

"investor";

"investor protection scheme";

"prescribed"; and

"recognised self-regulating organisation".

(3) In section 468 (authorised unit trusts), in subsections (6) and (8), for "78 of the Financial Services Act 1986" substitute " 243 of the Financial Services and Markets Act 2000".

(4) In section 469(7) (other unit trust schemes), for "Financial Services Act 1986" substitute "Financial Services and Markets Act 2000".

(5) In section 728 (information in relation to transfers of securities), in subsection (7)(a), for "Financial Services Act 1986" substitute "Financial Services and Markets Act 2000".

(6) In section 841(3) (power to apply certain provisions of the Tax Acts to recognised investment exchange), for "Financial Services Act 1986" substitute "Financial Services and Markets Act 2000".

The Finance Act 1991 (c. 31)

5.—(1) The Finance Act 1991 is amended as follows.

(2) In section 47 (investor protection schemes), omit subsections (1), (2) and (4).

(3) In section 116 (investment exchanges and clearing houses: stamp duty), in subsection (4)(b), for "Financial Services Act 1986" substitute "Financial Services and Markets Act 2000".

The Tribunals and Inquiries Act 1992 (c. 53)

6.—(1) The Tribunals and Inquiries Act 1992 is amended as follows.

(2) In Schedule 1 (tribunals under supervision of the Council on Tribunals), for the entry relating to financial services and paragraph 18, substitute—

"Financial services and markets	18. The Financial Services and Markets Tribunal."

The Judicial Pensions and Retirement Act 1993 (c. 8)

7.—(1) The Judicial Pensions and Retirement Act 1993 is amended as follows.

(2) In Schedule 1 (offices which may be qualifying offices), in Part II, after the entry relating to the President or chairman of the Transport Tribunal insert—

"President or Deputy President of the Financial Services and Markets Tribunal"

(3) In Schedule 5 (relevant offices in relation to retirement provisions)—

(a) omit the entry—

"Member of the Financial Services Tribunal appointed by the Lord Chancellor"; and

(b) at the end insert—

"Member of the Financial Services and Markets Tribunal".

SCHEDULE 21

Section 432(2).

TRANSITIONAL PROVISIONS AND SAVINGS

Self-regulating organisations

1.—(1) No new application under section 9 of the 1986 Act (application for recognition) may be entertained.

(2) No outstanding application made under that section before the passing of this Act may continue to be entertained.

(3) After the date which is the designated date for a recognised self-regulating organisation—

(a) the recognition order for that organisation may not be revoked under section 11 of the 1986 Act (revocation of recognition);

(b) no application may be made to the court under section 12 of the 1986 Act (compliance orders) with respect to that organisation.

(4) The powers conferred by section 13 of the 1986 Act (alteration of rules for protection of investors) may not be exercised.

(5) "Designated date" means such date as the Treasury may by order designate.

(6) Sub-paragraph (3) does not apply to a recognised self-regulating organisation in respect of which a notice of intention to revoke its recognition order was given under section 11(3) of the 1986 Act before the passing of this Act if that notice has not been withdrawn.

(7) Expenditure incurred by the Authority in connection with the winding up of any body which was, immediately before the passing of this Act, a recognised self-regulating organisation is to be treated as having been incurred in connection with the discharge by the Authority of functions under this Act.

(8) "Recognised self-regulating organisation" means an organisation which, immediately before the passing of this Act, was such an organisation for the purposes of the 1986 Act.

(9) "The 1986 Act" means the Financial Services Act 1986. 1986 c. 60.

Self-regulating organisations for friendly societies

2.—(1) No new application under paragraph 2 of Schedule 11 to the 1986 Act (application for recognition) may be entertained.

(2) No outstanding application made under that paragraph before the passing of this Act may continue to be entertained.

(3) After the date which is the designated date for a recognised self-regulating organisation for friendly societies—

(a) the recognition order for that organisation may not be revoked under paragraph 5 of Schedule 11 to the 1986 Act (revocation of recognition);

(b) no application may be made to the court under paragraph 6 of that Schedule (compliance orders) with respect to that organisation.

(4) "Designated date" means such date as the Treasury may by order designate.

(5) Sub-paragraph (3) does not apply to a recognised self-regulating organisation for friendly societies in respect of which a notice of intention to revoke its recognition order was given under section 11(3) of the 1986 Act (as applied by paragraph 5(2) of that Schedule) before the passing of this Act if that notice has not been withdrawn.

(6) Expenditure incurred by the Authority in connection with the winding up of any body which was, immediately before the passing of this Act, a recognised self-regulating organisation for friendly societies is to be treated as having been incurred in connection with the discharge by the Authority of functions under this Act.

(7) "Recognised self-regulating organisation for friendly societies" means an organisation which, immediately before the passing of this Act, was such an organisation for the purposes of the 1986 Act.

1986 c. 60. (8) "The 1986 Act" means the Financial Services Act 1986.

Section 432(3).

SCHEDULE 22

REPEALS

Chapter	Short title	Extent of repeal
1923 c. 8.	The Industrial Assurance Act 1923.	The whole Act.
1948 c. 39.	The Industrial Assurance and Friendly Societies Act 1948.	The whole Act.
1965 c. 12.	The Industrial and Provident Societies Act 1965.	Section 8. Section 70.
1974 c. 46.	The Friendly Societies Act 1974.	Section 4. Section 10. In section 11, from "and where" to "that society". In section 99(4), "in the central registration area".
1975 c. 24.	The House of Commons Disqualification Act 1975.	In Schedule 1, in Part III, "Any member of the Financial Services Tribunal in receipt of remuneration".
1975 c. 25.	The Northern Ireland Assembly Disqualification Act 1975.	In Schedule 1, in Part III, "Any member of the Financial Services Tribunal in receipt of remuneration".
1977 c. 46.	The Insurance Brokers (Registration) Act 1977.	The whole Act.
1979 c. 34.	The Credit Unions Act 1979.	Section 6(2) to (6). Section 11(2) and (6). Sections 11B, 11C and 11D. Section 12(4) and (5). In section 14, subsections (2), (3), (5) and (6). Section 28(2).

Chapter	Short title	Extent of repeal
1986 c. 53.	The Building Societies Act 1986.	Section 9. Schedule 3.
1988 c. 1.	The Income and Corporation Taxes Act 1988.	In section 76, in subsection (8), the definitions of "the 1986 Act", "authorised person", "investment business", "investor", "investor protection scheme", "prescribed" and "recognised self-regulating organisation".
1991 c. 31.	The Finance Act 1991.	In section 47, subsections (1), (2) and (4).
1992 c. 40.	The Friendly Societies Act 1992.	In section 13, subsections (2) to (5), (8) and (11). Sections 31 to 36. In section 37, subsections (1), (1A) and (7A) to (9). Sections 38 to 50. In section 52, subsection (2)(d) and, in subsection (5), the words from "or where" to the end. Schedule 7. In Schedule 8, paragraph 3(2).
1993 c. 8.	The Judicial Pensions and Retirement Act 1993.	In Schedule 5, "Member of the Financial Services Tribunal appointed by the Lord Chancellor".

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WORLD INEQUALITY REPORT 2018

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WORLD INEQUALITY REPORT **2018**

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WID.world fellows:
The report ultimately relies on the data collection, production and harmonization work carried out by more than a hundred WID.world fellows located over five continents and contributing to the World Wealth and Income Database (visit www.wid.world/team for more information). Analyses presented in the report reflect the views of the report's editors and not necessarily those of WID.world fellows.

In memory of Tony Atkinson (1944–2017)

Codirector of the World Top Incomes Database
(2011-2015) and of WID.world (2015-2017)

CONTENTS

EXECUTIVE SUMMARY

I. WHAT IS THE AIM OF THE WORLD INEQUALITY REPORT 2018?

The *World Inequality Report 2018* relies on a cutting-edge methodology to measure income and wealth inequality in a systematic and transparent manner. By developing this report, the World Inequality Lab seeks to fill a democratic gap and to equip various actors of society with the necessary facts to engage in informed public debates on inequality.

▶ The objective of the *World Inequality Report 2018* is to contribute to a more informed global democratic debate on economic inequality by bringing the latest and most complete data to the public discussion.

▶ Economic inequality is widespread and to some extent inevitable. It is our belief, however, that if rising inequality is not properly monitored and addressed, it can lead to various sorts of political, economic, and social catastrophes.

▶ Our objective is not to bring everyone into agreement regarding inequality; this will never happen, for the simple reason that no single scientific truth exists about the ideal level of inequality, let alone the most socially desirable mix of policies and institutions to achieve this level. Ultimately, it is up to public deliberation, and political institutions and their processes to make these difficult decisions. But this deliberative process requires more rigorous and transparent information on income and wealth.

▶ To equip citizens to make such decisions, we also seek to relate macroeconomic phenomenon—such as nationalization and privatization policies, capital accumulation, and the evolution of public debt—to microeconomic trends in inequality focused on individuals' earnings and government transfers, personal wealth, and debt.

▶ Reconciling macro and microeconomic inequality data is not a straightforward exercise given that many countries do not publicly release, or may not even produce, detailed and consistent income and wealth inequality statistics. Standard measures of inequality often rely on household surveys, which routinely underestimate the income and wealth of individuals at the top of the social ladder.

▶ To overcome current limitations, we rely on a groundbreaking methodology which combines in a systematic and transparent manner all data sources at our disposal: national income and wealth accounts (including, when possible, offshore wealth estimates); household income and wealth surveys; fiscal data coming from taxes on income; inheritance and wealth data (when they exist); and wealth rankings.

▶ The series presented in this report rely on the collective efforts of more than a hundred researchers, covering all continents, who contribute to the WID.world database. All the data are available online on wir2018.wid.world and are fully reproducible, allowing anyone to perform their own analysis and make up their own mind about inequality.

II. WHAT ARE OUR NEW FINDINGS ON GLOBAL INCOME INEQUALITY?

We show that income inequality has increased in nearly all world regions in recent decades, but at different speeds. The fact that inequality levels are so different among countries, even when countries share similar levels of development, highlights the important roles that national policies and institutions play in shaping inequality.

Income inequality varies greatly across world regions. It is lowest in Europe and highest in the Middle East.

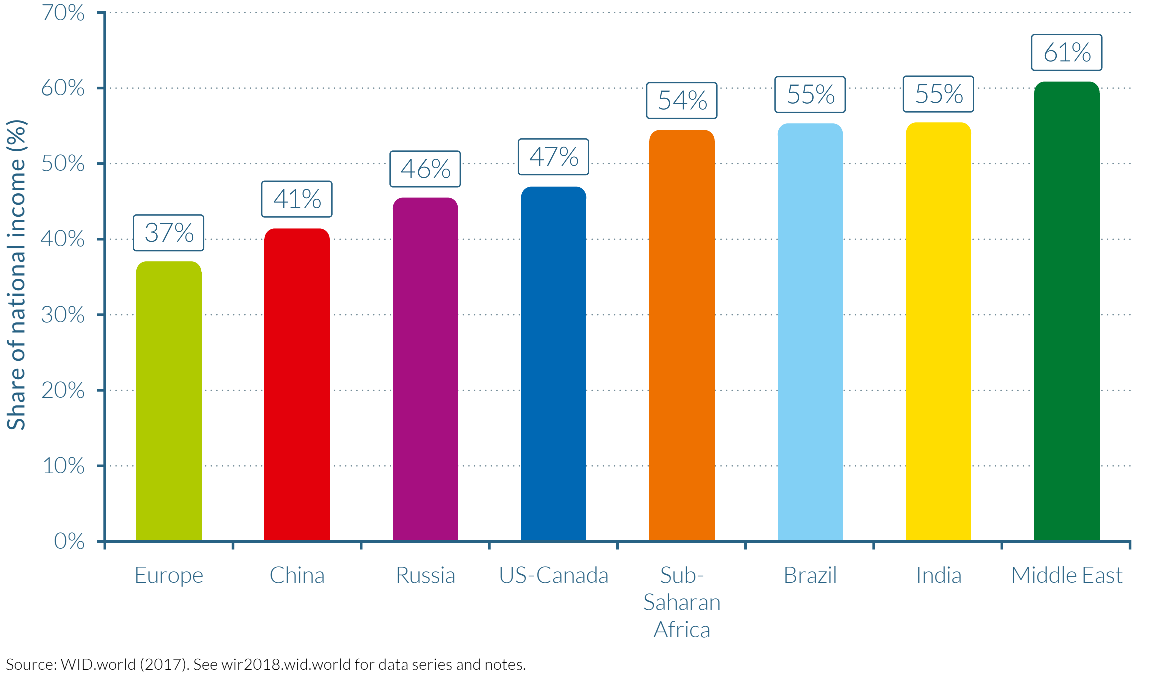
▶ Inequality within world regions varies greatly. In 2016, the share of total national income accounted for by just that nation's top 10% earners (top 10% income share) was 37% in Europe, 41% in China, 46% in Russia, 47% in US-Canada, and around 55% in sub-Saharan Africa, Brazil, and India. In the Middle East, the world's most unequal region according to our estimates, the top 10% capture 61% of national income (**Figure E1**).

In recent decades, income inequality has increased in nearly all countries, but at different speeds, suggesting that institutions and policies matter in shaping inequality.

▶ Since 1980, income inequality has increased rapidly in North America, China, India, and Russia. Inequality has grown moderately in Europe (**Figure E2a**). From a broad historical perspective, this increase in inequality marks the end of a postwar egalitarian regime which took different forms in these regions.

Figure E1

Top 10% national income share across the world, 2016

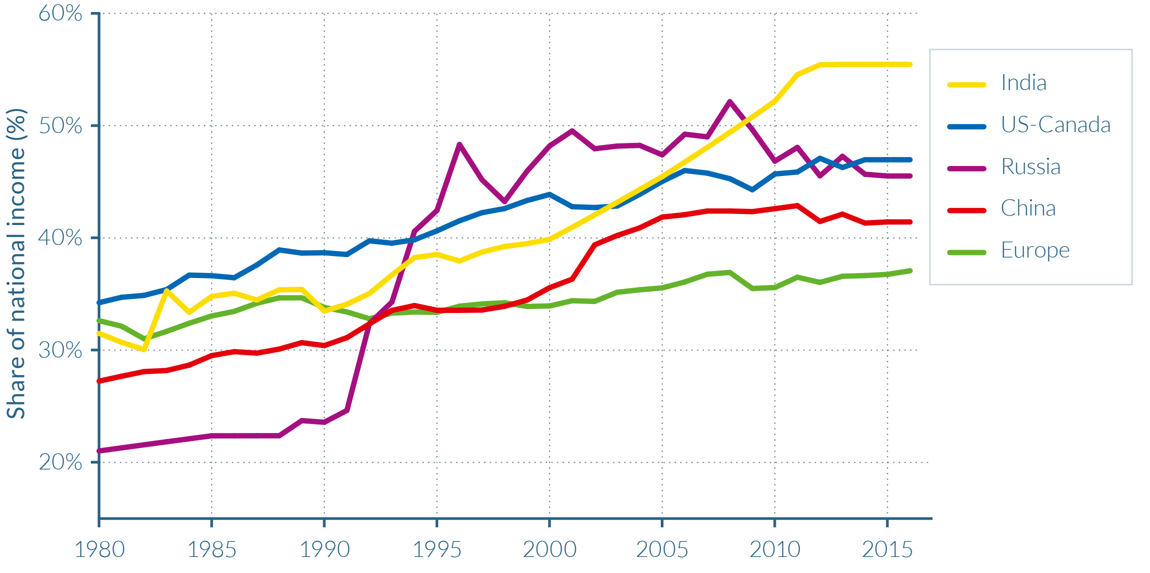


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 37% of national income was received by the Top 10% in Europe against 61% in the Middle-East.

Figure E2a

Top 10% income shares across the world, 1980–2016: Rising inequality almost everywhere, but at different speeds



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 47% of national income was received by the top 10% in US-Canada, compared to 34% in 1980.

▸ There are exceptions to the general pattern. In the Middle East, sub-Saharan Africa, and Brazil, income inequality has remained relatively stable, at extremely high levels (**Figure E2b**). Having never gone through the postwar egalitarian regime, these regions set the world "inequality frontier."

▸ The diversity of trends observed across countries since 1980 shows that income inequality dynamics are shaped by a variety of national, institutional and political contexts.

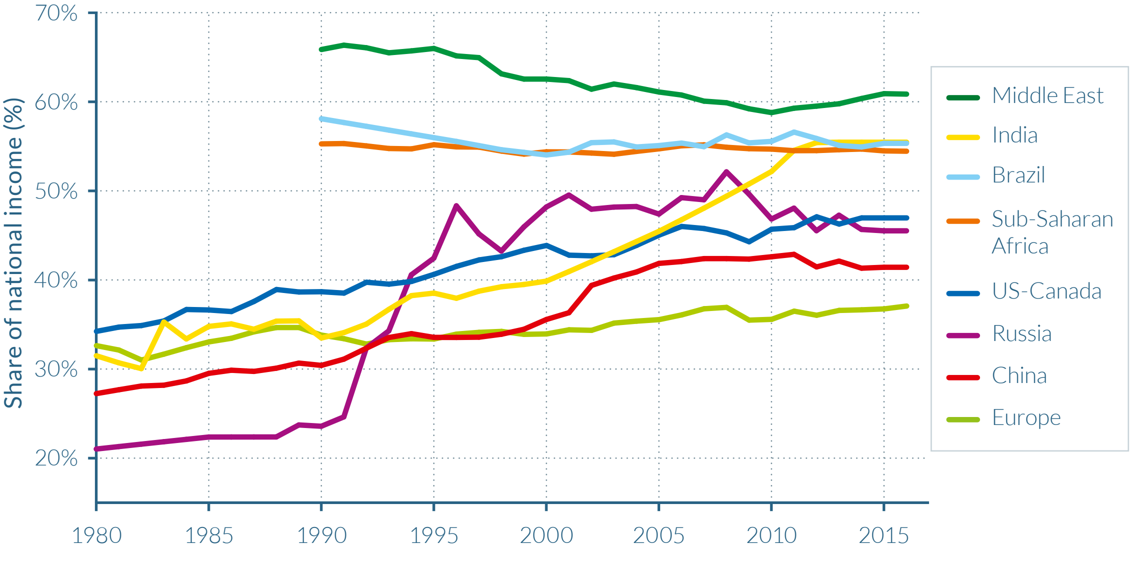
▸ This is illustrated by the different trajectories followed by the former communist or highly regulated countries, China, India, and Russia (**Figure E2a and b**). The rise in inequality was particularly abrupt in Russia, moderate in China, and relatively gradual in India, reflecting different types of deregulation and opening-up policies pursued over the past decades in these countries.

▸ The divergence in inequality levels has been particularly extreme between Western Europe and the United States, which had similar levels of inequality in 1980 but today are in radically different situations. While the top 1% income share was close to 10% in both regions in 1980, it rose only slightly to 12% in 2016 in Western Europe while it shot up to 20% in the United States. Meanwhile, in the United States, the bottom 50% income share decreased from more than 20% in 1980 to 13% in 2016 (**Figure E3**).

▸ The income-inequality trajectory observed in the United States is largely due to massive educational inequalities, combined with a tax system that grew less progressive despite a surge in top labor compensation since the 1980s, and in top capital incomes in the 2000s. Continental Europe meanwhile saw a lesser decline in its tax progressivity, while wage inequality was also moderated by educational and wage-setting policies that were relatively more favorable to low- and middle-income groups. In both regions, income inequality between men and women has declined but remains particularly strong at the top of the distribution.

Figure E2b

Top 10% income shares across the world, 1980–2016: Is world inequality moving towards the high-inequality frontier?



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 55% of national income was received by the Top 10% earners in India, against 31% in 1980.

How has inequality evolved in recent decades among global citizens? We provide the first estimates of how the growth in global income since 1980 has been distributed across the totality of the world population. The global top 1% earners has captured twice as much of that growth as the 50% poorest individuals. The bottom 50% has nevertheless enjoyed important growth rates. The global middle class (which contains all of the poorest 90% income groups in the EU and the United States) has been squeezed.

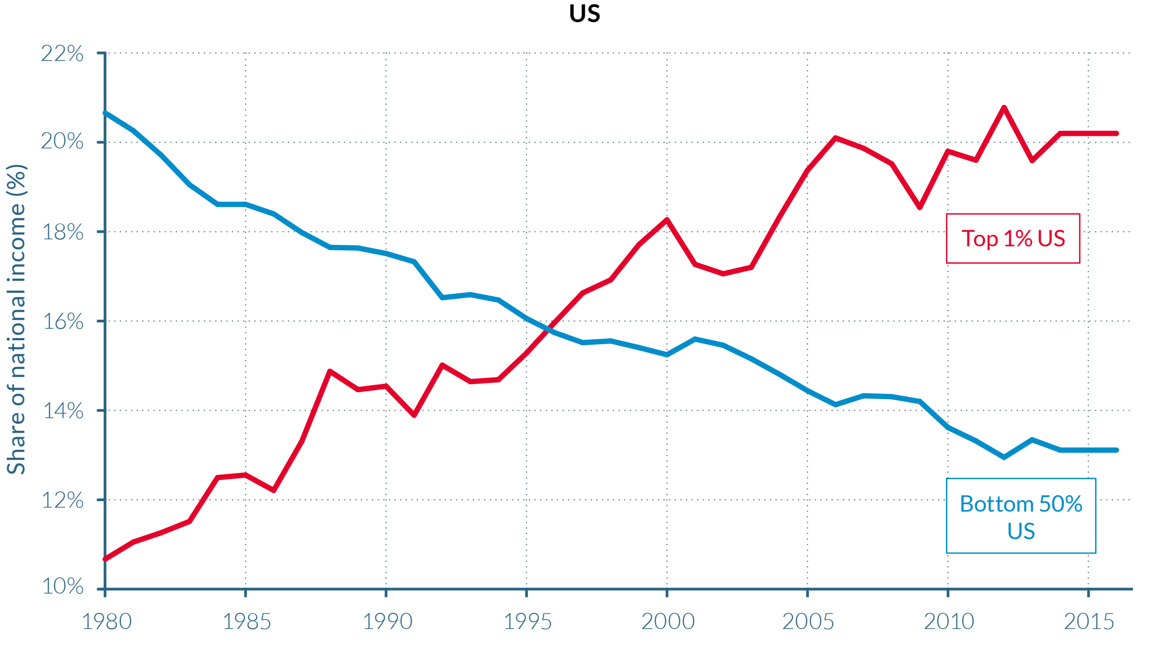
At the global level, inequality has risen sharply since 1980, despite strong growth in China.

▶ The poorest half of the global population has seen its income grow significantly thanks to high growth in Asia (particularly in China and India). However, because of high and rising inequality within countries, the top 1% richest individuals in the world captured twice as much growth as the bottom 50% individuals since 1980 (**Figure E4**). Income growth has been sluggish or even zero for individuals with incomes between the global bottom 50% and top 1% groups. This includes all North American and European lower- and middle-income groups.

▶ The rise of global inequality has not been steady. While the global top 1% income share increased from 16% in 1980 to 22% in 2000, it declined slightly thereafter to 20%. The income share of the global bottom 50% has oscillated around 9% since 1980 (**Figure E5**). The trend break after 2000 is due to a reduction in between-country average income inequality, as within-country inequality has continued to increase.

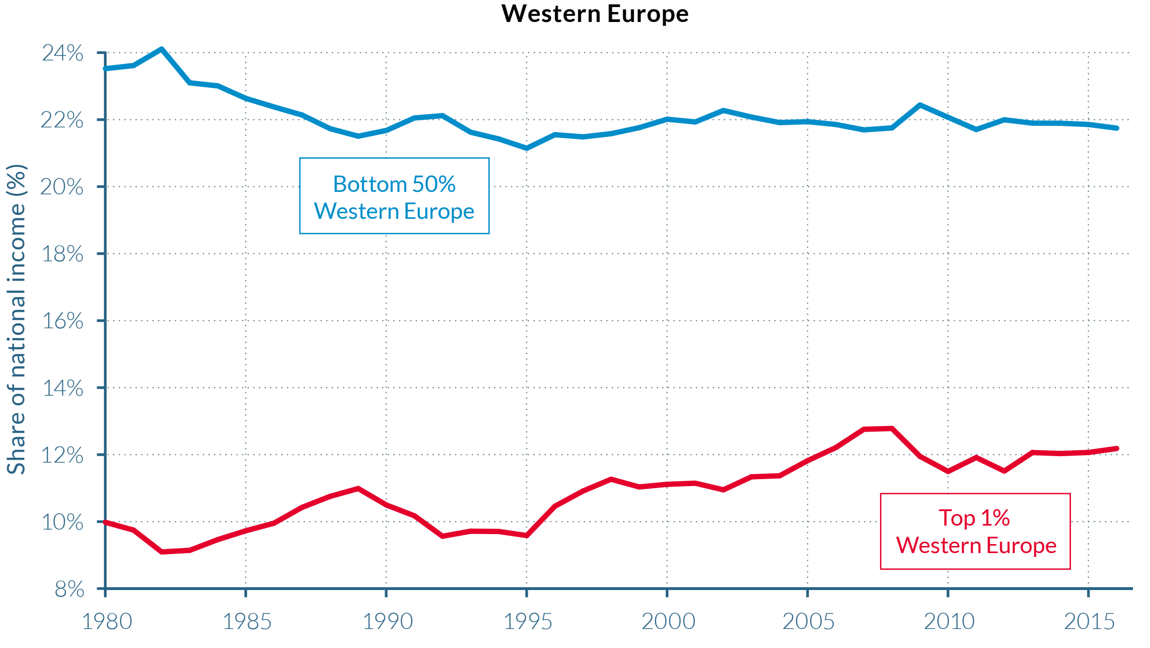
Figure E3

Top 1% vs. Bottom 50% national income shares in the US and Western Europe, 1980–2016: Diverging income inequality trajectories



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 12% of national income was received by the top 1% in Western Europe, compared to 20% in the United States. In 1980, 10% of national income was received by the top 1% in Western Europe, compared to 11% in the United States.

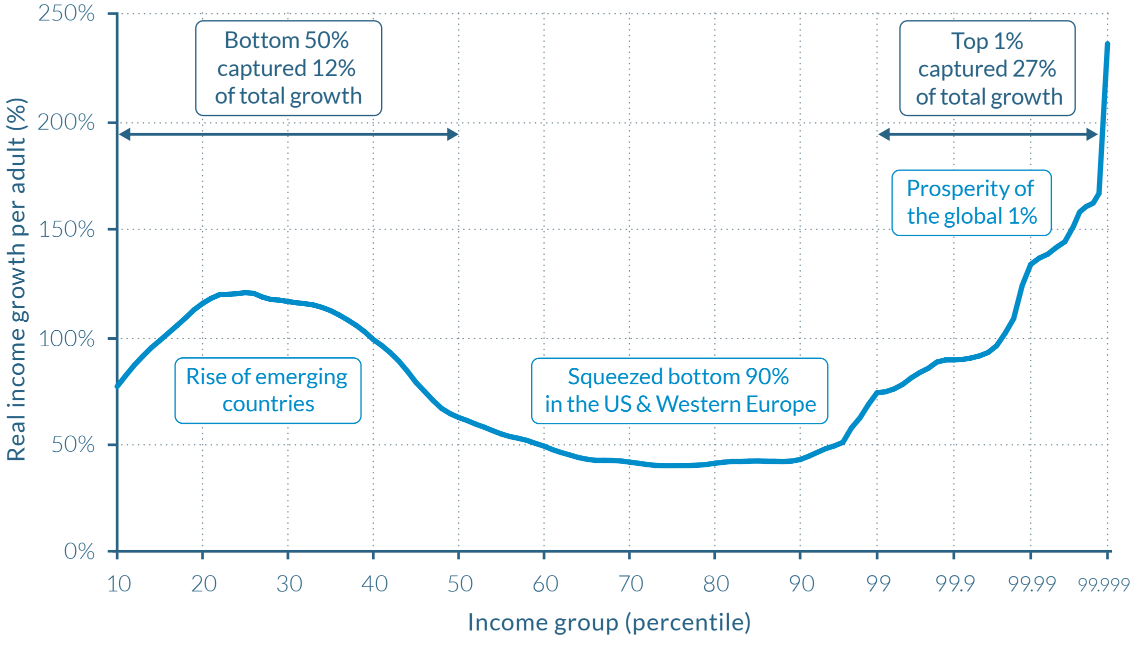


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 22% of national income was received by the Bottom 50% in Western Europe.

Figure E4

The elephant curve of global inequality and growth, 1980–2016

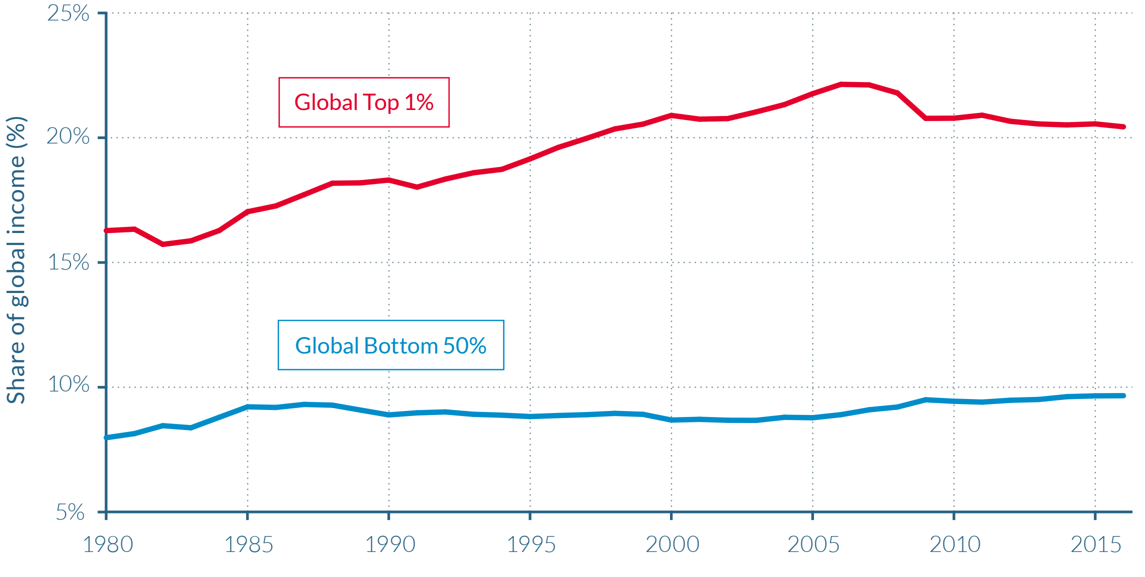


Source: WID.world (2017). See wir2018.wid.world for more details.

On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the world's richest 1%), growth was 74% between 1980 and 2016. The Top 1% captured 27% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

Figure E5

The rise of the global top 1% versus the stagnation of the global bottom 50%, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 22% of global income was received by the Top 1% against 10% for the Bottom 50%. In 1980, 16% of global income was received by the Top 1% against 8% for the Bottom 50%.

III. WHY DOES THE EVOLUTION OF PRIVATE AND PUBLIC CAPITAL OWNERSHIP MATTER FOR INEQUALITY?

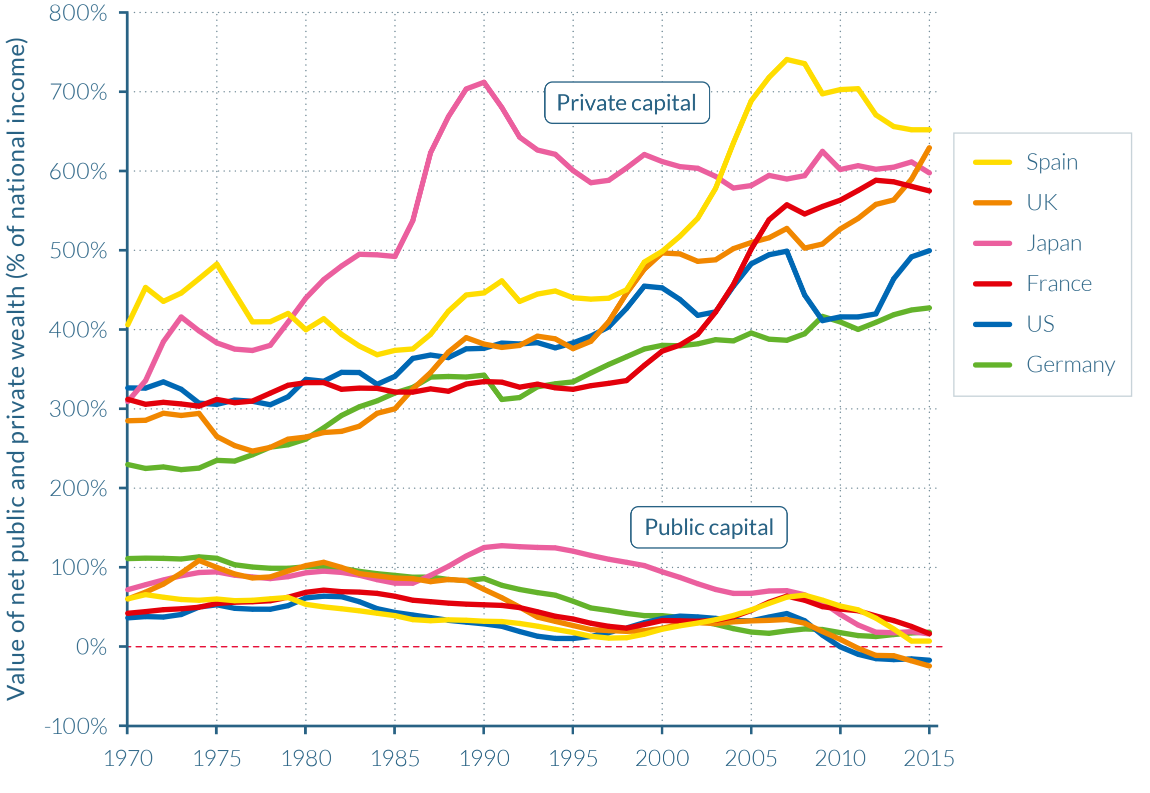
Economic inequality is largely driven by the unequal ownership of capital, which can be either privately or public owned. We show that since 1980, very large transfers of public to private wealth occurred in nearly all countries, whether rich or emerging. While national wealth has substantially increased, public wealth is now negative or close to zero in rich countries. Arguably this limits the ability of governments to tackle inequality; certainly, it has important implications for wealth inequality among individuals.

Over the past decades, countries have become richer but governments have become poor.

▶ The ratio of net private wealth to net national income gives insight into the total value of wealth commanded by individuals in

Figure E6

The rise of private capital and the fall of public capital in rich countries, 1970–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net public wealth (or public capital) in the US was negative (-17% of net national income) while the value of net private wealth (or private capital) was 500% of national income. In 1970, net public wealth amounted to 36% of national income while the figure was 326% for net private wealth. Net private wealth is equal to new private assets minus net private debt. Net public wealth is equal to public assets minus public debt.

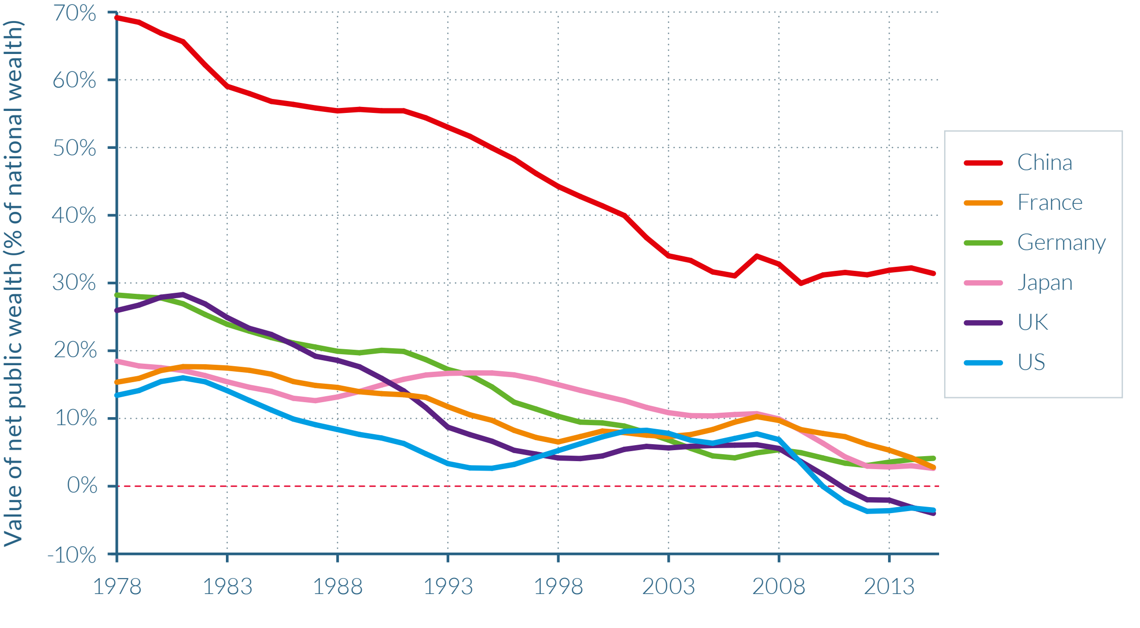
a country, as compared to the public wealth held by governments. The sum of private and public wealth is equal to national wealth. The balance between private and public wealth is a crucial determinant of the level of inequality.

▶ There has been a general rise in net private wealth in recent decades, from 200–350% of national income in most rich countries in 1970 to 400–700% today. This was largely unaffected by the 2008 financial crisis, or by the asset price bubbles seen in some countries such as Japan and Spain (**Figure E6**). In China and Russia there have been unusually large increases in private wealth; following their transitions from communist- to capitalist-oriented economies, they saw it quadruple and triple, respectively. Private wealth–income ratios in these countries are approaching levels observed in France, the UK, and the United States.

▶ Conversely, net public wealth (that is, public assets minus public debts) has declined in nearly all countries since the 1980s. In China and Russia, public wealth declined from 60–70% of national wealth to 20–30%. Net public wealth has even become negative in recent years in the United States and the UK, and is only slightly positive in Japan, Germany, and France (**Figure E7**). This arguably limits government ability to regulate the economy, redistribute income, and mitigate rising inequality. The only exceptions to the general decline in public property are oil-rich countries with large sovereign wealth funds, such as Norway.

Figure E7

The decline of public capital, 1970–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the share of public wealth in national wealth in France was 3%, compared to 17% in 1980.

IV. WHAT ARE OUR NEW FINDINGS ON GLOBAL WEALTH INEQUALITY?

The combination of large privatizations and increasing income inequality within countries has fueled the rise of wealth inequality among individuals. In Russia and the United States, the rise in wealth inequality has been extreme, whereas in Europe it has been more moderate. Wealth inequality has not yet returned to its extremely high early-twentieth-century level in rich countries.

Wealth inequality among individuals has increased at different speeds across countries since 1980.

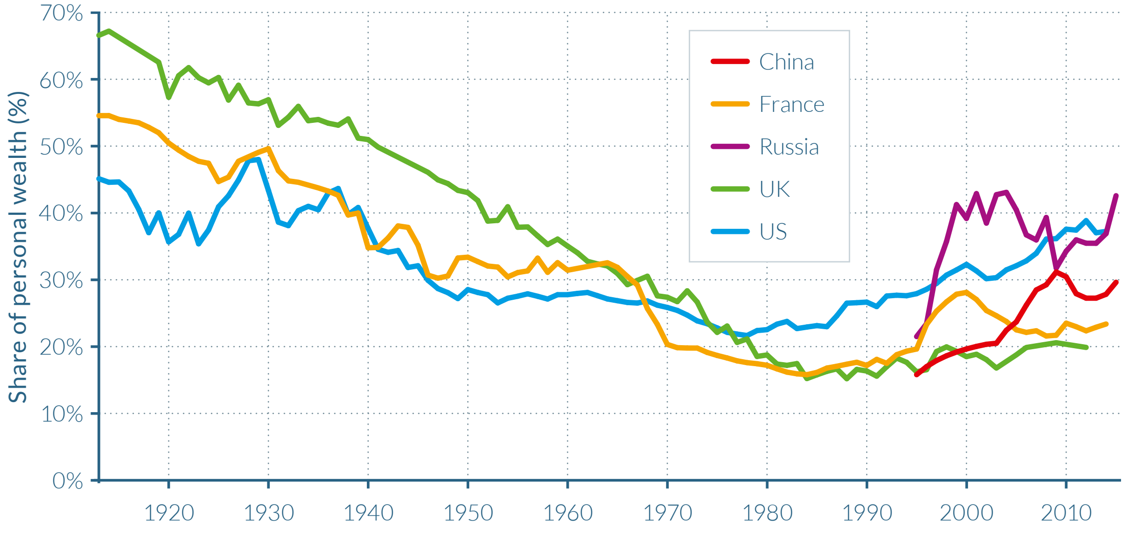
▶ Increasing income inequality and the large transfers of public to private wealth occurring over the past forty years have yielded rising wealth inequality among individuals. Wealth inequality has not, however, yet reached its early-twentieth-century levels in Europe or in the United States.

▶ The rise in wealth inequality has nonetheless been very large in the United States, where the top 1% wealth share rose from 22% in 1980 to 39% in 2014. Most of that increase in inequality was due to the rise of the top 0.1% wealth owners. The increase in top-wealth shares in France and the UK was more moderate over the past forty years, in part due to the dampening effect of the rising housing wealth of the middle class, and a lower level of income inequality than the United States' (**Figure E8**).

▶ Large rises in top-wealth shares have also been experienced in China and Russia following their transitions from communism to more capitalist economies. The top 1% wealth share doubled in both China and Russia between 1995 and 2015, from 15% to 30% and from 22% to 43%, respectively.

Figure E8

Top 1% wealth shares across the world, 1913–2015: the fall and rise of personal wealth inequality



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 1% wealth share was 43% in Russia against 22% in 1995.

V. WHAT IS THE FUTURE OF GLOBAL INEQUALITY AND HOW SHOULD IT BE TACKLED?

We project income and wealth inequality up to 2050 under different scenarios. In a future in which "business as usual" continues, global inequality will further increase. Alternatively, if in the coming decades all countries follow the moderate inequality trajectory of Europe over the past decades, global income inequality can be reduced—in which case there can also be substantial progress in eradicating global poverty.

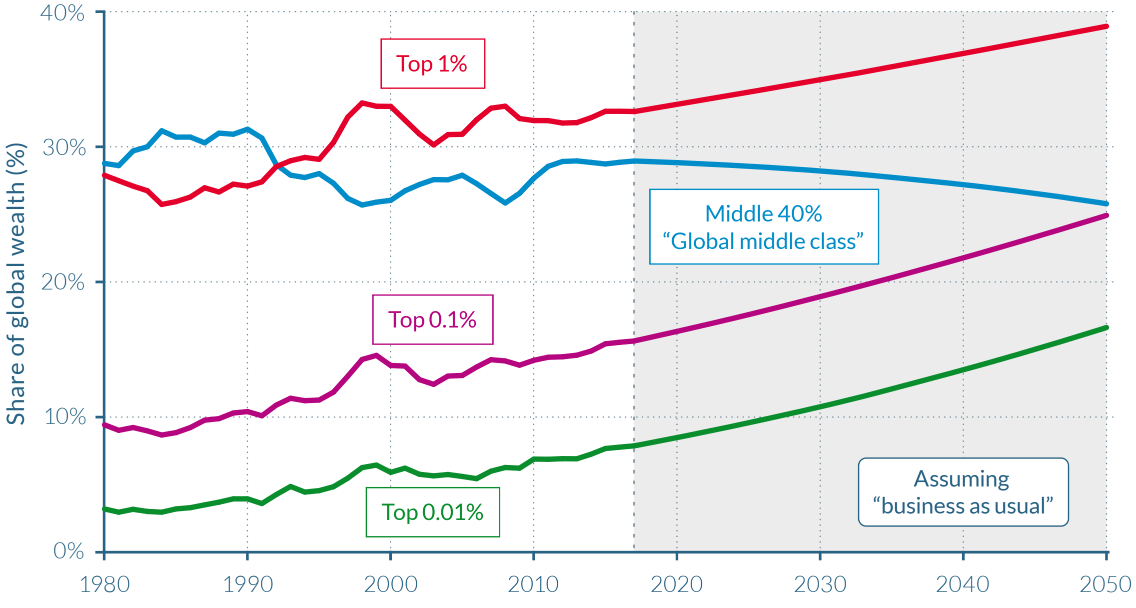
The global wealth middle class will be squeezed under "business as usual."

▶ Rising wealth inequality within countries has helped to spur increases in global wealth inequality. If we assume the world trend to be captured by the combined experience of China, Europe and the United States, the wealth share of the world's top 1% wealthiest people increased from 28% to 33%, while the share commanded by the bottom 75% oscillated around 10% between 1980 and 2016.

▶ The continuation of past wealth-inequality trends will see the wealth share of the top 0.1% global wealth owners (in a world represented by China, the EU, and the United States) catch up with the share of the global wealth middle class by 2050 (**Figure E9**).

Figure E9

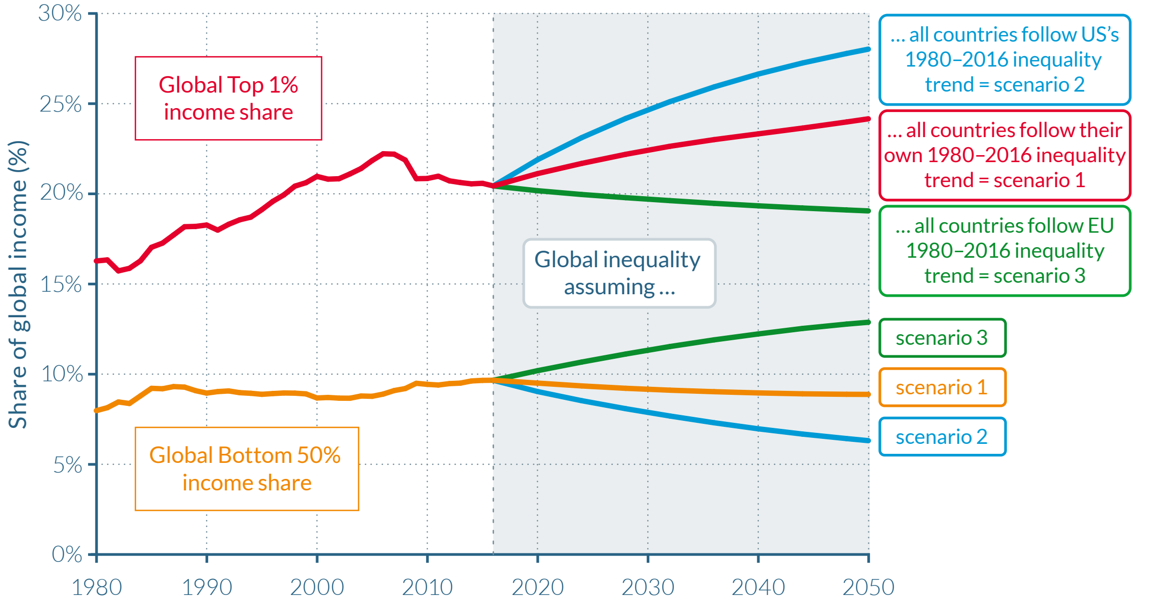
The squeezed global wealth middle class, 1980–2050



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, in a world represented by China, Europe and the US, the global wealth share of the Top 1% was 33%. Under "Business as usual", the Top 1% global wealth share would reach 39% by 2050, while the Top 0.1% wealth owners would own nearly as much wealth (26%) as the middle class (27%). The evolution of global wealth groups from 1987 to 2017 is represented by China, Europe and the US. Values are net of inflation.

Figure E10
Rising global income inequality is not inevitable in the future



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

If all countries follow the inequality trajectory of the US between 1980 and 2016 from 2017 to 2050, the income share of the global Top 1% will reach 28% by 2050. Income share estimates are calculated using Purchasing Power Parity (PPP) euros. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

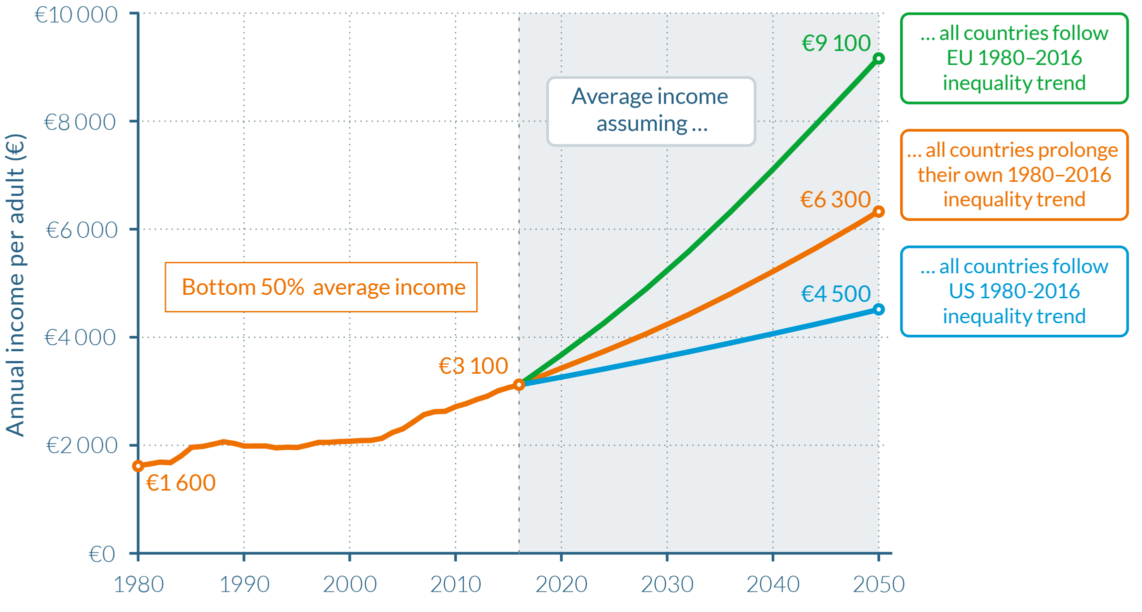
Global income inequality will also increase under a "business as usual" scenario, even with optimistic growth assumptions in emerging countries. This is not inevitable, however.

▸ Global income inequality will also increase if countries prolong the income inequality path they have been on since 1980—even with relatively high income growth predictions in Africa, Latin America, and Asia in the coming three decades. Global income inequality will increase even more if all countries follow the high-inequality trajectory followed by the United States between 1980 and 2016. However, global inequality will decrease moderately if all countries follow the inequality trajectory followed by the EU between 1980 and today (**Figure E10**).

▸ Within-country inequality dynamics have a tremendous impact on the eradication of global poverty. Depending on which inequality trajectory is followed by countries, the incomes of the bottom half of the world population may vary by factor of two by 2050 (**Figure E11**), ranging from €4 500 to € 9100 per year, per adult.

Figure E11

Inequality has substantial impacts on global poverty



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

If all countries follow the inequality trajectory of Europe between 1980 and 2016, the average income of the Bottom 50% of the world population will be €9 100 by 2050. Income estimates are calculated using Purchasing Power Parity (PPP) euros. For comparison, €1 = $1.3 = ¥4.4 at PPP. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

Tackling global income and wealth inequality requires important shifts in national and global tax policies. Educational policies, corporate governance, and wage-setting policies need to be reassessed in many countries. Data transparency is also key.

Tax progressivity is a proven tool to combat rising income and wealth inequality at the top.

▶ Research has demonstrated that tax progressivity is an effective tool to combat inequality. Progressive tax rates do not only reduce post-tax inequality, they also diminish pre-tax inequality by giving top earners less incentive to capture higher shares of growth via aggressive bargaining for pay rises and wealth accumulation. Tax progressivity was sharply reduced in rich and some emerging countries from the 1970s to the mid-2000s. Since the global financial crisis of 2008, the downward trend has leveled off and even reversed in certain countries, but future evolutions remain uncertain and will depend on democratic deliberations. It is also worth noting that inheritance taxes are nonexistent or near zero in high-inequality emerging countries, leaving space for important tax reforms in these countries.

A global financial register recording the ownership of financial assets would deal severe blows to tax evasion, money laundering, and rising inequality.

▶ Although the tax system is a crucial tool for tackling inequality, it also faces potential obstacles. Tax evasion ranks high among these, as recently illustrated by the Paradise

Papers revelations. The wealth held in tax havens has increased considerably since the 1970s and currently represents more than 10% of global GDP. The rise of tax havens makes it difficult to properly measure and tax wealth and capital income in a globalized world. While land and real-estate registries have existed for centuries, they miss a large fraction of the wealth held by households today, as wealth increasingly takes the form of financial securities. Several technical options exist for creating a global financial register, which could be used by national tax authorities to effectively combat fraud.

More equal access to education and well-paying jobs is key to addressing the stagnating or sluggish income growth rates of the poorest half of the population.

▶ Recent research shows that there can be an enormous gap between the public discourse about equal opportunity and the reality of unequal access to education. In the United States, for instance, out of a hundred children whose parents are among the bottom 10% of income earners, only twenty to thirty go to college. However, that figure reaches ninety when parents are within the top 10% earners. On the positive side, research shows that elite colleges who improve openness to students from poor backgrounds need not compromise their outcomes to do so. In both rich and emerging countries, it might be necessary to set transparent and verifiable objectives—while also changing financing and admission systems—to enable equal access to education.

▶ Democratic access to education can achieve much, but without mechanisms to ensure that people at the bottom of the distribution have access to well-paying jobs, education will not prove sufficient to tackle inequality. Better representation of workers in corporate governance bodies, and healthy minimum-wage rates, are important tools to achieve this.

Governments need to invest in the future to address current income and wealth inequality levels, and to prevent further increases in them.

▶ Public investments are needed in education, health, and environmental protection both to tackle existing inequality and to prevent further increases. This is particularly difficult, however, given that governments in rich countries have become poor and largely indebted. Reducing public debt is by no means an easy task, but several options to accomplish it exist—including wealth taxation, debt relief, and inflation— and have been used throughout history when governments were highly indebted, to empower younger generations.

INTRODUCTION

The objective of the *World Inequality Report 2018* is to contribute to a more informed public discussion on inequality by bringing the latest and most complete data to all sides in this global, democratic debate.

Economic inequality is widespread and to some extent inevitable. It is our belief, however, that where rising inequality is not properly addressed, it leads to all manner of political and social catastrophes. Avoiding these begins with careful monitoring.

In all societies, human beings care deeply about inequality. Changes in inequality levels have concrete consequences for people's living conditions, and they challenge our most basic and cherished notions of justice and fairness. Are different social groups getting all they deserve? Is the economic system treating different categories of labor-income earners and property owners in a balanced and equitable manner, both locally and globally? Across the world, people hold strong and often contradictory views on what constitutes acceptable and unacceptable inequality.

Again, to some extent, this will always be so. Our objective is not to bring everyone into agreement about inequality: this will never happen, for the simple reason that no single, scientific truth exists regarding the ideal level of inequality, let alone the ideal social policies and institutions to achieve and maintain it. Ultimately, it is up to public deliberation and political institutions and processes to make these difficult decisions.

Still, without aspiring to make everyone agree on the ideal level of inequality, we can hope and believe it is possible to agree about a number of inequality facts. The immediate objective of this report is to bring together new data series from the World Wealth and Income Database (WID.world) to document a number of newly discovered trends in global inequality.

WID.world is a cumulative and collaborative research process that originated in the early 2000s, and now includes over one hundred researchers covering more than seventy countries on all continents. WID.world provides open access to the most extensive available database on the historical evolution of the world distribution of income and wealth, both within and between countries.

In the context of the present report, we are able to present novel findings along three major lines. First, thanks to newly available data sources, we provide better coverage of emerging countries and of the world as a whole. Until recently, studies of inequality have tended to focus on the developed countries of Europe, North America, and Japan, largely due to better data access. Beginning with the *World Inequality Report 2018* we are able to present findings on inequality dynamics in emerging and developing countries, including China, India, Brazil, South Africa, Russia, and the Middle East. We show that inequality has increased in most world regions in recent decades, but at different speeds, suggesting that different policies and institutions can make a substantial difference. Such geographic coverage now allows us to track income growth rates of global income groups and analyze inequality among world citizens.

Second, we cover the entire distribution of incomes, from the bottom to the top, in a consistent manner. Until recently, most available long-run series on inequality focused on top-income shares. In this report, we present new findings on how the shares going to the lowest groups of populations have evolved. We show that bottom-income shares have declined significantly in many countries. In particular, we document a dramatic collapse of the bottom 50% income share in the United States since 1980 but not in other advanced economies, again suggesting that policies play a key role.

Third, our new series allow us to analyze the distribution of wealth and the structure of property in terms of how these have evolved. Most available series on inequality have focused on income rather than wealth. We are able in the *World Inequality Report 2018* to present new findings on the changing structure of public versus private wealth and the concentration of personal wealth. We show that net public wealth (assets minus debt) is close to zero or even negative in many developed countries, which stands in contrast to the situation observed in some emerging countries (most notably China).

These are important analytical advances, yet we are very much aware that we still face heavy limitations in our ability to measure the evolution of income and wealth inequality. Our objective in WID.world and in the *World Inequality Report* is not to claim that we have perfect data series, but rather to make explicit what we know and what we do not know. We attempt to combine and reconcile in a systematic manner the different data sources at our disposal: national income and wealth accounts; household income and wealth surveys; fiscal data coming from taxes on income, inheritance, and wealth (when they exist); and wealth rankings.

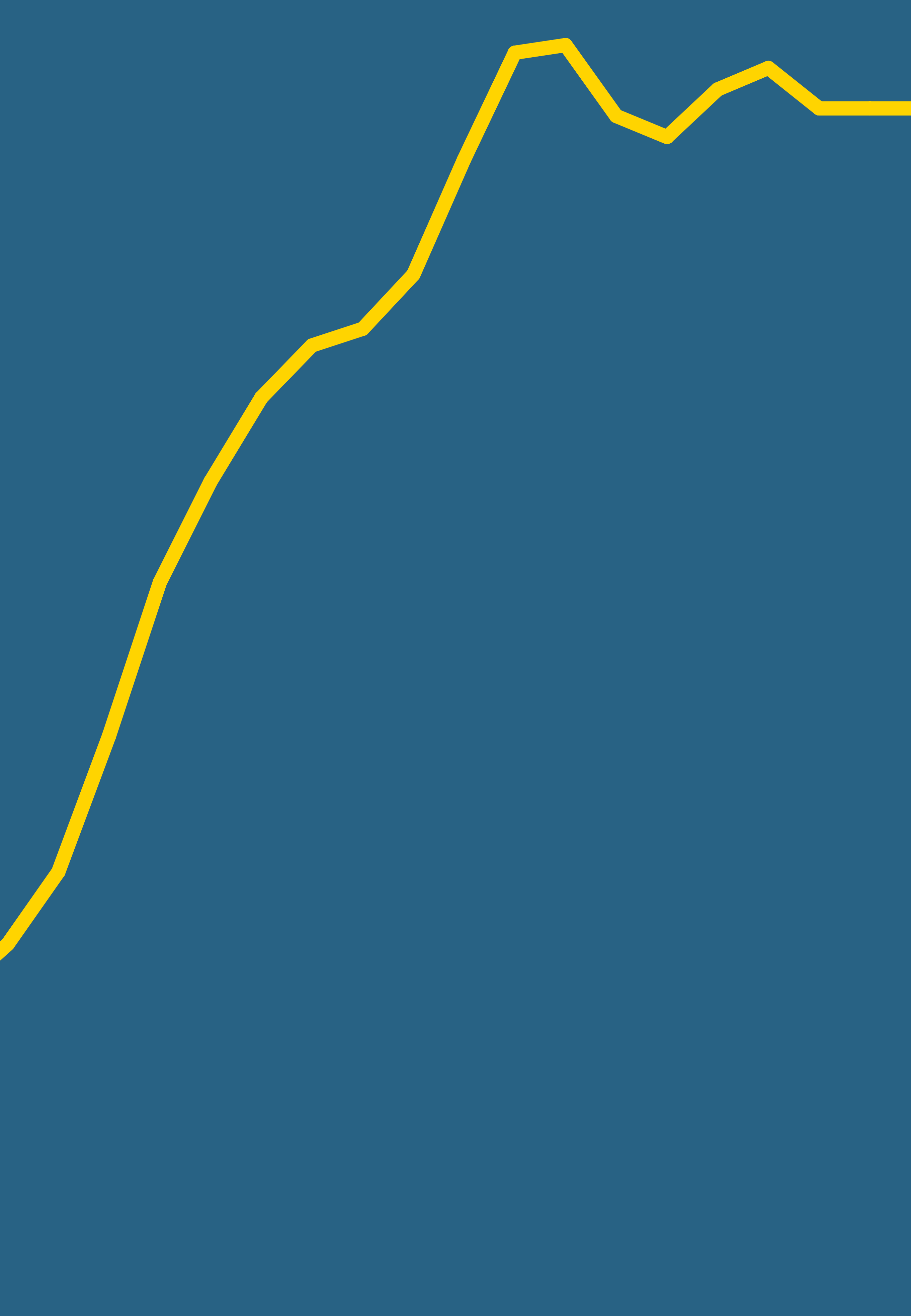
None of these data sources and their associated methodologies is sufficient in itself. In particular, we stress that our ability to measure the distribution of wealth is limited, and that the different data sources at our disposal are not always fully consistent with one another. But we believe that by combining these data sources in ways that are reasonable and explicitly described we can contribute to a better informed public debate. The methods and assumptions underlying our series are transparently presented in research papers available online. We make all raw data sources and computer codes easily accessible so that our work can be reproduced and extended by others.

Part of our aim is to put pressure on governments and international organizations to release more raw data on income and wealth. In our view, the lack of transparency regarding inequality of income and wealth seriously undermines the possibilities for peaceful democratic discussion in today's globalized economy. In particular, it is critical that governments provide public access to reliable and detailed tax statistics, which in turn requires that they operate properly functioning reporting systems for income, inheritance, and wealth. Short of this, it is very difficult to have an informed debate about the evolution of inequality and what should be done about it.

Our most important reason for providing all the necessary details about data sources and concepts is to enable interested citizens to make up their own minds about these important and difficult issues. Economic issues do not belong to economists, statisticians, government officials, or business leaders. They belong to everyone, and it is our chief objective to contribute to the power of the many.

PART I

THE WID.WORLD PROJECT AND THE MEASUREMENT OF ECONOMIC INEQUALITY



1

THE WID.WORLD PROJECT AND THE MEASUREMENT OF ECONOMIC INEQUALITY

This report is based on economic data available on WID.world, the most extensive database on the historical evolution of the world distribution of income and wealth, both within and between countries.

▹ WID.world is a cumulative and collaborative research process that originated in the early 2000s, and now includes over one hundred researchers covering more than seventy countries on all continents.

▹ Official inequality measures mostly rely on self-reported survey data, which frequently underestimate top income levels and usually are inconsistent with macroeconomic growth figures.

▹ Consequently, people often have a difficult time relating the GDP growth figures they hear about in the media to the individual income and wealth trajectories they see around them. This can lead to a lack of trust in economic statistics and get in the way of healthy public debates on inequality.

▹ WID.world attempts to correct for this problem by combining available sources (national accounts, fiscal and wealth data, surveys), spanning time periods as long as two hundred years for some countries, in a consistent and systematic manner.

▹ Our goal is to present inequality statistics that are consistent with macroeconomic statistics such as GDP and that can be easily understood and used by the public, to help ground the democratic debate in facts.

▹ We use modern digital tools to make these data available freely online on WID.world. Our data series are fully transparent and reproducible; our computer codes, assumptions, and detailed research papers are available online so that all interested persons can access and use them.

How to measure income and wealth inequality?

Economic inequality is a complex phenomenon that can be measured in various ways using different indicators and data sources. Choices among these indicators are not neutral and may have substantial impacts on findings. This is not only a matter of academic debate among statisticians. Anyone hoping to design appropriate policies should have a clear understanding of current and past inequality dynamics. We thus briefly discuss below key concepts which are central to understanding the rest of this report.

Whatever the source of data and the metric used to monitor economic inequality, its measurement starts from the same basic input: a distribution. For any income or wealth group, a distribution shows the number of individuals in this group and their shares of the group's total income or wealth. As such, a distribution is a relatively complex set of information, which is not straightforward to summarize. Inequality indices attempt to describe such complex data sets in a synthetic way.

Official inequality reports and statisticians often use synthetic measures of inequality such as the Gini index. Technically speaking, the Gini corresponds to the average distance between the income or wealth of all the pairs of individuals. To make it comparable between countries and over time, it is appropriately normalized so that complete equality corresponds to 0, and complete inequality (one person owning everything) corresponds to 1. The Gini index is often presented as a convenient, synthetic tool that allows comparisons of inequality across time and space.

However, this kind of index is technical both in its calculation and in the mathematical knowledge required of the reader to interpret it. According to the World Bank, for example, the Gini index for consumption inequality in Vietnam in 2014 was equal to 0.38. Is this large or small? A Gini of 0.38 implies that the distance separating Vietnam from perfect inequality (which is 1 on the index) is 0.62. Is this an acceptable distance from perfect inequality? It is not easy for citizens, journalists, and policymakers to make sense of such a metric.

Additionally, the strength of the Gini index—that it combines information on all individuals in a society—is also its main weakness. Because it summarizes a distribution in a single index, a given value for the Gini coefficient can result from distributions that are actually radically different. For example, a country may experience both a Gini-reducing decrease in poverty and a rise in the share of income going to the top 10%, which increases the Gini. If these effects offset each other, the overall Gini can remain constant, creating the impression that the distribution of income is not changing—while in fact the middle class is being squeezed out.

Because of its underlying mathematical properties, the Gini index also tends to downplay shifts happening at the top end and at the bottom of the distribution, precisely where the most evolution has taken place over the last decades. Finally, the raw data used to compute Gini indexes is often of relatively low quality, especially at the top of the distribution: top income and wealth levels are often implausibly low. The use of synthetic indexes can sometimes be a way to sweep such data issues under the rug.

Rather than use a single index, we believe it is preferable to use several metrics of inequality and to be transparent about which specific groups of the population are driving the evolution of inequality. This is the choice we make throughout this report. Distributions can be broken down into concrete social groups representing fixed fractions of the population—for example, the bottom 10% of the population, the next 10%, and so on, all the way up to the top 10% and the top 1%. For each group, it is then possible to measure the average income in that group, and the minimum income required to be part of it. For instance, in the United States in 2016, an adult needs to earn more than $124 000 per year (€95 000) to break into the top 10% group. On average, the top 10% earners make $317 000 per year (€242 000). By stark contrast, the bottom 50% earners make $16 000 per year (€13 000) on average. Arguably, anyone in the United States can relate to such measures and compare these values to their own income.

Another powerful way to measure inequality is to focus on the share of national income captured by each group. In the United States, for example, the top 10% captures 47% of national income in 2016. That is, the average income in the top 10% is 4.7 times larger than the average income in the economy as a whole; this group earns 4.7 times more than it would in a perfectly equal society. The bottom 90%, by contrast, captures 53% of national income, so individuals in the bottom 90% on average earn 59% of the average income per adult (that is, 0.53 divided by 0.90). There is no moral judgment associated with this statement: the shares of the various groups may or may not be justified. What matters here is that this metric is both accurate and meaningful.

The analysis should not stop with the top 10%, but also describe the shares and income levels of other income groups, such as the bottom 50% or the 40% who fall between the bottom 50% and the top 10% and who are often referred to as the “middle class.” One may also want to refine the focus on the top of the distribution, looking at the top 1%, for instance, as recent research has shown that inequality within the top 10% is large and growing. It may then also be relevant to further decompose the top 1% into even smaller groups such as tenths of percentiles. This process can be continued, dividing the top 0.1% into tenths of tenth percentiles, and the top 0.01% into a tenths of tenths of tenth percentiles. Overall, this approach allows for a more detailed but still straightforward description of the level and evolution of inequality relative to what can be achieved by using synthetic indexes.

Where to look for global inequality data

Understandable inequality indices are necessary but not sufficient to enable sound debates on inequality. Ultimately what matter are reliable and trusted economic data sources. Producing reliable inequality statistics takes time, however, and providing such estimates for several countries and over long periods is not possible without the participation of many researchers—researchers with country-specific knowledge, access to data sources, and adequate understanding of the political, economic, and cultural specificities of each country. This may help explain why, thus far, the production of inequality statistics has been decentralized across different research groups, often using different concepts and estimation techniques.

Several world inequality databases exist today. These inequality databases include for instance the World Bank’s PovcalNet, the Luxembourg Income Study (LIS), the Socio-Economic Database for Latin America and the Caribbean (SEDLAC) and the OECD Income Distribution Database (IDD). There are also various sources that combine the aforementioned databases to increase their coverage, the most important being the World Panel Income Distribution (LM-WPID) and the Standardized World Income Inequality Database (SWIID). Lastly, the United Nations compiles the World Income Inequality Database (WIID), which consists of a nearly exhaustive census of all primary databases and individual research initiatives, with detailed information about the concepts used.

These databases have proved useful to researchers, policymakers, journalists, and the general public focusing on the evolution of inequality over the past decades. However, these sources also rely almost exclusively on a specific information source—namely, household surveys—which have important limitations when it comes to measuring inequality. Household surveys consist mostly of face-to-face or virtual interviews with individuals who are asked questions about their incomes, wealth, and other socio-economic aspects of their lives. Surveys are particularly valuable because they gather information about not only income or assets, but also social and demographic dimensions. They thus allow for a better understanding of the determinants of income and wealth inequality, and help place income and wealth inequality in broader contexts—such as racial, spatial, educational, or gender inequality.

The main problem with household surveys, however, is that they usually rely entirely on self-reported information about income and wealth. As a consequence, they misrepresent top income and wealth levels, and therefore overall inequality. This can also contribute to major inconsistencies between macroeconomic growth (as recorded by GDP statistics) and household income growth (as recorded by surveys for the bottom and middle parts of the distribution), thereby leading to a lack of trust in economic statistics. (**Box 1.1**, p. 32)

Fiscal data capture inequality dynamics that survey data cannot

Survey estimates of inequality rely on self-reported information collected from nationally representative groups of the population. The first problem with any such survey is its limited sample size. Given the small number of extremely rich individuals, the likelihood that they will be included in surveys is typically very small. Some surveys attempt to address this issue by oversampling the rich — select more rich individuals to be surveyed—, but this is typically insufficient to obtain reliable information on the wealthy, because non-response rates are high among the rich. Furthermore, because very large self-reported incomes in surveys are sometimes due to reporting errors, surveys often use top codes (or corrections) to clean up extreme values. Therefore, surveys generally severely underestimate the income and wealth levels at the very top of the distribution, precisely where some of the largest changes have occurred over the past decades.

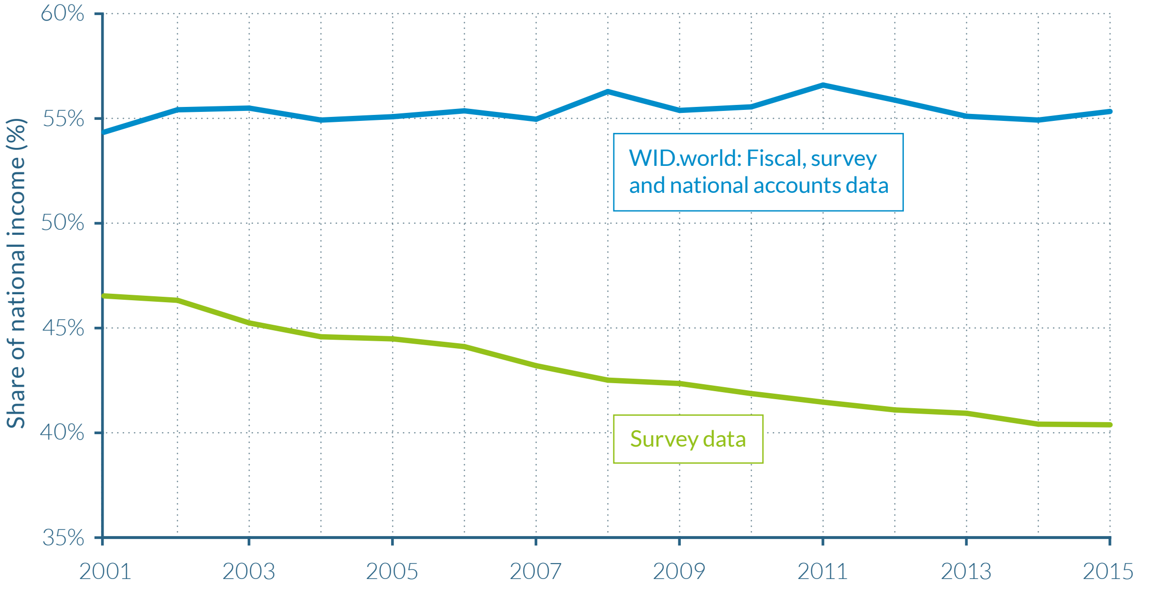
The best way to overcome this limitation is to combine different types of data sources, and in particular to use administrative tax data together with survey data. Initially compiled for tax collection purposes, tax data are also valuable for researchers. As compared to surveys, they give a more complete and reliable picture of the distribution of income and wealth among the wealthy.

To illustrate the differences in inequality estimates between survey and fiscal data, consider the following examples. According to official survey data, the top 1% of Chinese earners captured 6.5% of national income in 2015. However, new estimates produced as part of the WID.world project show that correcting surveys with newly released tax data on high-income earners is enough to increase the income share of the top 1% from 6.5% to close to 11.5% of national income.[1] In Brazil, survey data indicate that the income received by the richest 10% is just over 40% of total income in 2015, but when surveys are combined with fiscal data and national accounts, we find that this group receives, in fact, more than 55% of national income (see **Figure 1.1**). As can be seen from these two examples, the extent to which surveys underestimate top shares can vary from one country to another—and also from one percentile to another—but it is always likely to be substantial. Comparisons between countries are likely to be unreliable if made based on survey data without adjusting for the top by including fiscal and national accounts data.

Poor coverage of the wealthy in household surveys can also impede accurate comparisons across time. For example, according to Brazilian survey data, inequality in the country decreased between 2001 and 2015—but income tax data show that, in fact, inequality remained stubbornly high over this period. Similar results can be found in China, where the income share of the top 10%

Figure 1.1

Top 10% income share in Brazil, 2001–2015: survey vs. national accounts (WID.world) series



Source: Morgan (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 10% received around 40% of national income according to household surveys. However, corrected estimates using fiscal, survey and national accounts show that their share is 55%.

increased by fifteen percentage points from 1978 to 2015, while, according to official survey estimates, the increase was only by nine percentage points. In India, the absence of top earners in survey data could explain up to 30% of the gap between the very low macroeconomic growth of consumption seen in survey data, and the much faster growth rate seen in national account data.[2]

Administrative tax data are not free from measurement issues at the top. They also tend to underestimate top income and wealth levels, due to tax evasion. For this reason, our inequality estimates should be viewed in most cases as lower-bound estimates—but at least these are more plausible lower bounds than survey-based measures. In all countries, including in countries with potentially widespread evasion, we find that top income levels reported in tax data are substantially larger than in surveys. The reason for this is simple: noncompliant taxpayers face at least some potential sanctions if they underreport their incomes to tax authorities, whereas no such sanctions exist for underreporting income in a survey. Furthermore, tax authorities increasingly collect data from third parties (such as employers and banks), which increases tax compliance.

Another advantage of tax data over surveys is coverage of longer time periods. Administrative tax data are usually available on a yearly basis starting with the beginning of the twentieth century for the income tax, and as far back as the early nineteenth century for the inheritance tax in some countries. In contrast, nationally representative surveys are rarely carried out annually, and were not generally carried out at all before the 1970s–1980s. Using them, it would be impossible to study long-run evolutions—a serious limitation given that some of the most important transformations in inequality span long periods of time. Having data covering many decades helps disentangles long-term trends reflecting major macroeconomic transformations from short-term variations due to episodic shocks or measurement issues.

The renewed focus on income inequality and the World Top Incomes Database

During the past fifteen years, there has been renewed interest in understanding the long-run evolution of income inequality. Many studies have constructed top income share series for a large number of countries.[3] These studies have generated large volumes of data, intended as a research resource for further analysis as well as a source to inform the public debate on inequality trends. To a large extent, this literature followed the pioneering work of Simon Kuznets, extending his income share measurement to more countries and years.[4]

In January 2011, The World Top Incomes Database (WTID) was created to provide convenient and free access to these series. Thanks to the contribution of over a hundred researchers, the WTID expanded to include series on income inequality for more than thirty countries, spanning most of the twentieth and early twenty-first centuries. These series had a large impact on the global inequality debate because they made it possible to compare the income shares of top groups (for example, the top 1%) over long periods of time, revealing new facts and refocusing the discussion on the rise in inequality seen in recent decades.

Although the top income share series available in the WTID all had a common methodological underpinning and goal—using tax data to document the long-run evolution of income concentration—the units of observation, the income concepts, and the statistical methods used were never made fully homogeneous over time and across countries. Attention was restricted for the most part, moreover, to the top decile rather than to the entire distribution, and these series were mostly about income, not wealth. All this pointed to the need for a methodological reexamination and clarification.

In December 2015, the WTID was subsumed into the WID, the World Wealth and Income Database (WID.world). The change in name reflects the extended scope and ambition of the project. The new database aims at measuring not only income but also wealth inequality, and it aims at capturing the dynamics of income and wealth across the entire distribution and not only at the top.

WID.world's key novelty: distributing national accounts in a consistent way

The key novelty of the WID.world project is to produce Distributional National Accounts (DINA) relying on a consistent and systematic combination of fiscal, survey, wealth and national accounts data sources.[5] The complete DINA methodological guidelines (Alvaredo et al., 2016), as well as all computer codes and detailed data series and research papers, are available online on WID.world. Here we summarize only some of the main methodological points.

As explained above, administrative data on income and wealth tend to be more reliable sources of information than surveys. Unfortunately, they provide information on only a subset of the population—namely, the part filing tax returns. This issue is particularly important in emerging countries. In India, for example, income tax payers represent only slightly more than 6% of the adult population; thus, survey data are the only available sources of information to measure inequality in the bottom 94% of the distribution. We must critically and cautiously rely on survey data sources in combination with fiscal and wealth sources and national accounts to estimate the distribution of national income or wealth.

Another limitation of tax data is that they are subject to changes in fiscal concepts over time and across countries. Typically, depending on whether income components (such as labor income, dividends, and capital income) are subject to tax, they may or may not appear in the tax data from which distributional statistics can be computed. These differences can make international and historical comparisons difficult.

To some extent, these harmonization issues can be overcome by using national account data—and in particular, the concepts of national income and national wealth—as a benchmark. Our choice of these concepts for the analysis of inequality does not mean that we consider them perfectly satisfactory. Quite the contrary, our view is that national accounts statistics are insufficient and need to be greatly improved.

In our view, however, the best way to improve on the national accounts is to confront them with other sources and to attempt to distribute national income and wealth across percentiles. The key advantage of national accounts is that they follow internationally standardized definitions for measuring the economic activity of nations. As such, they allow for a more consistent comparison over time and across countries than fiscal data. National accounts definitions, in particular, do not depend upon local variations in tax legislation or other parts of the legal system.

One of the most widely used aggregate of the national accounts is gross domestic product (GDP). But GDP statistics do not provide any information about the extent to which the different social groups benefit (or not) from growth.[6] In addition, GDP is not a satisfactory measure of the total income of a country, because a country with extensive capital depreciation or large income flowing abroad can have a large GDP but much less income to distribute to its residents.

The concept of national income (NI) is a better benchmark indicator to compare countries and to analyze the distribution of income and growth. National income is equal to GDP minus capital depreciation plus net foreign

Box 1.1

What type of economic inequality do we measure in the *World Inequality Report*?

This report attempts to present an integrated and consistent approach to gauging both income and wealth inequality. As its title indicates, the key ambition and novelty of the World Wealth and Income Database (WID.world), upon which this report is built, is indeed to put equal emphasis on wealth and income, and to relate the two aspects of economic inequality as closely as possible.

There are several reasons for this. First, in order to properly analyze income inequality, it is critical to decompose total income into two categories of income flows: income from labor and income from capital. The latter category has played an important role in the rise of inequality in recent decades—and an even bigger role if we look at the evolution of the distribution of income in the very long run.

Next, one of our key goals is to relate macroeconomic issues—such as capital accumulation, the aggregate structure of property, privatization or nationalization policies, and the evolution of public debt—to the microeconomic study of inequality. Far too often, the study of the “capital” side of the economy (that is, focused on capital, investment, debt, and so forth) is separated from the study of the “household” side (that is, looking at wages, transfers, poverty, inequality, and other issues).

We should make clear, however, that a lot of progress needs to be made before we can present a fully integrated approach. The present report should be viewed as one step in this direction. For example, in Part IV of the report, we are able to fully analyze the joint evolution of inequality of income and wealth for a number of countries (in particular, the United States and France). Doing so requires careful measurement not only of the inequality of pre-tax and post-tax income, but also of the distribution of saving rates across the different deciles of the distribution of pre-tax income.

This kind of analysis will gradually be extended to more and more countries, as more data become income. It reflects a nation's income more closely than GDP does. The WID.world database combines macroeconomic data from different sources in order to produce national income series for about two hundred countries. These national income estimates are consistent with those of international organizations, with one important improvement: our series address the issue that some income is missing from published national accounts. In the official data, foreign income paid is higher than foreign income received at the global level—because some of the income received in tax havens is nowhere recorded. We allocate this global missing income drawing on methods first developed by Zucman (2013).[7]

Total fiscal income (as measured by tax data) is always less than national income (as measured in the national accounts). Part of the difference is due to tax-exempt income flows such as imputed rent (the rental value of owner-occupied housing) and undistributed profits (the profits of corporations not distributed to individuals but ultimately benefitting owners of corporations). When data are available and sufficiently precise, we attribute the fraction of national income missing from fiscal data to the income groups who benefit from these sources of income. This operation can have significant implications for the distribution of income. For example, once we add undistributed profits to fiscal income, the share of income earned by the top 1% in China increases from 11.5% to 14% in 2015. A number of recent research papers have attempted to construct inequality statistics accounting for tax-exempt income, both in developed and emerging countries, including the United States, China, France, Brazil, and Russia.

available. The combination of series on the distribution of pre-tax and post-tax income, savings, and wealth will also allow us to relate in a systematic manner the inequality of income, wealth, and consumption (that is, income minus savings).

In our view, however, it would be a mistake to overemphasize the consumption perspective, as the literature on inequality and poverty has sometimes done. Consumption is obviously a very important indicator of wealth, particularly at the bottom of the distribution. The problem is that the household surveys routinely used to study consumption inequality tend to underestimate the consumption, income, and wealth levels reached by the top of the distribution. Also, the notion of consumption is not always well defined for top income groups, which typically save very large proportions of their income. They choose to do so partly in order to consume more in later years, but more generally in order to consume the prestige, security, and economic power conferred by wealth ownership. In order to develop a consistent and global perspective on economic inequality—that is, a perspective that views economic actors not only as consumers and workers but also as owners and investors—it is critical, in our view, to put equal emphasis on income and wealth.

Our various concepts of income and wealth—in particular, pre-tax national income, post-tax national income, and personal wealth—are defined using international guidelines in national income and wealth accounts (SNA 2008). The exact technical definitions are available online in the DINA Guidelines (Distributional National Accounts).[a]

a See F. Alvaredo, A. B. Atkinson, L. Chancel, T. Piketty, E. Saez, and G. Zucman, "Distributional National Accounts (DINA) Guidelines: Concepts and Methods Used in WID.world," WID.world Working Paper no. 2016/2, December 2016, http://wid.world/document/dinaguidelines-v1/.

Data limitations currently make such adjustments impossible, however, in a number of countries, which implies that inequality estimates for these countries tend to be downwardly biased. In such cases, we simply use our national income series to scale up fiscal incomes proportionally so that they add up to national income.[8] This transformation does not affect the distribution of income, but allows us to compare the evolution of income levels over time and across countries more meaningfully. For example, our data show that the average pre-tax national income per adult within the top 1% is similar in India and China in 2013 (€131 000 versus €157 000, respectively) but much higher in Brazil (€436 000) and in the United States (€990 000).

Taking wealth inequality into account

One reason for the growing interest in wealth inequality is the recognition that the increase in income inequality in recent years is partly a result of rising capital incomes (in addition to changes in wages and earned income). These capital incomes include interest, dividends, retained earnings of corporations, and rents. While most of the population earns little capital income, this form of income accounts for a significant proportion of income at the top of the income distribution.

Another reason for the renewed interest in wealth is that aggregate wealth itself is rising faster than income—so the ratio of national wealth to national income is rising fast in many countries (as was first shown by Piketty and Zucman, 2014). One consequence is that inherited wealth—which declined for much of the twentieth century—is taking on renewed significance in a number of countries. There is also extensive evidence (in billionaire rankings, for example) that top global wealth-holders have accumulated wealth at a much faster rate than the average person and have therefore benefited from a substantial increase in their share of global wealth.

Because most countries do not tax wealth directly, producing reliable estimates of wealth inequality requires combining different data sources, such as billionaire rankings and also income tax data and inheritance tax data—as in the pioneering work of A. B. Atkinson and A. Harrison (1978).[9] The globalization of wealth management since the 1980s raises additional new challenges, as a growing amount of world wealth is held in offshore financial centers. Work led by Gabriel Zucman shows that accounting for these offshore assets has large implications for the measurement of wealth at the very top end of the distribution (see **Figure 1.2**).[10] More generally, it is becoming critical to measure the inequality of income and wealth from a global perspective, and not simply at the country level, as we discuss below.

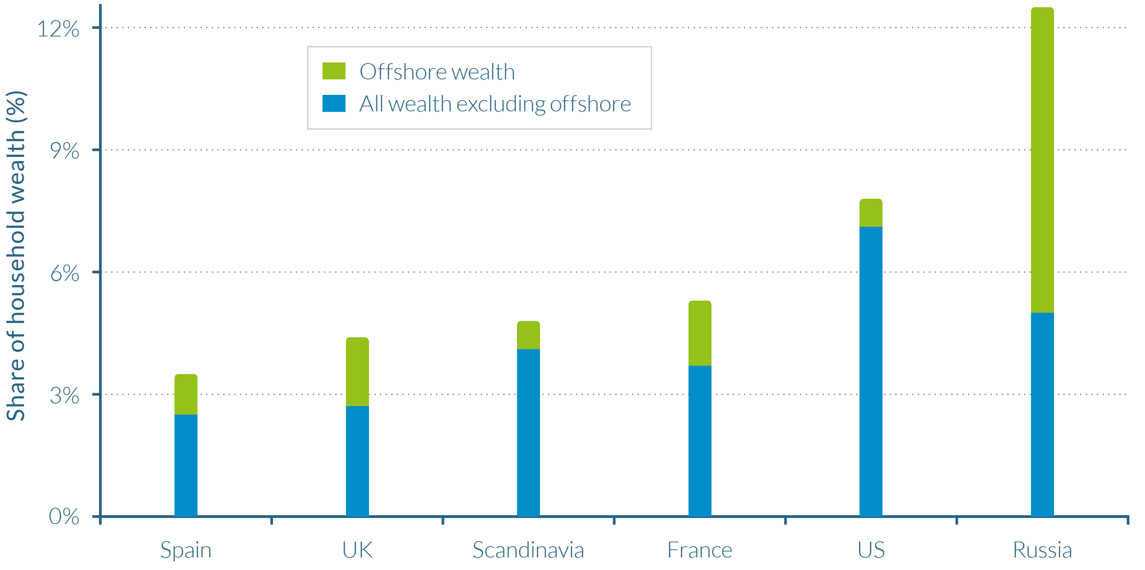
From national to regional and global distributions of income and wealth

One central objective of the WID.world project is to produce global income and wealth distributions. This amounts to ranking individuals from the poorest to the richest at the global level, ignoring national boundaries. We also provide estimates of income and wealth inequality for broad regions, such as Europe and the Middle East.

One might wonder whether it makes sense to produce global inequality estimates, given that most policies (including policies to tackle inequality) are voted and implemented at the national level. In our view, it is complementary to study inequality dynamics at the national, regional, and global levels. First, although there exists no global government, there are attempts to foster global cooperation to tackle issues such tax havens and environmental inequalities. Next, growing economic interdependence implies that one needs to look at global inequality dynamics to fully understand the underlying economic forces shaping national inequality. Finally, political perceptions about inequality might be determined by one's position not only within a given country but also by comparison to others at the regional and global level.

Figure 1.2

Top 0.01% wealth share and its composition in emerging and rich countries, 2000–2009



Source: Alstadsæter, Johannesen and Zucman (2017). See wir2018.wid.world for data series and notes.
Between 2000-2009, the average wealth share of the Top 0.01% in Scandinavia was 4.8%. 0.7 percentage points of this wealth was held offshore.

Since the 1980s the world has evolved towards more economic, financial, and cultural integration. Even if globalization may be called into question today—as recent elections in the UK and the United States have proved—the world remains an interconnected environment where capital, goods, services, and ideas are highly mobile and their circulation is facilitated by innovations in information technology. To some extent, there is already a global community, and in this global environment it is logical for citizens to compare themselves to one another.

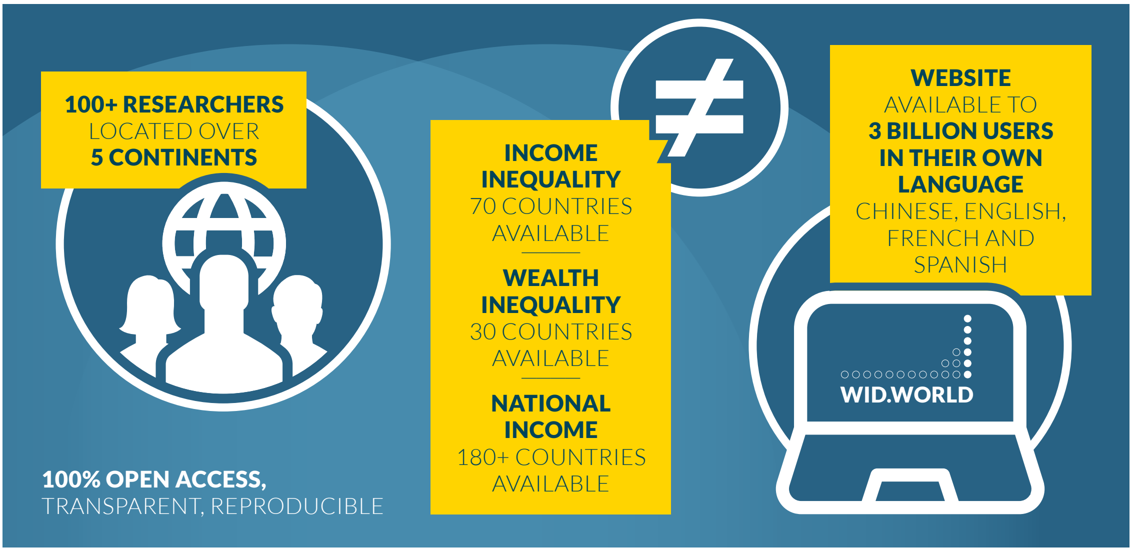
Individuals in one country may feel deeply concerned, from an ethical perspective, by the situations of those at the bottom of the global distribution.[11] They may also be concerned about their own positions in the global or regional distributions of income and wealth. The stagnating or sluggish income growth of lower- and middle-income groups in rich countries, considered in a context of high growth in emerging countries and at the top of the global income pyramid, may have contributed to anti-establishment votes over recent years. National citizens may already be thinking across borders.

Global inequality data are also necessary to analyze the distributional consequences of globalization. Is growth at the global top disproportionately high? Or is the share of total growth captured by the global top 1% small compared to the growth that has accrued to the bottom 50%? The first step toward answering these fundamental questions is to collect and produce global inequality statistics that cover all groups of the population, up to the very top.

As will be described in Chapter 2.1, we move toward this goal carefully, aggregating only regions and countries for which we have consistent data series. We present results for the global distribution of income, but data limitations do not allow us yet to analyze the global distribution of wealth. (Our "global" wealth estimates take into account only the United States, Europe, and China.) Producing truly global wealth distribution series will be

Figure 1.3

The WID.world project in 2018



a major goal of future editions of the *World Inequality Report*. Eventually, we also seek to deepen our understanding of the interplay between global economic inequality and other forms of global inequality, such as environmental injustice.[12] Such inequality metrics can help environmental and economic policy making—for example, when it comes to allocating efforts to tackle climate change across individuals, countries, and regions.

WID.world and the *World Inequality Report:* open access, transparency, and replicability at its core

In January 2017, we released the first version of the WID.world website with the objective of reaching a wide audience of researchers and the general public with a user-friendly interface. Thanks to the work of over a hundred researchers located on five continents, the WID.world website now gathers income inequality data for more than 70 countries, wealth inequality and public and private wealth data for more than 30 countries, and national income and GDP data for more than 180 countries. Thus WID.world provides access to the most extensive available database on the historical evolution of income and wealth inequality, both between and within countries. As part of our attempts to democratize access to inequality data, we have also made WID.world available in four languages—Chinese (Mandarin), English, French, and Spanish—and thus to three billion people in their own language (see **Figure 1.3**).

Open access, transparency, and reproducibility are the core values of the WID.world project. The website was designed to allow anyone, expert or nonexpert, to access and make sense of historical global inequality data. All WID.world series, moreover, are accompanied with a methodological paper providing extensive descriptions of the method and concepts used.

Raw data and the computer codes used to generate inequality estimates are also updated on the website. This level of transparency is another key innovation in the landscape of economic data providers. It allows any interested researcher to refine our estimates, make different assumptions if they wish, and help develop new ideas for how inequality can be better measured and how this data can be used for the benefit of society. Our website comes along with a set of tools to analyze economic inequality.

The *World Inequality Report 2018* is part of this initiative to democratize access to inequality statistics. All the series discussed and presented in the report are also available online and can be entirely reproduced. We should note, however, that this report contains analyses carried out specifically for the report, and hence, the report may not necessarily represent the views of all WID.world fellows. The *World Inequality Report* is a product of the World Inequality Lab, which relies on research completed as part of the WID.world project and novel research on global inequality dynamics.

NOTES

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7 See T. Blanchet and L. Chancel, "National Accounts Series Methodology," WID.world Working Paper no. 2016/1, September 2016, http://wid.world/document/1676/; and G. Zucman, "The Missing Wealth of Nations: Are Europe and the U.S. Net Debtors or Net Creditors?" *Quarterly Journal of Economics* 128, no. 3 (2013): 1321–1364.

8 We multiplied each income group's average fiscal income by National Income/Total Fiscal Income.

9 A. B. Atkinson and A. J. Harrison, *Distribution of Personal Wealth in Britain* (Cambridge: Cambridge University Press, 1978).

10 See Zucman, "The Missing Wealth of Nations"; G. Zucman, "Taxing across Borders: Tracking Personal Wealth and Corporate Profits," *Journal of Economic Perspectives* 28, no. 4 (2014): 121–148; and A. Alstadsæter, N. Johannesen, and G. Zucman, "Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality," NBER Working Paper no. 23805, National Bureau of Economic Research, September 2017, http://www.nber.org/papers/w23805.pdf.

11 S. Anand, and P. Segal, "The Global Distribution of Income," *Handbook of Income Distribution* 2, part A (2015): 937–979.

12 L. Chancel and T. Piketty, "Carbon and inequality: from Kyoto to Paris," CEPR Policy Portal Vox, December 1, 2015, http://voxeu.org/article/carbon-and-inequality-kyoto-paris; L. Chancel and T. Piketty, "Trends in the Global Inequality of Carbon Emissions (1998–2013) and Prospects for an Equitable Adaptation Fund," Paris School of Economics, November 3, 2015, http://piketty.pse.ens.fr/files/ChancelPiketty2015.pdf.

PART II

TRENDS IN GLOBAL INCOME INEQUALITY

2.1

GLOBAL INCOME INEQUALITY DYNAMICS

The information in this chapter draws on "The Elephant Curve of Global Inequality and Growth," by Facundo Alvaredo, Lucas Chancel, Thomas Piketty, Emmanuel Saez, and Gabriel Zucman, 2017. WID.world Working Paper Series (No. 2017/20), forthcoming in *American Economic Review*.

- ▷ Data series on global inequality are scarce and caution is required in interpreting them. However, by combining consistent and comparable data, as we have done in this *World Inequality Report*, we can provide striking insights.
- ▷ Since 1980, income inequality has increased rapidly in North America and Asia, grown moderately in Europe, and stabilized at an extremely high level in the Middle East, sub-Saharan Africa, and Brazil.
- ▷ The poorest half of the global population has seen its income grow significantly thanks to high growth in Asia. But the top 0.1% has captured as much growth as the bottom half of the world adult population since 1980.
- ▷ Income growth has been sluggish or even nil for individuals between the global bottom 50% and top 1%. This includes North American and European lower- and middle-income groups.
- ▷ The rise of global inequality has not been steady. While the global top 1% income share increased from 16% in 1980 to 22% in 2000, it declined slightly thereafter to 20%. The trend break after 2000 is due to a reduction in between-country average income inequality, as within-country inequality has continued to increase.
- ▷ When measured using market exchange rates, the top 10% share reaches 60% today, instead of 53% when using purchasing power parity (PPP) exchange rates.
- ▷ Global income growth dynamics are driven by strong forces of convergence between countries and divergence within countries. Standard economic trade models fail to explain these dynamics properly—in particular, the rise of inequality at the very top and within emerging countries. Global dynamics are shaped by a variety of national institutional and political contexts, described and discussed in the following chapters of this report.

Managing data limitations to construct a global distribution of income

The dynamics of global inequality have attracted growing attention in recent years.[1] However, we still know relatively little about how the distribution of global income and wealth is evolving. Available studies have largely relied on household surveys, a useful source of information, but one that does not accurately track the evolution of inequality at the top of the distribution. New methodological and empirical work carried out in the context of WID.world allows a better understanding of global income dynamics.

We stress at the outset that the production of global inequality dynamics is in its infancy and will still require much more work. It is critical that national statistical and tax institutions release income and wealth inequality data in many countries where data are not available currently—in particular, in developing and emerging countries. Researchers also need to thoroughly harmonize and analyze these data to produce consistent, comparable estimates. The World Inequality Lab and the WID.world research consortium intend to continue contributing to these tasks in the coming years.

Even if there are uncertainties involved, it is already possible to produce meaningful global income inequality estimates. The WID.world database contains internationally comparable income inequality estimates covering the entire population, from the lowest to the highest income earners, for many countries: the United States, China, India, Russia, Brazil, the Middle East, and the major European countries (such as France, Germany, and the United Kingdom). A great deal can already be inferred by comparing inequality trends in these regions. Using simple assumptions, we have estimated the evolution of incomes in the rest of the world so as to distribute 100% of global income every year since 1980 (**Box 2.1.1**). This exercise should be seen as a first step towards the construction of a fully consistent global distribution of income. We plan to present updated and extended versions of these estimates in the future editions of the *World Inequality Report* and on WID.world, as we gradually manage to access more data sources, particularly in Africa, Latin America, and Asia.

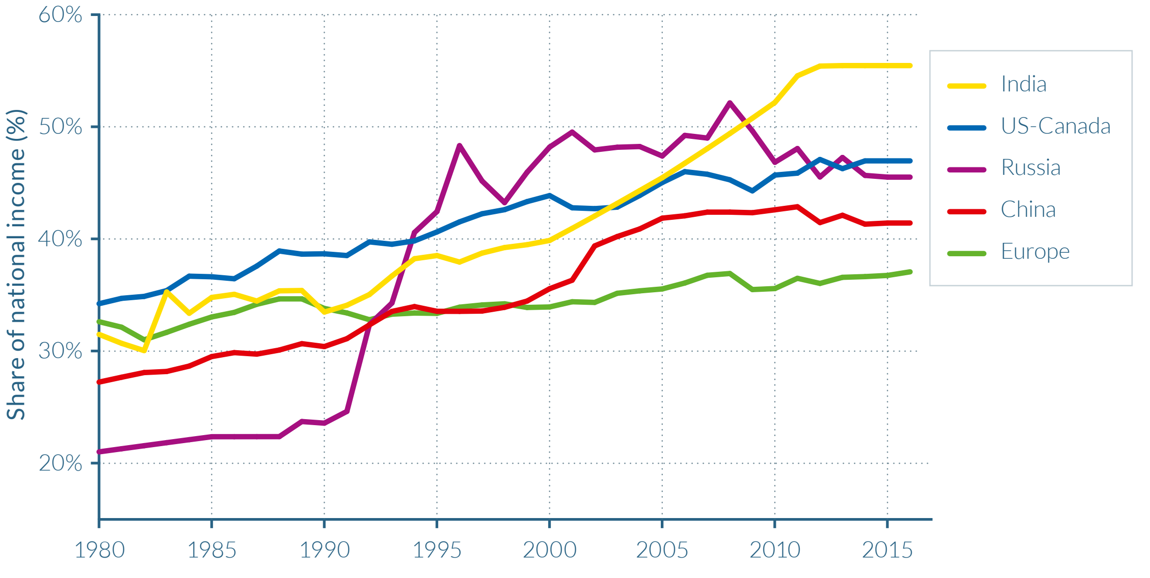
The exploration of global inequality dynamics presented here starts in 1980, for two main reasons. First, 1980 corresponds to a turning point in inequality and redistributive policies in many countries. The early 1980s mark the start of a rising trend in inequality and major policy changes, both in the West (with the elections of Ronald Reagan and Margaret Thatcher, in particular) and in emerging economies (with deregulation policies in China and India). Second, 1980 is the date from which data become available for a large enough number of countries to allow a sound analysis of global dynamics.

We start by presenting our basic findings regarding the evolution of income inequality within the main world regions. Three main findings emerge.

First, we observe rising inequality in most of the world's regions, but with very different magnitudes. More specifically, we display in **Figure 2.1.1a** the evolution of the top 10% income share in Europe (Western and Eastern Europe combined, excluding Ukraine, Belorussia, and Russia), North America (defined as the United States and Canada), China, India, and Russia. The top 10% share has increased in all five of these large world regions since 1980. The top 10% share was around 30–35% in Europe, North America, China, and India in 1980, and only about 20–25% in Russia. If we put these 1980 inequality levels into broader and longer perspective, we find that they were in place since approximately the Second World War, and that these are relatively low inequality levels by historical standards (Piketty, 2014). In effect, despite their many differences, all these world regions went through a relatively egalitarian phase between 1950 and 1980. For simplicity, and for the time being, this rela-

Figure 2.1.1a

Top 10% income shares across the world, 1980–2016: Rising inequality almost everywhere, but at different speeds



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 47% of national income was received by the top 10% in US-Canada, compared to 34% in 1980.

tively low inequality regime can be described as the "post-war egalitarian regime," with obvious important variations between social-democratic, New Deal, socialist, and communist variants to which we will return.

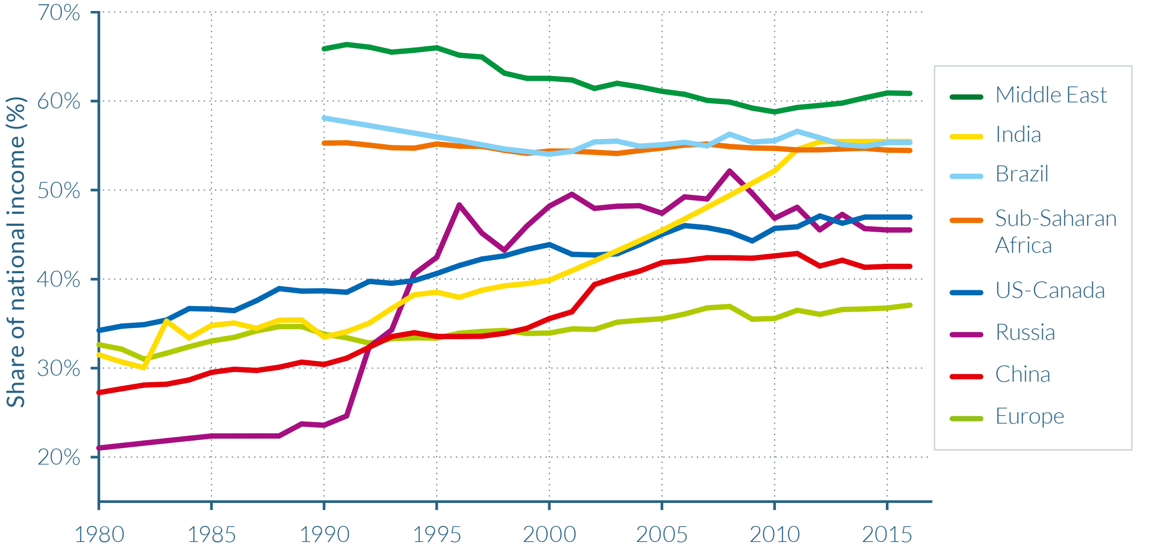
Top 10% income shares then increased in all these regions between 1980 and 2016, but with large variations in magnitude. In Europe, the rise was moderate, with the top 10% share increasing to about 35–40% by 2016. However, in North America, China, India, and even more so in Russia (where the change in policy regime was particularly dramatic), the rise was much more pronounced. In all these regions, the top 10% share rose to about 45–50% of total income in 2016. The fact that the magnitude of rising inequality differs substantially across regions suggests that policies and institutions matter: rising inequality cannot be viewed as a mechanical, deterministic consequence of globalization.

Next, there are exceptions to this general pattern. That is, there are regions—in particular, the Middle East, Brazil (and to some extent Latin America as a whole), and South Africa (and to some extent sub-Saharan Africa as a whole)—where income inequality has remained relatively stable at extremely high levels in recent decades. Unfortunately, data availability is more limited for these three regions, which explains why the series start in 1990, and why we are not able to properly cover all countries in these regions (see **Figure 2.1.1b**).

In spite of their many differences, the striking commonality in these three regions is the extreme and persistent level of inequality. The top 10% receives about 55% of total income in Brazil and sub-Saharan Africa, and in the Middle East, the top 10% income share is typically over 60% (see **Figure 2.1.1c**). In effect, for various historical reasons, these three regions never went through the post-war egalitarian regime and have always been at the world's high-inequality frontier.

Figure 2.1.1b

Top 10% income shares across the world, 1980–2016: Is world inequality moving toward the high-inequality frontier?

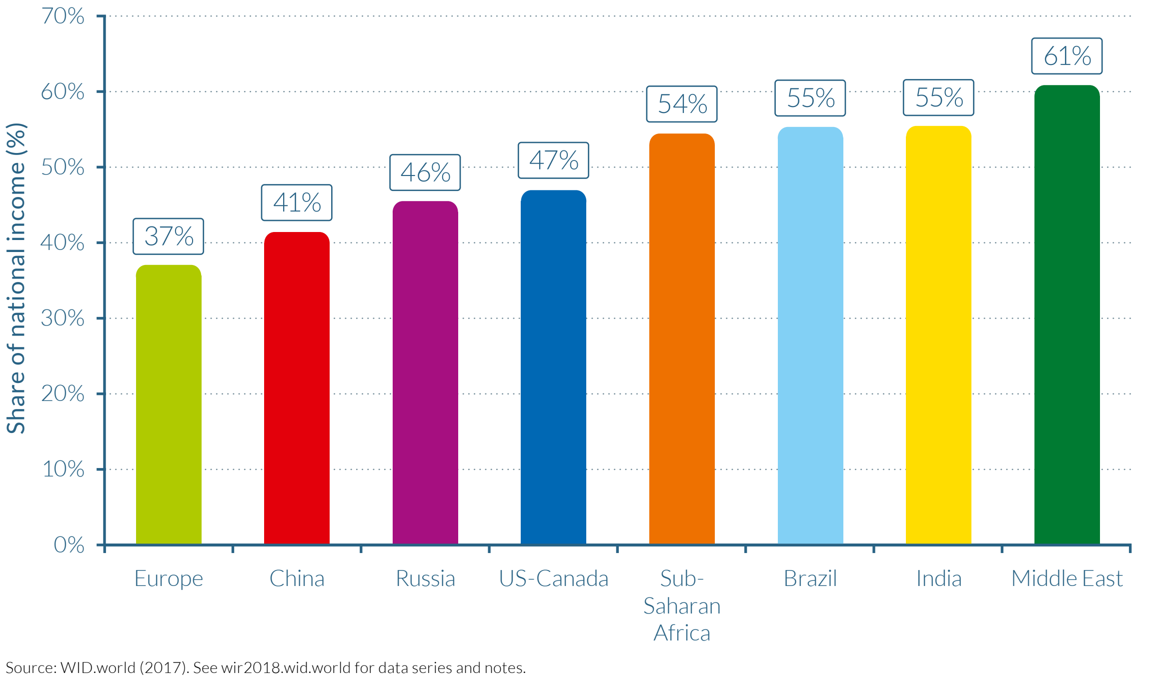


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 55% of national income was received by the Top 10% earners in India, against 31% in 1980.

Figure 2.1.1c

Top 10% income shares across the world, 2016

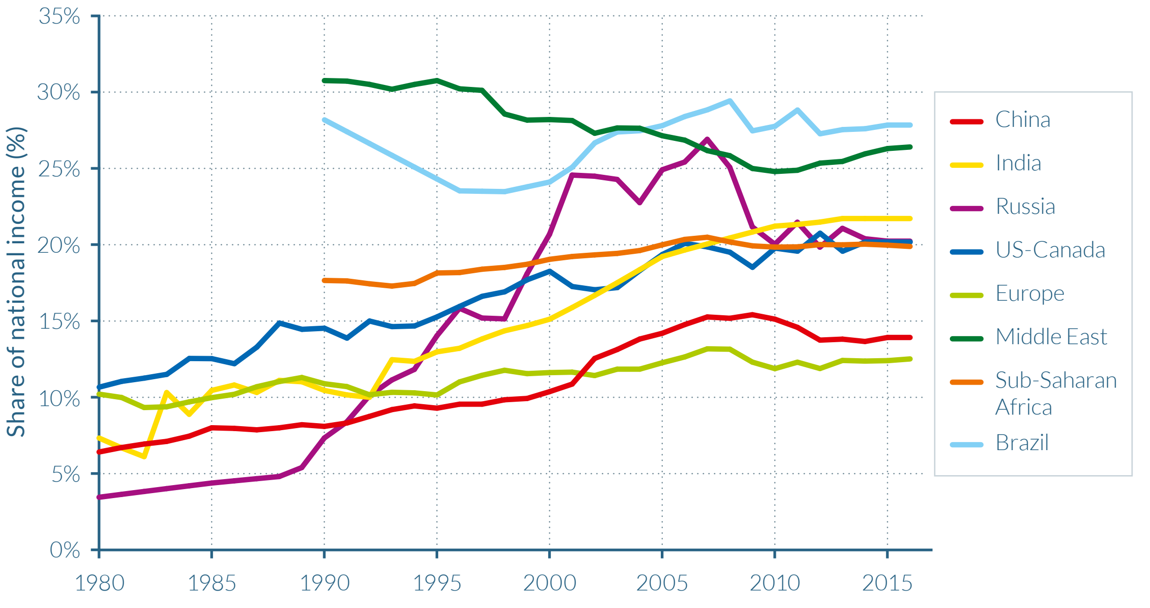


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 37% of national income was received by the Top 10% in Europe against 61% in the Middle-East.

Figure 2.1.1d

Top 1% income shares across the world, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 14% of national income was received by the Top 1% in China.

The third striking finding is that the variations in top-income shares over time and across countries are very large in magnitude, and have a major impact on the income shares and levels of the bottom 50% of the population. It is worth keeping in mind the following orders of magnitude: top 10% income shares vary from 20–25% to 60–65% of total income (see **Figures 2.1.1a** and **2.1.1b**). If we focus upon very top incomes, we find that top 1% income shares vary from about 5% to 30% (see **Figure 2.1.1d**), just like the share of income going to the bottom 50% of the population (see **Figure 2.1.1e**).

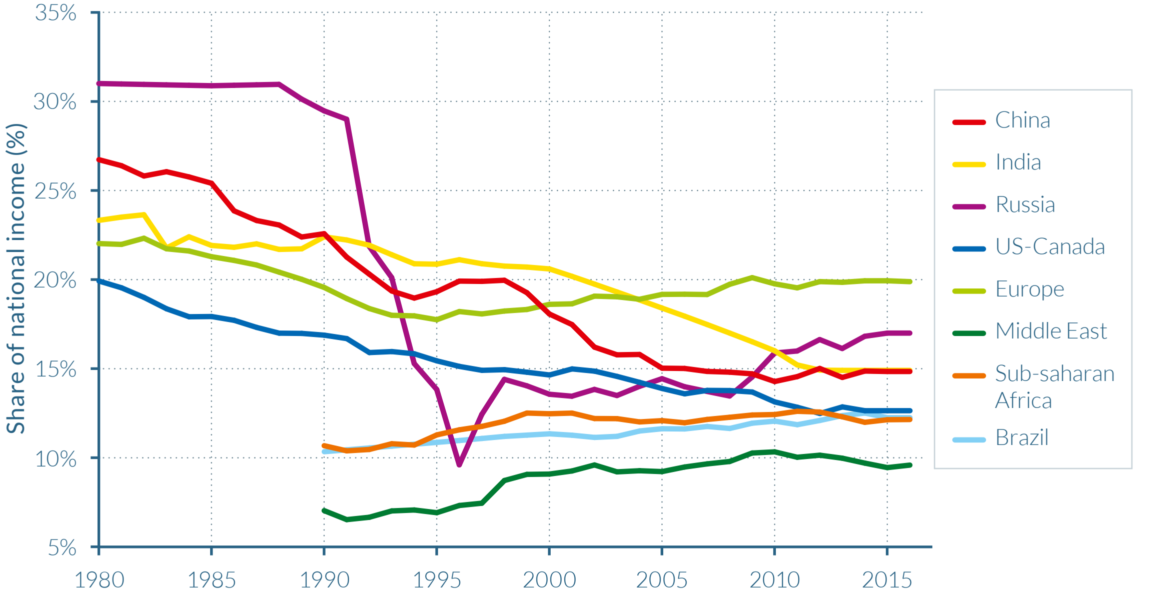
In other words, the same aggregate income level can give rise to widely different income levels for the bottom and top groups depending on the distribution of income prevailing in the specific country and time period under consideration. In brief, the distribution matters quite a bit.

What have been the growth trajectories of different income groups in these regions since 1980? **Table 2.1.1** presents income growth rates in China, Europe, India, Russia, and North America for key groups of the distribution. The full population grew at very different rates in the five regions. Real per-adult, national income growth reached an impressive 831% in China and 223% in India. In Europe, Russia, and North America, income growth was lower than 100% (40%, 34%, and 74%, respectively). Behind these heterogeneous average growth trajectories, the different regions all share a common, striking characteristic.

In all these countries, income growth is systematically higher for upper income groups. In China, the bottom 50% earners grew at less than 420% while the top 0.001% grew at more than 3 750%. The gap between the bottom 50% and the top 0.001% is even more important in India (less than 110% versus more than 3 000%). In Russia, the top of the distribution had extreme growth rates; this reflects the shift from a regime in which top incomes were constrained by the commu-

Figure 2.1.1e

Bottom 50% income shares across the world, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 12% of national income was received by the Bottom 50% in Sub-Saharan Africa.

nist system towards a market economy with few regulations constraining top incomes. In this global picture, in line with **Figure 2.1.1**, Europe stands as the region with the lowest growth gap between the bottom 50% and the full population, and with the lowest growth gap between the bottom 50% and top 0.001%.

Table 2.1.1

Global income growth and inequality, 1980–2016

	Total cumulative real growth per adult					
Income group	**China**	**Europe**	**India**	**Russia**	**US-Canada**	**World**
Full Population	831%	40%	223%	34%	63%	60%
Bottom 50%	417%	26%	107%	-26%	5%	94%
Middle 40%	785%	34%	112%	5%	44%	43%
Top 10%	1316%	58%	469%	190%	123%	70%
Top 1%	1920%	72%	857%	686%	206%	101%
Top 0.1%	2421%	76%	1295%	2562%	320%	133%
Top 0.01%	3112%	87%	2078%	8239%	452%	185%
Top 0.001%	3752%	120%	3083%	25269%	629%	235%

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

From 1980 to 2016, the average income of the Bottom 50% in China grew 417%. Income estimates are calculated using 2016 Purchasing Power Parity (PPP) euros. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

The right-hand column of table 2.1.1 presents income growth rates of different groups at the level of the entire world. These growth rates are obtained once all the individuals of the different regions are pooled together to reconstruct global income groups. Incomes across countries are compared using purchasing power parity (PPP) so that a given income can in principle buy the same bundle of goods and services in all countries. Average global growth is relatively low (60%) compared to emerging countries' growth rates. Interestingly enough, at the world level, growth rates do not rise monotonically with income groups' positions in the distribution. Instead, we observe high growth at the bottom 50% (94%), low growth in the middle 40% (43%), and high growth at the top 1% (more than 100%)—and especially at the top 0.001% (close to 235%).

To better understand the significance of these unequal rates of growth, it is useful to focus on the share of total growth captured by each group over the entire period. **Table 2.1.2** presents the share of growth per adult captured by each group. Focusing on both metrics is important because the top 1% global income group could have enjoyed a substantial growth rate of more than 100% over the past four decades (meaningful at the individual level), but still represent only a little share of total growth. The top 1% captured 35% of total growth in the US-Canada, and an astonishing 69% in Russia.

At the global level, the top 1% captured 27% of total growth—that is, twice as much as the share of growth captured by the bottom 50%. The top 0.1% captured about as much growth as the bottom half of the world population. Therefore, the income growth captured by very top global earners since 1980 was very large, even if demographically they are a very small group.

Building a global inequality distribution brick by brick

A powerful way to visualize the evolution of global income inequality dynamics is to plot the total growth rate of each income groups (see **Box 2.1.2**). This provides a more precise representation of growth dynamics than **Table 2.1.1**. To properly understand the role played by each region in global inequality dynamics, we follow a step-by-step approach to construct this global growth curve by adding one region after another and discussing each step of the exercise.

Table 2.1.2

Share of global growth captured by income groups, 1980–2016

Income group	China	Europe	India	Russia	US-Canada	World
Full Population	100%	100%	100%	100%	100%	100%
Bottom 50%	13%	14%	11%	-24%	2%	12%
Middle 40%	43%	38%	23%	7%	32%	31%
Top 10%	43%	48%	66%	117%	67%	57%
Top 1%	15%	18%	28%	69%	35%	27%
Top 0.1%	7%	7%	12%	41%	18%	13%
Top 0.01%	4%	3%	5%	20%	9%	7%
Top 0.001%	2%	1%	3%	10%	4%	4%

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

From 1980 to 2016, the Middle 40% in Europe captured 38% of total income growth in the region. Income estimates are calculated using 2016 Purchasing Power Parity (PPP) euros. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

Box 2.1.1

How did we construct global income inequality measures?

Global estimates in the *World Inequality Report* are based on a combination of sources used at the national level (including tax receipts, household surveys and national accounts as discussed in Part I). Consistent estimates of national income inequality are now available for the USA, Western Europe (and in particular France, Germany, the United Kingdom) as well as China, India, Brazil, Russia and the Middle East. These regions represent approximately two thirds of the world adult population and three quarters of global income.

In this chapter on global income inequality, we have ultimately distributed the totality of global income, to the totality of the world population. To achieve this, we had to distribute the quarter of global income to the third of the global population for which there is currently no consistent income inequality data available. One crucial information we have, however, is total national income in each country. This information is essential, as it already determines a large part of global income inequality among individuals.

How then to distribute national income to individuals in countries without inequality data? We tested different ways and found that these had very moderate impacts on the distribution of global income, given the limited share of income and population concerned by these assumptions. In the end, we assumed that countries with missing inequality information had similar levels of inequality as other countries in their region. Take an example, we know the average income level in Malaysia, but not (yet) how national income is distributed to all individuals in this country. We then assumed that the distribution of income in Malaysia was the same, and followed the same trends, as in the region formed by China and India. This is indeed an over simplification, but to some extent this is an acceptable method as alternative assumptions have a limited impact on our general conclusions.

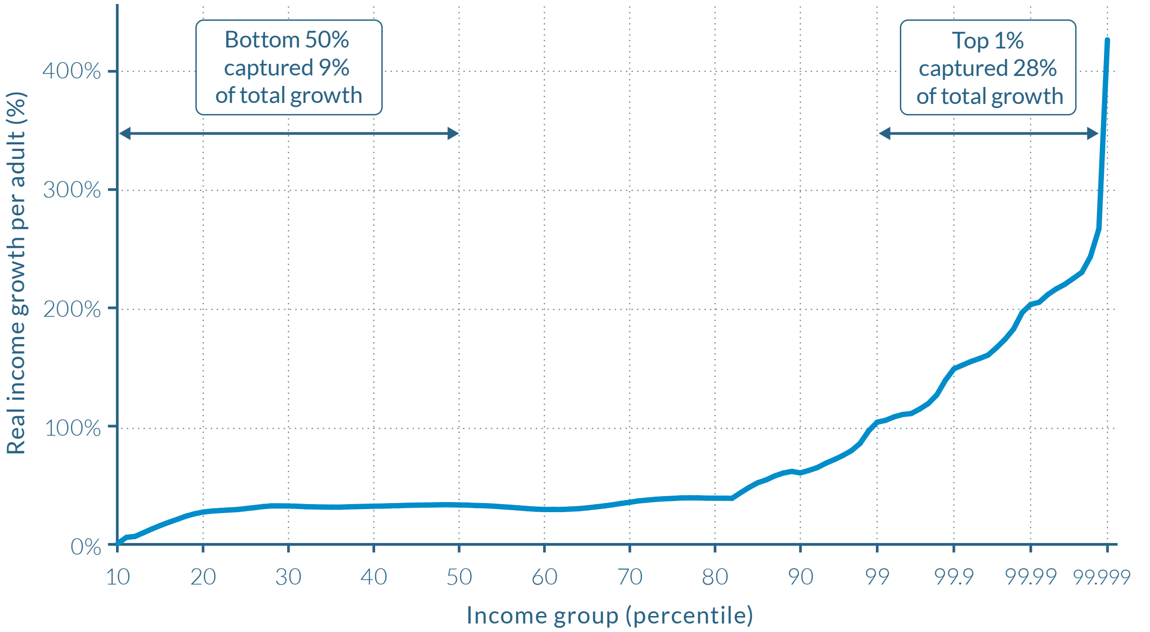
Sub-Saharan Africa is a particular case: we did not have any country with consistent income inequality data over the past decades (whereas in Asia we have consistent estimates for China and India, in Latin America, we have estimates for Brazil, etc.). For Sub-Saharan Africa, we thus relied on household surveys available from the World Bank (these estimates cover 70% of Sub-Saharan Africa's population and yet a higher proportion of the region's income). These surveys were matched with fiscal data available from WID.world so as to provide a better representation of inequality at the top of the social pyramid (see Part I).

Doing so then allowed us to produce a global distribution of income. The methodology we followed[a] is available on wir2018.wid.world, as well as all the computer codes we used, so as to allow anyone make alternative assumptions or contribute to extend this work. In future editions of the *World Inequality Report*, we will progressively expand the geographical coverage of our data.

a See L. Chancel and A. Gethin, "Building a global income distribution brick by brick", WID.world Technical Note, 2017/5 as well as L. Chancel. and L. Czajka. "Estimating the regional distribution of income in Sub-Saharan Africa". WID.world Technical Note, 2017/6.

Figure 2.1.2

Total income growth by percentile in US-Canada and Western Europe, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the world's richest 1%) growth was 104% between 1980 and 2016. The Top 1% captured 28% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

We start with the distribution of growth in a region regrouping Europe and North America (**Figure 2.1.2**). These two regions have a total of 880 million individuals in 2016 (520 million in Europe and 360 million in North America) and represent most of the population of high-income countries. In Euro-America, cumulative per-adult income growth over the 1980–2016 period was +28%, which is relatively low as compared to the global average (+66%). While the bottom 10% income group saw their income decrease over the period, all individuals between percentile 20 and percentile 80 had a growth rate close to the average growth rate. At the very top of the distribution, incomes grew very rapidly; individuals in the top 1% group saw their incomes rise by more than 100% over the time period and those in the top 0.01% and above grew at more than 200%.

How did this translate into shares of growth captured by different groups? The top 1% of earners captured 28% of total growth—that is, as much growth as the bottom 81% of the population. The bottom 50% earners captured 9% of growth, which is less than the top 0.1%, which captured 14% of total growth over the 1980–2016 period. These values, however, hide large differences in the inequality trajectories followed by Europe and North America. In the former, the top 1% captured as much growth as the bottom 51% of the population, whereas in the latter, the top 1% captured as much growth as the bottom 88% of the population. (See chapter 2.3 for more details.)

The next step is to add the population of India and China to the distribution of Euro-America. The global region now considered represents 3.5 billion individuals in total (including 1.4 billion individuals from China and 1.3 billion from India). Adding India and China remarkably modifies the shape of the global growth curve (**Figure 2.1.3**).

Box 2.1.2

Interpreting inequality graphs in this report

Total growth curves (or "growth incidence curves") shed light on the income growth rate of each income group in a given country or at the world level. The popularization of such graphs is largely due to their use by Christoph Lakner and Branko Milanovic. In this report we are able to provide novel insights on global income dynamics thanks to the new inequality series constructed in WID.world (as detailed in Part 1). In particular, we are able to decompose the top 1% of the global distribution into smaller groups and observe their relative importance in total growth. If anything, our general conclusion is that the "elephant curve" is even more marked than what was initially pointed out by Lakner and Milanovic.

How to interpret these graphs? The horizontal axis sorts global income groups in ascending order from the poorest (left-hand side) to the richest (right-hand side). The first ninety-nine brackets correspond to each of the bottom ninety-nine percentiles of the global population. Each bracket represents 1% of the global population and occupies the same length on the graph. The global top 1% group is not represented on the same scale as the bottom 99%. We split it into twenty-eight smaller groups in the following way. The group is first split into ten groups of equal size (representing each 0.1% of the population). The richest of these groups is then itself split into ten groups of equal size (each representing 0.01% of the global population). The richest of these groups is again split into ten groups of equal size. The richest group represented on the horizontal axis (group 99.999) thus corresponds to the top 0.001% richest individuals in the world. This represents 49 000 individuals in 2016.

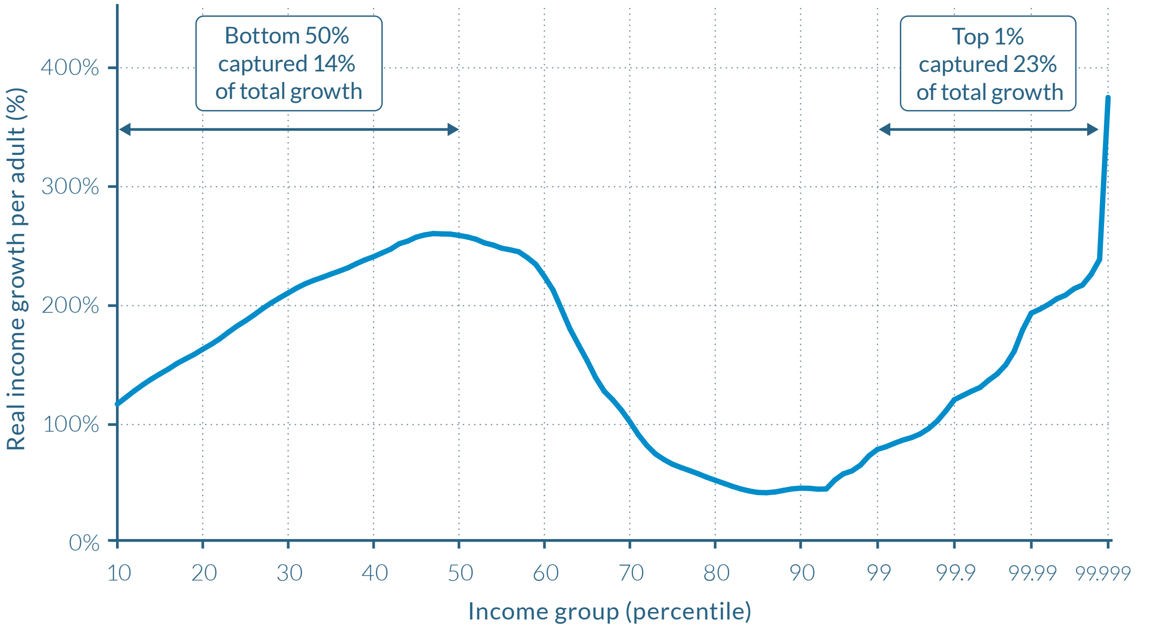
Each of these twenty-eight groups comprising the top 1% earners occupies the same space as percentiles of the bottom 99%. This is a simple way to represent clearly the importance of these groups in total income growth. The global top 1% group captured 27% of total growth from 1980 to 2016—that is, about a quarter of total growth. On the horizontal axis, this group occupies about a quarter of the scale.

There are other ways to scale percentiles on the horizontal axis. Appendices A2.1 and A2.2 show two variants. In the first, each group occupies a space that is proportional to its population size; in effect, the 28 groups decomposing the top 1% are squeezed together. In the other, each group is given a segment that is proportional to its share of total growth captured. In this case, it is the groups at the bottom of the global distribution that are squeezed. Our benchmark representation is a combination of these two variants.

The vertical axis presents the total real pre-tax income growth rate for each of the 127 groups defined above. Real income means that incomes are corrected for inflation. "Pre-tax" refers to incomes before taxes and transfers (but after the operation of the pension system). Note that the values are presented as total growth rates over the period rather than as annualized growth rates, which are perhaps somewhat more common in economic debates. Over long time spans such as the 1980–2016 period analyzed here, it is generally more meaningful to discuss total growth rates than to discuss average annual growth rates. Because of the multiplicative power of growth rates, small differences in annualized growth rates lead to large differences in total growth rates over long time spans. To illustrate this, let us take two income groups whose incomes grow at 4% and 5% over thirty-five years, respectively. The first group does not grow as fast as the second one, but the difference may seem limited. In fact, over thirty-five years, the total income growth is 295% in the first case and 452% in the second, which indeed represents a substantial difference in terms of purchasing power and standards of living.

Figure 2.1.3

Total income growth by percentile in China, India, US-Canada, and Western Europe, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the world's richest 1%), growth was 77% between 1980 and 2016. The Top 1% captured 23% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

The first half of the distribution is now marked by a "rising tide" as total income growth rates increase substantially from the bottom of the distribution to the middle. The bottom half of the population records growth rates which go as high as 260%, largely above the global average income growth of 146%. This is due to the fact that Chinese and Indians, who make up the bulk of the bottom half of this global distribution, enjoyed much higher growth rates than their European and North American counterparts. In addition, growth was also very unequally distributed in India and China, as revealed by **Table 2.1.1**.

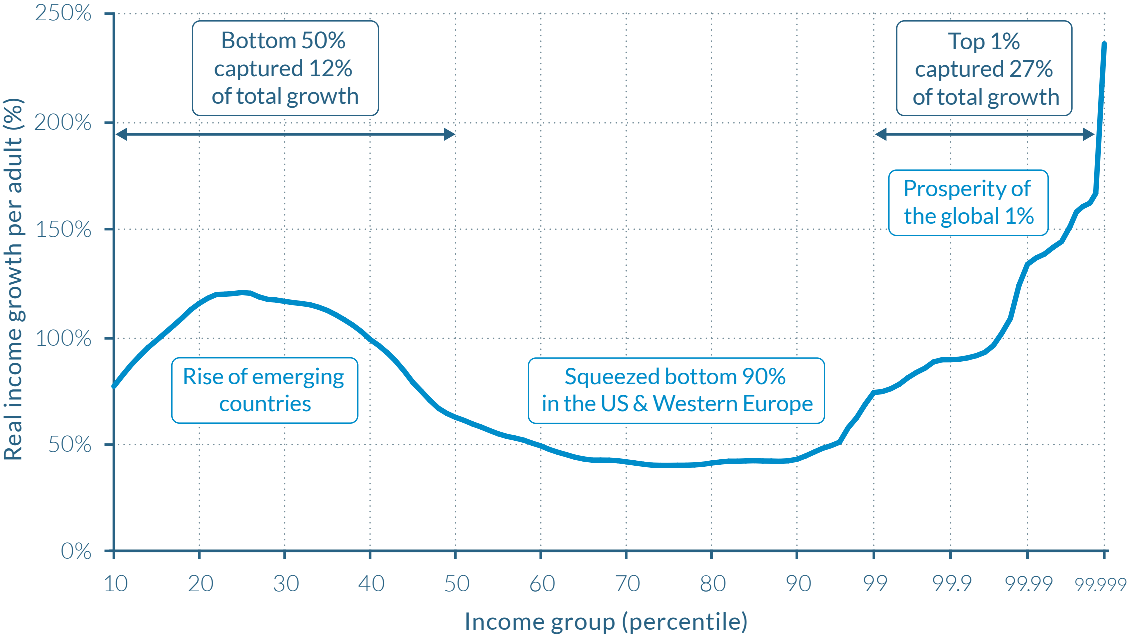
Between percentiles 70 and 99 (individuals above the poorest 70% of the population but below the richest 1%), income growth was substantially lower than the global average, reaching only 40–50%. This corresponds to the lower- and middle-income groups in rich countries which grew at a very low rates. The extreme case of these is the bottom half of the population in the United States, which grew at only 3% over the period considered. (See Chapter 2.4.)

Earlier versions of this graph have been termed "the elephant curve," as the shape of the curve resembles the silhouette of the animal. These new findings confirm and amplify earlier results.[2] In particular they make it possible to measure much more reliably the share of income growth captured at the top of the global income distribution—a figure which couldn't be properly measured before.

At the top of the global distribution, incomes grew extremely rapidly—around 200% for the top 0.01% and above 360% for the top 0.001%. Not only were these growth rates important from the perspective of individuals, they also matter a lot in terms of global

Figure 2.1.4

Total income growth by percentile across all world regions, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for more details.

On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the world's richest 1%), growth was 74% between 1980 and 2016. The Top 1% captured 27% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

growth. The top 1% captured 23% of total growth over the period—that is, as much as the bottom 61% of the population. Such figures help make sense of the very high growth rates enjoyed by Indians and Chinese sitting at the bottom of the distribution. Whereas growth rates were substantial among the global bottom 50%, this group captured only 14% of total growth, just slightly more than the global top 0.1%—which captured 12% of total growth. Such a small share of total growth captured by the bottom half of the population is partly due to the fact that when individuals are very poor, their incomes can double or triple but still remain relatively small—so that the total increase in their incomes does not necessarily add up at the global level. But this is not the only explanation. Incomes at the very top must also be extraordinarily high to dwarf the growth captured by the bottom half of the world population.

The next step of the exercise consists of adding the populations and incomes of Russia (140 million), Brazil (210 million), and the Middle East (410 million) to the analysis. These additional groups bring the total population now considered to more than 4.3 billion individuals—that is, close to 60% of the world total population and two thirds of the world adult population. The global growth curve presented in Appendix Figure A2.3 is similar to the previous one except that the "body of the elephant" is now shorter. This can be explained by the fact that Russia, the Middle East, and Brazil are three regions which recorded low growth rates over the period considered. Adding the population of the three regions also slightly shifts the "body of the elephant" to the left, since a large share of the population of the countries incorporated in the analysis is neither very poor nor very rich from a global point of view and thus falls in the middle of the distribution. In this synthetic global region, the top 1%

earners captured 26% of total growth over the 1980–2016 period—that is, as much as the bottom 65% of the population. The bottom 50% captured 15% of total growth, more than the top 0.1%, which captured 12% of growth.

The final step consists of including all remaining global regions—namely, Africa (close to 1 billion individuals), the rest of Asia (another billion individuals), and the rest of Latin America (close to half a billion). In order to reconstruct income inequality dynamics in these regions, we take into account between-country inequality, for which information is available, and assume that within countries, growth is distributed in the same way as neighboring countries for which we have specific information (see **Box 2.1.1**). This allows us to distribute the totality of global income growth over the period considered to the global population.

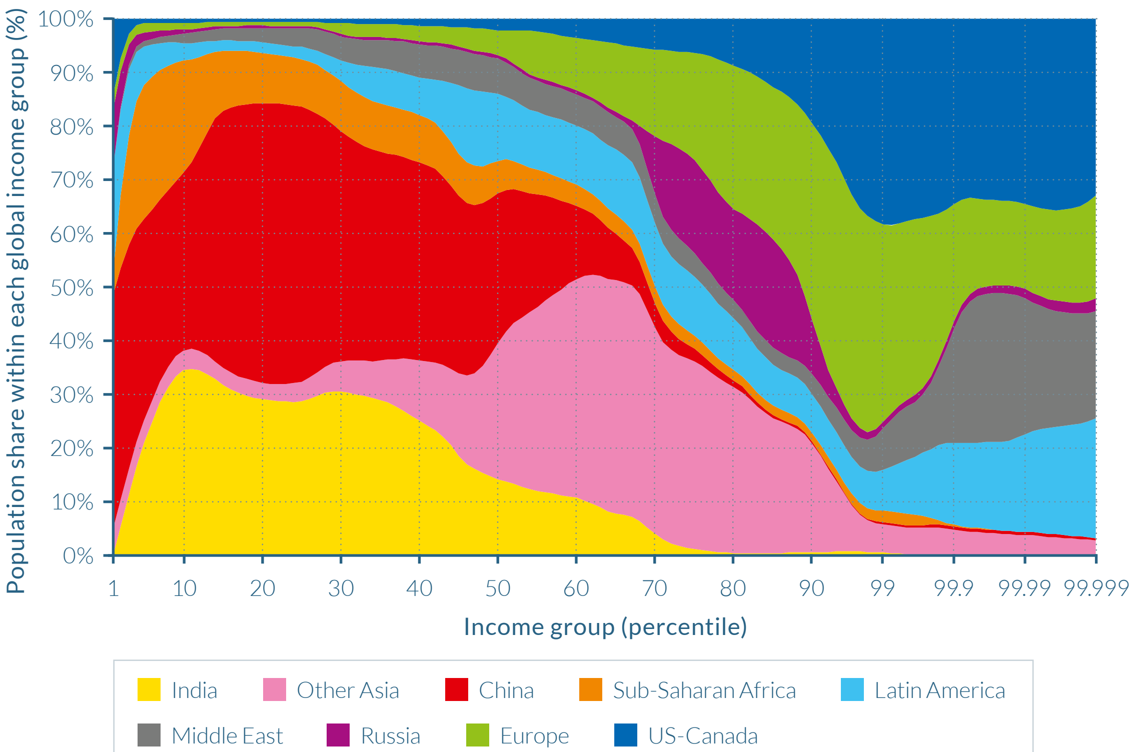
When all countries are taken into account, the shape of the curve is again transformed (**Figure 2.1.4**). Now, average global income growth rates are further reduced because Africa and Latin America had relatively low growth over the period considered. This contributes to increasing global inequality as compared to the two cases presented above. The findings are the same as those presented in the right-hand column of **Table 2.1.2**: the top 1% income earners captured 27% of total growth over the 1980–2016 period, as much as the bottom 70% of the population. The top 0.1% captured 13% of total growth, about as much as the bottom 50%.

The geography of global income inequality was transformed over the past decades

What is the share of African, Asians, Americans, and Europeans in each global income

Figure 2.1.5

Geographic breakdown of global income groups in 1990



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

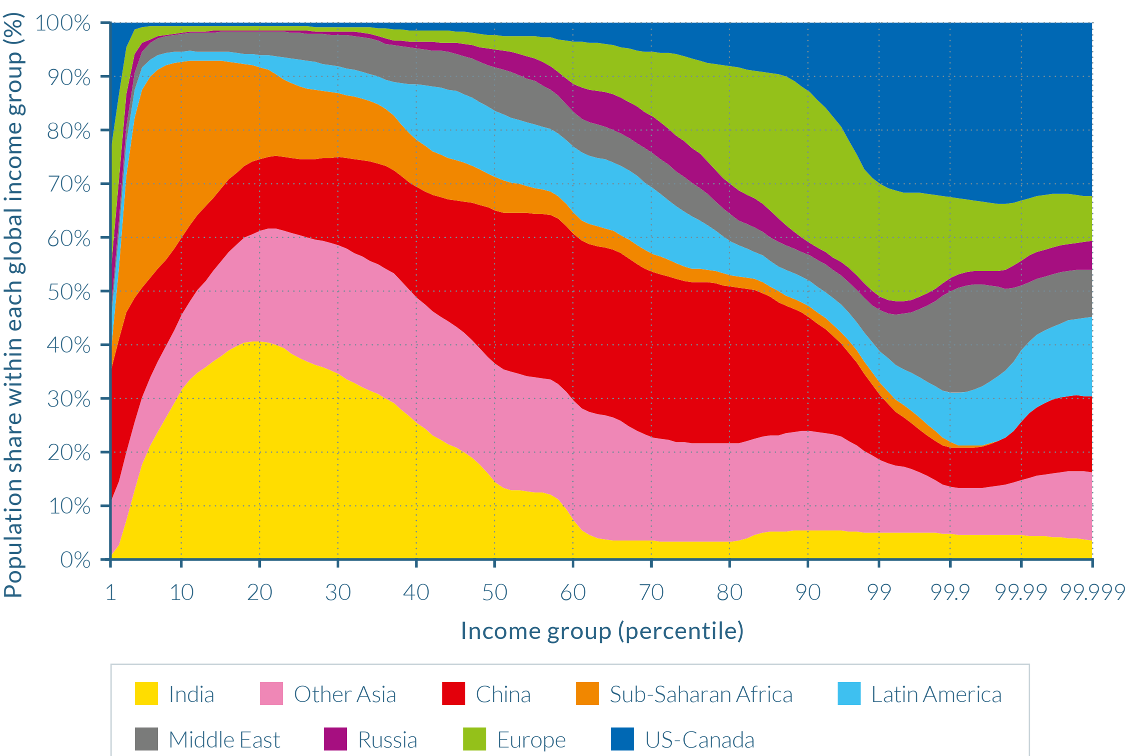
In 1990, 33% of the population of the world's Top 0.001% income group were residents of the US and Canada.

groups and how has this evolved over time? **Figures 2.1.5 and 2.1.6** answer these questions by showing the geographical composition of each income group in 1990 and in 2016. Between 1980 and 1990, the geographic repartition of global incomes evolved only slightly, and our data allow for more precise geographic repartition in 1990, so it is preferable to focus on this year. In a similar way to how Figures 2.1.2 through 2.1.4 decomposed the data, Figures 2.1.5 and 2.1.6 decompose the top 1% into 28 groups (see **Box 2.1.1**). To be clear, all groups above percentile 99 are the decomposition of the richest 1% of the global population.

In 1990, Asians were almost not represented within top global income groups. Indeed, the bulk of the population of India and China are found in the bottom half of the income distribution. At the other end of the global income ladder, US-Canada is the largest contributor to global top-income earners. Europe is largely represented in the upper half of the global distribution, but less so among the very top groups. The Middle East and Latin American elites are disproportionately represented among the very top global groups, as they both make up about 20% each of the population of the top 0.001% earners. It should be noted that this overrepresentation only holds within the top 1% global earners: in the next richest 1% group (percentile group p98p99), their share falls to 9% and 4%, respectively. This indeed reflects the extreme level of inequality of these regions, as discussed in chapters 2.10 and 2.11. Interestingly, Russia is concentrated between percentile 70 and percentile 90, and Russians did not make it into the very top groups. In 1990, the Soviet system compressed income distribution in Russia.

Figure 2.1.6

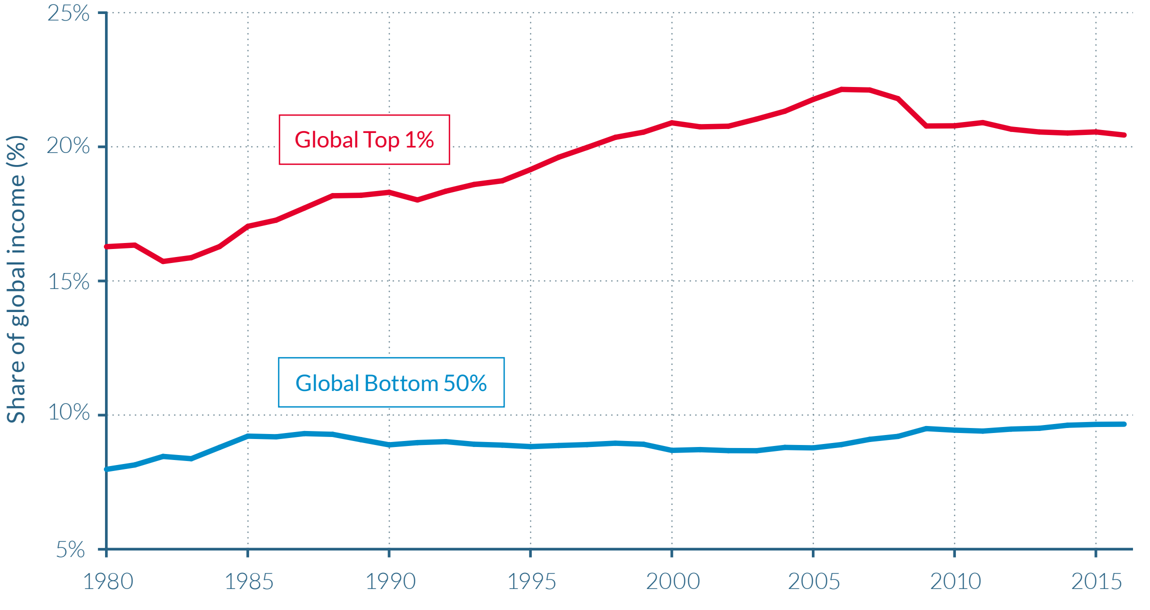
Geographic breakdown of global income groups in 2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 5% of the population of the world's Top 0.001% income group were residents of Russia.

Figure 2.1.7
Global Bottom 50% and Top 1% income shares, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 22% of global income was received by the Top 1% against 10% for the Bottom 50%. In 1980, 16% of global income was received by the Top 1% against 8% for the Bottom 50%.

In 2016, the situation is notably different. The most striking evolution is perhaps the spread of Chinese income earners, which are now located throughout the entire global distribution. India remains largely represented at the bottom with only very few Indians among the top global earners.

The position of Russian earners was also stretched throughout from the poorest to the richest income groups. This illustrates the impact of the end of communism on the spread of Russian incomes. Africans, who were present throughout the first half of the distribution, are now even more concentrated in the bottom quarter, due to relatively low growth as compared to Asian countries. At the top of the distribution, while the shares of both North America and Europe decreased (leaving room for their Asian counterparts), the share of Europeans was reduced much more. This is because most large European countries followed a more equitable growth trajectory over the past decades than the United States and other countries, as will be discussed in chapter 2.3.

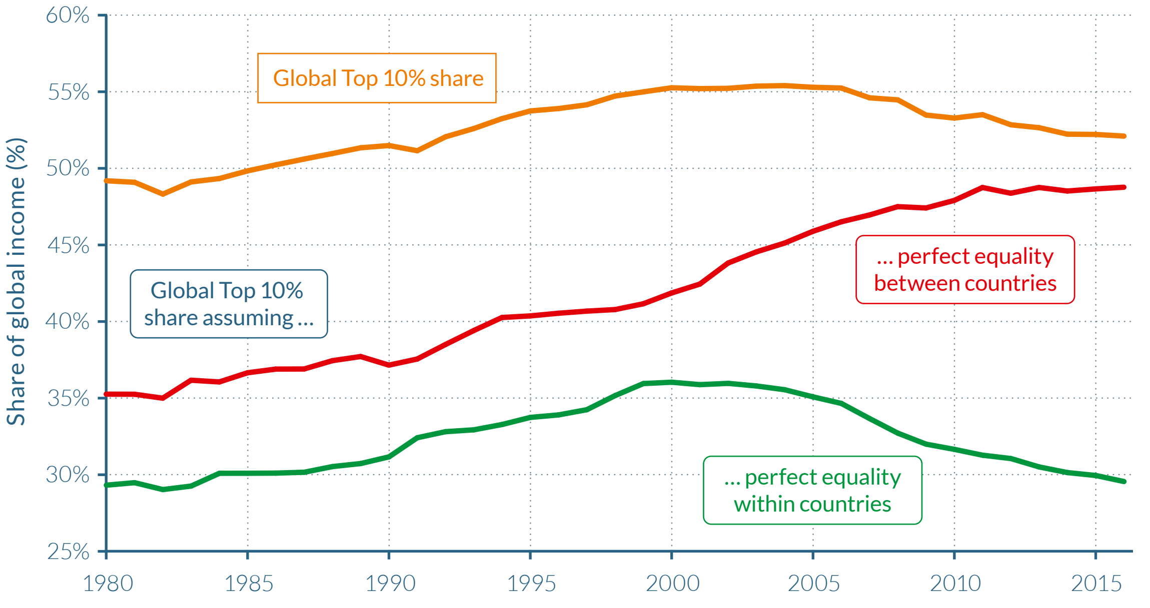
Since 2000, the picture is more nuanced but within-country inequality is on the rise

How did global inequality evolve between 1980 and 2016? **Figure 2.1.7** answers this question by presenting the share of world income held by the global top 1% and the global bottom 50%, measured at purchasing power parity. The global top 1% income share rose from about 16% of global income in 1980 to more than 22% in 2007 at the eve of the global financial crisis. It was then slightly reduced to 20.4% in 2016, but this slight decrease hardly brought back the level of global inequality to its 1980 level. The income share of bottom half of the world population oscillated around 9% with a very slight increase between 1985 and 2016.

The first insight of this graph is the extreme

Figure 2.1.8

Global Top 10% income share, 1980–2016: between versus within country inequality



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2010, 53% of the world's income was received by the Top 10%. Assuming perfect equality in average income between countries, the Top 10% would have received 48% of global income.

level of global inequality sustained throughout the entire period with a top 1% income group capturing two times the total income captured by the bottom 50% of the population—implying a factor 100 difference in average per-adult income levels. Second, it is apparent that high growth in emerging countries since 2000, in particular in China, or the global financial crisis of 2008 was not sufficient to stop the rise in global income inequality.

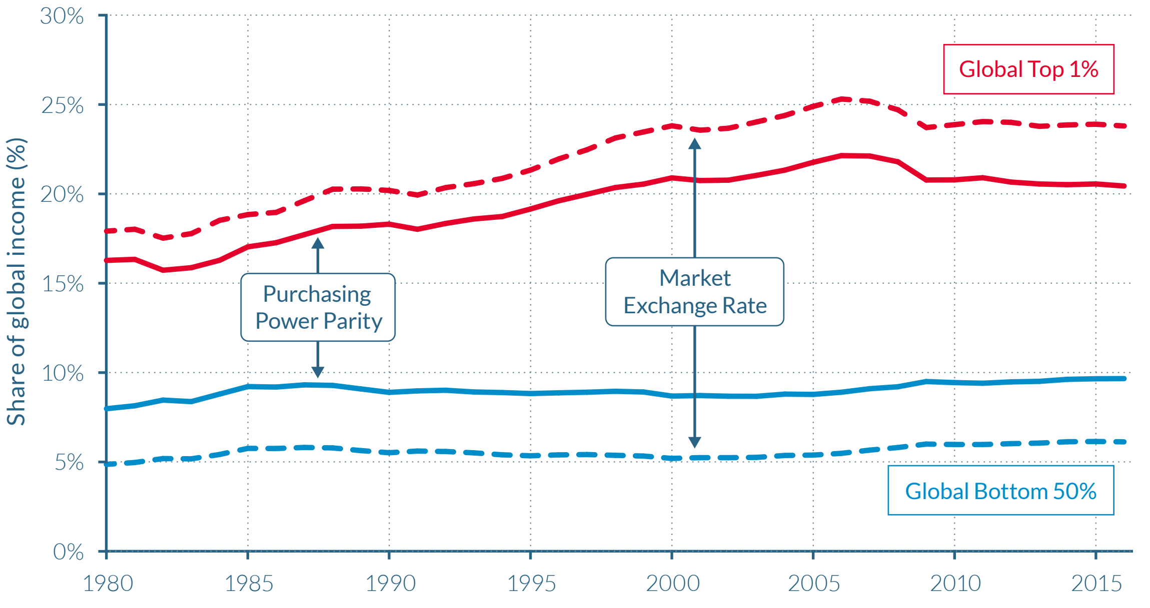
When global inequality is decomposed into a between- and within-country inequality component, it is apparent that within-country inequality continued to rise since 2000 whereas between-country inequality rose up to 2000 and decreased afterwards. **Figure 2.1.8** presents the evolution of the global 10% income share, which reached close to 50% of global income in 1980, rose to 55% in 2000–2007, and decreased to slightly more than 52% in 2016. Two alternative scenarios for the evolution of the global top 10% share are presented. The first one assumes that all countries had exactly the same average income (that is, that there was no between-country inequality), but that income was as unequal within these countries as was actually observed. In this case, the top 10% share would have risen from 35% in 1980 to nearly 50% today. In the second scenario, it is assumed that between-country inequality evolved as observed but it is also assumed that everybody within countries had exactly the same income level (no within-country inequality). In this case, the global top 10% income share would have risen from nearly 30% in 1980 to more than 35% in 2000 before decreasing back to 30%.

Measured at market exchange rate, global inequality is even higher

Prices can be converted from one currency to another using either market exchange rates or purchasing power parities (as we did above). Market exchanges rates are the prices at which people are willing to buy and sell

Figure 2.1.9

Bottom 50% and Top 1% shares of global income, 1980-2016: PPP versus market exchange rates



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2010, the Top 1% received 24% of global income when measured using Market Exchange Rates (MER). When measured using Purchasing Power Parity (PPP), their share was 21%. Thick lines are measured at PPP values, dashed lines at MER values. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

currencies, so at first glance they should reflect people's relative purchasing power. This makes them a natural conversion factor between currencies. The problem is that market exchange rates reflect only the relative purchasing power of money in terms of tradable goods. But non-tradable goods (typically services) are in fact cheaper relative to tradable ones in emerging economies (given the so-called Balassa-Samuelson effect). Therefore, market exchange rates will underestimate the standard of living in the poorer countries. In addition, market exchange rates can vary for all sorts of other reasons—sometimes purely financial and/or political—in a fairly chaotic manner. Purchasing power parity is an alternative conversion factor that addresses these problems (based on observed prices in the various countries). The level of global income inequality is therefore substantially higher when measured using market exchange rates than it is with purchasing power parity. It increases the global top 1% share in 2016 from 20% to 24% and reduces the bottom 50% share from nearly 10% to 6% (**Figure 2.1.9**).

Purchasing power parity definitely gives a more accurate picture of global inequality from the point of view of individuals who do not travel across the world and who essentially spend their incomes in their own countries. Market exchange rates are perhaps better to inform about inequality in a world where individuals can easily spend their incomes where they want, which is the case for top global earners and tourists, and increasingly the case for anyone connected to the internet. It is also the case for migrant workers wishing to send remittances back to their home countries. Both purchasing power parity and market exchange rates are valid measures to track global income inequality, depending on the object of study or which countries are compared to one another.

In this report, we generally use purchasing power parity for international comparisons, but at times, market exchange rates are also used to illustrate other meaningful aspects of international inequality.

Carefully looking at countries' diverse growth trajectories and policy changes is necessary to understand drivers of national and global inequality

The past forty years were marked by a steep rise of global inequality, and growth in emerging countries was not high enough to counterbalance it. Whether future growth in emerging countries might invert the trend or not is a key question, which will be addressed in Part V of this report. Before turning to that question, one should understand better the drivers of the trends observed since 1980.

Given that this period was marked by increasing trade integration between countries, it might seem reasonable to seek explanations in economic trade models. The standard economic models of international trade, however, fail to account for dynamics of inequality observed over the past four decades. Take Heckscher-Ohlin, the most well-known of the two-skill-groups economic trade models. According to it, trade liberalization should increase inequality in rich countries, but reduce it in low-income countries.

How does the model reach this conclusion? The underlying mechanism is fairly simple. It is built around the fact that there are more high-skilled workers (such as aeronautical engineers) in the United States than in China, and more low-skilled workers (such as textile workers) in China than in the United States. Before trade liberalization started between these two countries, aeronautical engineers were relatively scarce in China and thus enjoyed relatively high pay compared to textile workers which were abundant. Conversely, in the United States, low-skilled earners were relatively scarce at the time, and the income differential between engineers and textile workers was limited.

When the United States and China started to trade, each country specialized in the domain for which they had the most workers, in relative terms. China thus specialized in textiles, so that textile workers were in higher demand and saw their wages increase, while aeronautical engineers came to be in lower demand and saw their wages decrease. Conversely, the United States specialized in aircraft building, so the aeronautical engineers saw their wages increase, while the textile workers saw their wages decrease. By virtue of the factor price equalization theorem, the wages of low-skilled workers in China and the United States started to converge, along with the wages of high-skilled workers.

While inequality did rise in the United States, as this model predicts, it also sharply rose in China, as well as in India and Russia, as seen in **Figure 2.1.1a**—contrary to the model's predictions. Regardless of whether the Heckscher-Ohlin is otherwise valid or not, it cannot account for the evolution of global inequality. How can we account for these empirical findings? As **Table 2.1.1** suggests, countries followed very different growth and inequality trajectories over the past decades. It seems necessary to carefully look at these trajectories as well as the institutional and policy shifts which may have occurred in various regions of the world over the past forty years.

Understanding the drivers of global income inequality requires a thorough analysis of the distribution of national income growth within countries. These dynamics are explored in the following chapters.

2.2

TRENDS IN INCOME INEQUALITY BETWEEN COUNTRIES

Information in this chapter is based on "National Accounts Series Methodology," by Thomas Blanchet and Lucas Chancel, 2016. WID.world Working Paper Series (No. 2016/1), and on subsequent WID.world updates.

▷ When focusing on income inequalities between countries, it is more meaningful to compare national incomes than gross domestic product (GDP). National income takes into account depreciation of obsolete machines and other capital assets as well as flows of foreign income.

▷ At the global level, average per-adult national income is €1 340 per month. North Americans enjoy an income three times higher, while Europeans have an income two times higher. Average per-adult income in China is slightly lower than the global average. As a country, however, China represents a higher share of global income than North America or Europe (19%, 17%, and 17%, respectively).

▷ This situation sharply contrasts with that of 1980, when China represented only 3% of total global income. Over this period, strong converging forces were in play which reduced global income inequality between countries. While growth slowed in Western Europe, it skyrocketed in Asia and China in particular, following the modernization of its economy and its opening to global markets.

▷ However, diverging forces were also in play in other parts of the world. From 1980 to now, average incomes in sub-Saharan Africa and South America fell behind the world average.

National income is more meaningful than GDP to compare income inequalities between countries

Public debates generally focus on the growth of gross domestic product (GDP) to compare countries' economic performance. However, this measure is of only limited use in measuring national welfare. GDP measures the value of all goods and services sold in an economy, after having subtracted the costs of materials or services incurred in production processes. As such, it does not properly account for capital depreciation, or for public "bads" such as environmental degradation, rising crime, or illnesses (because these lead to expenditures that contribute to GDP). These limitations have led many statistical agencies, and a growing number of governments, to develop and use complementary indicators of economic performance and well-being.[3]

Beyond the fact that the GDP framework is not meant for the analysis of inequality within countries, it has two other important limitations when the focus is on income inequality between countries. The first one is that gross domestic product, as its name indicates, is a gross measure: it does not take into account expenses required to replace capital that has been deteriorated or that has become obsolete during the course of production of goods and services in an economy. Machines, computers, roads, and electric systems have to be repaired or replaced every year. This has been termed capital depreciation or consumption of fixed capital (CFC). Subtracting it from GDP yields the net domestic product, which is a more accurate measure of true economic output than GDP. Consumption of fixed capital actually varies over time and countries (**Table 2.2.1**). Countries that have an important stock of machines in their overall stock of capital tend to replace higher shares of overall capital. This is generally true for advanced and automatized economies—in particular, for Japan, where consumption of fixed capital is equal to 21% of its GDP (which reduces GDP by close to €8 000 per year and per adult). Consumption of fixed capital is also high in the European Union and the United States (16–17%). On the contrary, economies that possess relatively fewer machines and a higher share of agricultural land in their capital stock tend to have lower CFC values. CFC is equal to 11% of GDP in India, and 12% in Latin America. CFC variations thus modify the levels of global inequality between countries. Such variations tend to reduce global inequality, since the income dedicated to replacing obsolete machines tends to be higher in rich countries than in low-income countries. In the future, we plan to better account for the depreciation of natural capital in these estimates.

GDP figures have another important limitation when the need is to compare income inequality between countries and over time. At the global level, net domestic product is equal to net domestic income: by definition, the market value of global production is equal to global income. At the national level, however, incomes generated by the sale of goods and services in a given country do not necessarily remain in that country. This is the case when factories are owned by foreign individuals, for instance. Taking foreign incomes into account tends to increase global inequality between countries rather than reduce it. Rich countries generally own more assets in other parts of the world than poor countries do. **Table 2.2.1** shows that net foreign income in North America amounts to 0.9% of its GDP (which corresponds to an extra €610 ($670) received by the average North American adult from the rest of the world.[4] Meanwhile, Japan's net foreign income is equal to 3.5% of its GDP (corresponding to €1 460 per year and per adult). Net foreign income within the European Union is slightly negative when measured at PPP values (**Table 2.2.1**) and very slightly positive when measured at market exchange rate values (**Table 2.2.2**). This figure in fact hides strong disparities within the European Union. France and Germany have strongly positive net foreign income (2 to 3% of their GDP), while Ireland and the United Kingdom have negative net foreign incomes (this is

Table 2.2.1

The distribution of world national income and gross domestic product, 2016: Purchasing Power Parity

	Population *(million)*				**GDP** *(trillion 2016 € PPP)*	**CFC** *(% of GDP)*	**NFI** *(% of GDP)*	**National Income** *(trillion 2016 € PPP)*		**Per adult National Income** *(2016 € PPP)*	**Equivalent per adult monthly income** *(2016 € PPP)*
	Total		**Adult**								
World	7 372	**100%**	4 867	**100%**	92	14%	-0.5%	78	**100%**	16 100	1 340
Europe	747	**10%**	593	**12%**	19	15%	-0.6%	16	**20%**	27 100	2 260
incl. European Union	523	**7%**	417	**9%**	16	17%	-0.2%	13	**17%**	31 400	2 620
incl. Russia/ Ukraine	223	**3%**	176	**4%**	3	9%	-2.5%	3	**4%**	16 800	1 400
America	962	**13%**	661	**14%**	23	15%	-0.2%	19	**25%**	29 500	2 460
incl. United States/Canada	360	**5%**	263	**5%**	16	16%	0.9%	13	**17%**	50 700	4 230
incl. Latin America	602	**8%**	398	**8%**	7	12%	-2.5%	6	**8%**	15 400	1 280
Africa	1 214	**16%**	592	**12%**	4	10%	-2.1%	4	**5%**	6 600	550
incl. North Africa	240	**3%**	140	**3%**	2	9%	-1.7%	2	**2%**	11 400	950
incl. Sub-Saharan Africa	974	**13%**	452	**9%**	3	11%	-2.3%	2	**3%**	5 100	430
Asia	4 410	**60%**	2 994	**62%**	44	14%	-0.4%	38	**49%**	12 700	1 060
incl. China	1 382	**19%**	1 067	**22%**	18	14%	-0.7%	15	**19%**	14 000	1 170
incl. India	1 327	**18%**	826	**17%**	7	11%	-1.2%	6	**7%**	7 000	580
incl. Japan	126	**2%**	105	**2%**	4	21%	3.5%	3	**4%**	31 000	2 580
incl. Other	1 575	**21%**	995	**20%**	16	13%	-0.7%	14	**18%**	14 200	1 180
Oceania	39	**1%**	27	**1%**	1	16%	-1.5%	1	**1%**	31 700	2 640
incl. Australia and NZ	29	**0.4%**	21	**0.4%**	1	16%	-1.5%	1	**1%**	38 200	3 180
incl. Other	10	**0.1%**	5	**0.1%**	0.03	7%	-2.4%	0.03	**0%**	5 600	470

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, Europe represented 20% of world income measured using Purchasing Power Parity. Europe also represented 12% of the world's adult population and 10% of the world's total population. GDP: Gross Domestic Product. CFC: Consumption of Fixed Capital. NFI: Net Foreign Income. PPP: Purchasing Power Parity. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ¥4.4. PPP accounts for differences in the cost of living between countries. Values are net of inflation. Numbers may not add up due to rounding.

largely due to the financial services and foreign companies established there). On the other hand, Latin America annually pays 2.4% of its GDP to the rest of the world. Interestingly, China has a negative net foreign income. It pays close to 0.7% of its GDP to foreign countries, reflecting the fact that the return it receives on its foreign portfolio is lower than the return received by foreign investments in China.

By definition, at the global level, net foreign income should equal zero: what is paid by some countries must be received by others. However, up to now, international statistical institutions have been unable to report flows of net foreign incomes consistently. At the global level, the sum of reported net foreign incomes has not been zero. This has been termed the "missing income" problem: a share of total income vanishes from global economic statistics, implying non-zero net foreign income at the global level.

The *World Inequality Report 2018* relies on a novel methodology which takes income flows from tax havens into account. Our methodology relies on estimations of offshore wealth measured by Gabriel Zucman.[5] It should be noted that, when measured at market exchange rates, net foreign income flows should sum to zero (**Table 2.2.2**), but there is no reason for this to happen when incomes are measured at purchasing power parity (**Table 2.2.1**). Taking into account missing net foreign incomes does not radically change global inequality figures but can make a large difference for particular countries. This constitutes a more realistic representation of income inequality between countries than figures generally discussed.

Asian growth contributed to reduce inequality between countries over the past decades

At the global level, per-adult monthly income in 2016 is €1 340 ($1 740) at purchasing power parity (PPP) and €990 ($1 090) at market exchange rate (MER). As discussed, PPP and MER are different ways to measure incomes and inequality across countries. Whereas MER reflects market prices, PPP aims to take price differences between countries into account.

National income is about three times higher in North America at PPP (€4 220 or $5 490 per adult per month) than the global average and it is two times higher in the European Union at PPP than the global average (€2 630 or $3 420 per adult per month). Using MER values, gaps between rich countries and the global average are reinforced: United States and Canada are five times richer than the world average whereas the EU is close to three times richer.[6] In China, per-adult income is €1 170 or $1 520 at PPP—that is, slightly lower than world average (€1 340 or $1 740). China as a whole represents 19% of today's global income. This figure is higher than North America (17%) and the European Union (17%). Measured at MER, the Chinese average is, however, equal to €700 or $770, notably lower than the world average (€990 or $1 090). The Chinese share of global income is reduced to 15% versus 27% for US-Canada and 23% for the EU.

This marks a sharp contrast with the situation in 1980. Thirty-eight years ago, China represented only 3% of global income versus 20% for US-Canada and 28% for the European Union (at purchasing power parity estimates: see **Table 2.2.3**). Indeed, China's impressive real per-adult national income growth rate over the period (831% from 1980 to 2016, versus 106% from 1950 to 1980: see **Table 2.2.4**) highly contributed to reducing between-country inequalities over the world. Another converging force lies in the reduction of income growth rates in Western Europe, as compared to the previous decades (180% per-adult growth between 1950 and 1980 versus 45% afterwards). This deceleration in growth rates was due to the end of the "golden age" of growth in Western Europe but also due to the Great Recession, which led to a decade of lost growth in Europe. Indeed, per-adult income in Western Europe was in

Table 2.2.2

The distribution of world national income and gross domestic product, 2016: Market Exchange Rates

	Population *(million)*				GDP *(trillion 2016 € MER)*	CFC *(% of GDP)*	NFI *(% of GDP)*	National Income *(trillion 2016 € MER)*		Per adult National Income *(2016 € MER)*	Equivalent per adult monthly income *(2016 € MER)*
	Total		Adult								
World	7 372	**100%**	4 867	**100%**	68	15%	0%	58	**100%**	11 800	980
Europe	747	**10%**	593	**12%**	17	16%	-0.2%	14	**24%**	23 800	1 980
incl. European Union	523	**7%**	417	**9%**	16	17%	0.04%	13	**23%**	31 100	2 590
incl. Russia/Ukraine	223	**3%**	176	**4%**	1	9%	-2.5%	1	**2%**	6 500	540
America	962	**13%**	661	**14%**	23	15%	0.2%	19	**34%**	29 400	2 450
incl. United States/Canada	360	**5%**	263	**5%**	18	16%	0.9%	16	**27%**	59 500	4 960
incl. Latin America	602	**8%**	398	**8%**	4	12%	-2.4%	4	**7%**	9 600	800
Africa	1 214	**16%**	592	**12%**	2	10%	-2.0%	2	**3%**	2 900	240
incl. North Africa	240	**3%**	140	**3%**	1	9%	-1.5%	1	**1%**	4 300	360
incl. Sub-Saharan Africa	974	**13%**	452	**9%**	1	11%	-2.2%	1	**2%**	2 500	210
Asia	4 410	**60%**	2 994	**62%**	25	15%	0.1%	21	**37%**	7 100	590
incl. China	1 382	**19%**	1 067	**22%**	10	14%	-0.7%	9	**15%**	8 300	690
incl. India	1 327	**18%**	826	**17%**	2	11%	-1.2%	2	**3%**	2 200	180
incl. Japan	126	**2%**	105	**2%**	4	23%	3.5%	4	**6%**	34 400	2 870
incl. Other	1 575	**21%**	995	**20%**	8	14%	-0.5%	7	**12%**	7 000	580
Oceania	39	**1%**	27	**1%**	1	18%	-1.9%	1	**2%**	38 800	3 230
incl. Australia and NZ	29	**0.4%**	21	**0.4%**	1	18%	-1.9%	1	**2%**	47 500	3 960
incl. Other	10	**0.1%**	5	**0.1%**	0.03	7%	-2.4%	0.02	**0%**	4 300	360

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, Europe represented 24% of world income measured using Market Exchange Rates. Europe also represented 12% of the world's adult population and 10% of the world's total population. GDP: Gross Domestic Product. CFC: Consumption of Fixed Capital. NFI: Net Foreign Income. MER: Market Exchange Rate. All values have been converted into 2016 Market Exchange Rate euros at a rate of €1 = $1.1 = ¥7.3. Figures take into account inflation. Numbers may not add up due to rounding.

Table 2.2.3

The distribution of world national income and gross domestic product, 1980: Purchasing Power Parity

	Population *(million)*				**GDP** *(trillion € PPP 2016)*	**CFC** *(% of GDP)*	**NFI** *(% of GDP)*	**National Income** *(trillion 2016 € PPP)*		**Per adult National Income** *(2016 € PPP)*	**Equivalent per adult monthly income** *(2016 € PPP)*
	Total		**Adult**								
World	4 389	**100%**	2 400	**100%**	28	13%	-0.2%	25	**100%**	10 500	880
Europe	673	**15%**	470	**20%**	11	14%	-0.1%	9	**37%**	20 000	1 670
incl. European Union	469	**11%**	328	**14%**	8	14%	-0.2%	7	**28%**	21 600	1 800
incl. Russia/ Ukraine	204	**5%**	142	**6%**	3	17%	0.0%	2	**9%**	16 200	1 350
America	598	**14%**	343	**14%**	9	14%	-0.4%	7	**30%**	21 700	1 810
incl. United States/Canada	252	**6%**	172	**7%**	6	15%	0.9%	5	**20%**	29 600	2 470
incl. Latin America	346	**8%**	172	**7%**	3	11%	-3.0%	2	**9%**	13 800	1 150
Africa	477	**11%**	215	**9%**	1.3	10%	-1.9%	1	**5%**	5 500	460
incl. North Africa	111	**3%**	51	**2%**	0.5	10%	-2.1%	0.5	**2%**	9 200	770
incl. Sub-Saharan Africa	365	**8%**	163	**7%**	0.8	10%	-1.8%	1	**3%**	4 332	360
Asia	2 619	**60%**	1 359	**57%**	7.1	12%	0.2%	7	**27%**	5 000	420
incl. China	987	**22%**	532	**22%**	0.9	11%	0.0%	1	**3%**	1 500	130
incl. India	697	**16%**	351	**15%**	0.8	7%	0.6%	1	**3%**	2 200	180
incl. Japan	117	**3%**	81	**3%**	1.9	17%	0.0%	2	**6%**	19 900	1 660
incl. Other	817	**19%**	394	**16%**	3.4	10%	0.4%	4	**15%**	9 300	780
Oceania	22	**1%**	14	**1%**	0.4	15%	-1.6%	0.3	**1%**	21 300	1 780
incl. Australia and NZ	18	**0.4%**	12	**0.5%**	0.3	16%	-1.5%	0.3	**1%**	24 200	2 020
incl. Other	5	**0.1%**	2	**0.1%**	0.0	7%	-4.2%	0.0	**0%**	4 400	370

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 1980, Europe represented 37% of world income measured using Purchasing Power Parity. Europe also represented 20% of the world's adult population and 15% of the world's total population. GDP: Gross Domestic Product. CFC: Consumption of Fixed Capital. NFI: Net Foreign Income. PPP: Purchasing Power Parity. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ¥4.4. PPP accounts for differences in the cost of living between countries. Values are net of inflation. Numbers may not add up due to rounding.

Table 2.2.4

Total national income growth rates by world region, 1950–2016

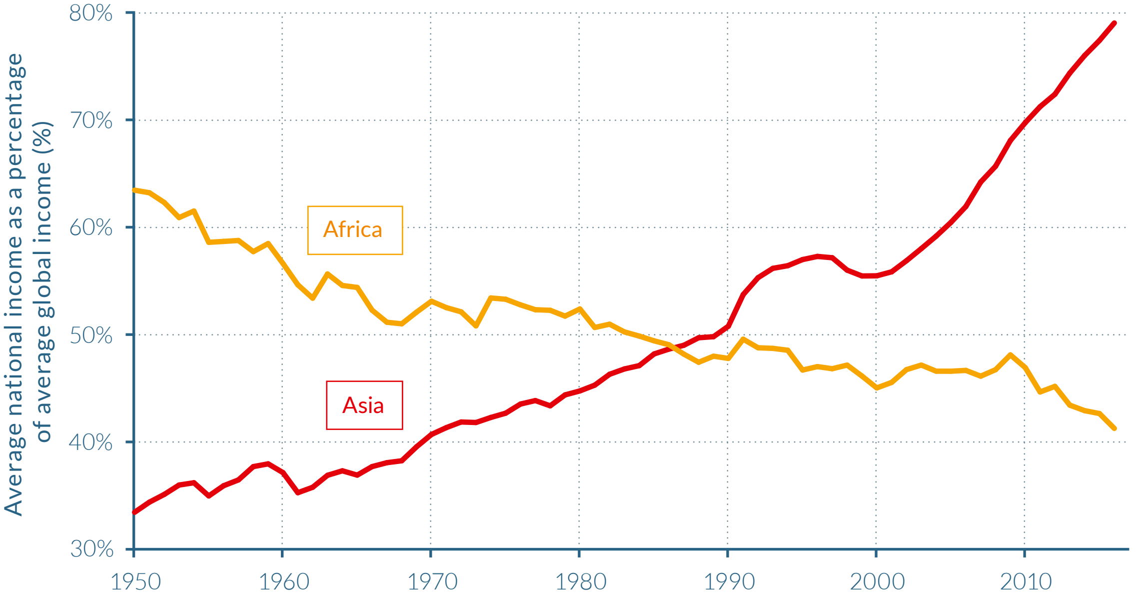
	National Income		National Income per capita		National Income per adult	
	1950–1980	1980–2016	1950–1980	1980–2016	1950–1980	1980–2016
World	282%	226%	116%	85%	122%	54%
Europe	256%	79%	181%	54%	165%	36%
incl. European Union	259%	94%	192%	66%	180%	45%
incl. Russia/ Ukraine	249%	31%	156%	18%	129%	4%
America	227%	163%	78%	62%	80%	36%
incl. United States/Canada	187%	164%	89%	84%	82%	71%
incl. Latin America	365%	161%	116%	49%	117%	12%
Africa	258%	233%	72%	30%	85%	20%
incl. North Africa	394%	235%	130%	58%	148%	24%
incl. Sub-Saharan Africa	203%	232%	46%	22%	58%	18%
Asia	446%	527%	188%	230%	198%	152%
incl. China	273%	1864%	106%	1237%	114%	831%
incl. India	199%	711%	61%	299%	67%	223%
incl. Japan	740%	103%	504%	86%	372%	56%
incl. Other	518%	376%	187%	99%	203%	52%
Oceania	208%	194%	38%	69%	50%	49%
incl. Australia and NZ	199%	193%	69%	81%	71%	58%

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

Between 1950 and 1980, Africa's income grew by 258%, whereas income per adult grew by only 85% during the same period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

Figure 2.2.1

Average income in Africa and Asia relative to the global average, 1950–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 1950, average real income per adult in Africa was 63% of the world average income. This figured decreased to 41% in 2016. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

2016 the same as ten years before, before the onset of the financial crisis.

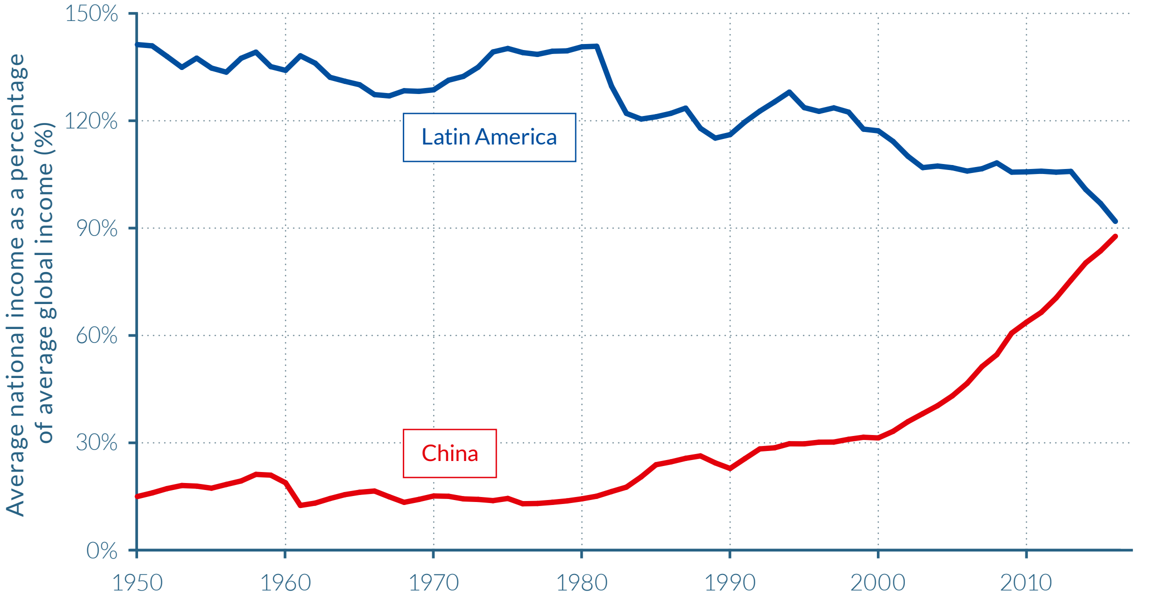
Despite a reduction of inequality between countries, average national income inequalities remain strong among countries. Developing and emerging countries did not all grow at the same rate as China. India's average monthly per-adult income (€580 or $750) is still only 0.4 times the world average measured at PPP, while sub-Saharan Africa is only 0.3 times the world average (€430 or $560) today. Average North Americans earn close to ten times more than average sub-Saharan Africans.

Diverging forces were also at play in certain parts of the world, such as sub-Saharan Africa and Latin America.

Huge inequalities persist among countries but, in some cases, they actually worsened. Certain low- to middle-income regions are relatively worse off today than four decades ago. Between 1980 and 2016, per-adult incomes in Africa grew more slowly (18%) than the world's average per-adult incomes (54%). This growth trend, marked by a combination of political and economic crises and wars, is not limited to the poorest region of the world. In South America, as well, incomes have grown by only 12% since 1980. As a result, these regions' average incomes fell relative to the world average, from 65% to only 40% of the world average in 1950, versus 140% to less than 100% in Latin America (**Figures 2.2.1** and **2.2.2**).

Figure 2.2.2

Average income in China and Latin America relative to the global average, 1950–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 1950, average real income per adult in Latin America was 141% of the world average income. This figure decreased to 92% in 2016. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

2.3

TRENDS IN INCOME INEQUALITY WITHIN COUNTRIES

- After a historical decline in most parts of the world from the 1920s to the 1970s, income inequality is on the rise in nearly all countries. The past four decades, however, display a variety of national pathways, highlighting the importance of political and institutional factors in shaping income dynamics.

- In the industrialized world, Anglo-Saxon countries have experienced a sharp rise in inequality since the 1980s. In the United States, the bottom 50% income share collapsed while the top share boomed. Continental European countries were more successful at containing rising inequality, thanks to a policy and institutional context more favorable to lower- and middle-income groups.

- In China, India, and Russia, three formerly communist or highly regulated economies, inequality surged with opening and liberalization policies. The steepest rise occurred in Russia, where the transition to a market economy was particularly abrupt.

- Inequality is extreme in Brazil, the Middle East, and South Africa, the world's most unequal regions. In these three large emerging markets, inequality currently reaches extreme levels: the top 10% earners capture 55% to 65% of national income.

- Little is known of the long-run dynamics of income inequality in many low-income countries. More information is essential for peaceful democratic debates in these countries, especially given that official estimates are very likely to understate existing levels of inequality.

After a historical decline from the 1920s to the 1970s, income inequality is on the rise in most regions of the world

Income inequality was sharply reduced in the first half of the twentieth century—more precisely, between the 1920s and the 1970s—in most countries of the world, but it has been on the rise almost everywhere since the late 1970s. In Europe and North America, the long-run decline in income inequality was due to the combination of political, social, and economic shocks already discussed. These included the destruction of human and physical capital led by the World Wars, the Great Depression, nationalization policies, and government control over the economy. After the Second World War, a new policy regime was put in place, including the development of social security systems, public education, social and labor policies, and progressive taxation. This combination of factors severely affected very high fortunes, and enabled the rise of a patrimonial middle class and a general decline in inequality in Europe—and to a lesser extent, in North America.[7]

In emerging economies, political and social shocks led to an even more radical reduction of income inequality. The abolition of private property in Russia, land redistribution, massive investments in publication education, and strict government control over the economy via five-year plans effectively spread the benefits of growth from the early 1920s to the 1970s. In India, which did not undergo a communist revolution but implemented socialist policies after gaining its independence, income inequality was also severely reduced over the same period. For most of the global population, the first three-quarters of the twentieth century corresponded to a very strong compression in the distribution of national incomes. The economic elite captured a much smaller share of economic growth in the late 1970s than it did at the beginning of the century.

The trend was then reversed in most countries—even though there are notable exceptions deserving attention. Countries did not all follow the same path. Large emerging countries, as they underwent profound deregulations of their economies, saw inequalities surge as they opened up and liberalized but followed different transition strategies. In rich countries, inequality levels also varied largely according to changes in institutional and policy contexts, with sharp income inequality rises in the Anglo-Saxon world and more moderate increases in continental Europe and Japan. Certain Western European and Northern European countries almost contained the rise in income inequality.

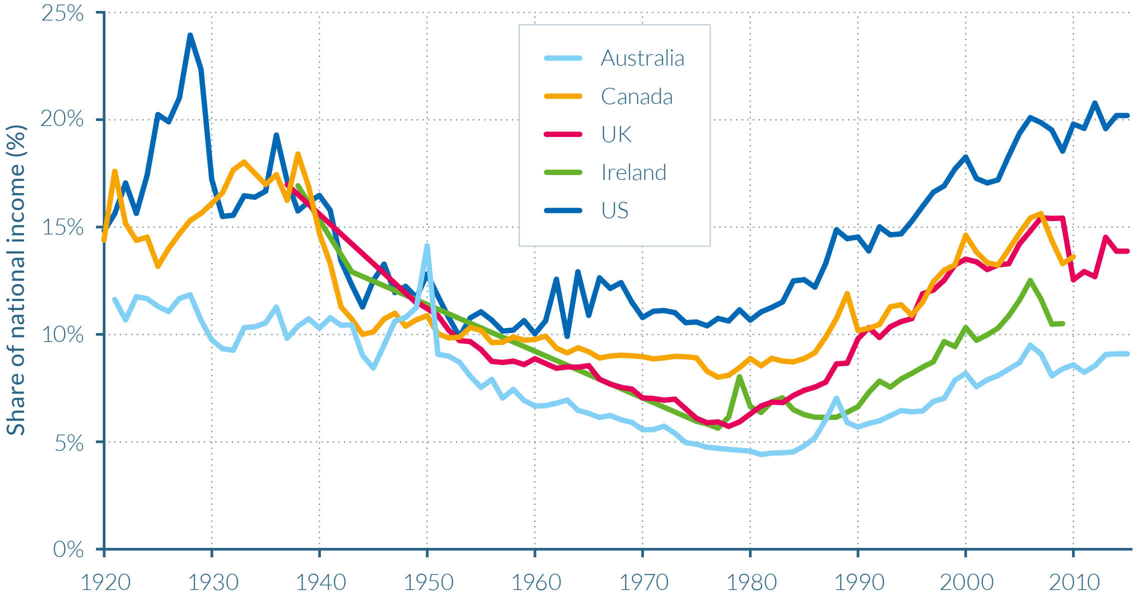
Given the multitude of trends presented in this chapter, it would be imprudent to seek a single story line behind the rise of inequality across countries. Our findings show that national cultural, political, and policy context are key to understanding the dynamics of income inequality. In this chapter, we largely focus on the evolution of top-income shares, as they are now available for a very large set of countries. In the country-by-country chapters that come next, the focus will be more detailed and we will shift the attention to bottom-income groups.

Bottom-income groups were shut off from economic growth in the United States, while top incomes surged in the Anglo-Saxon world

Top 1% income shares have been steadily increasing in Anglo-Saxon countries since the early 1980s, after a historical decline throughout the first part of the twentieth century (see **Figure 2.3.1**). Inequality exploded in the United States: the top percentile income share there was less than 11% in 1980, and it was slightly above 20% in 2014. Britain's top percentile share rose from less than 6% in the late 1970s to nearly 14% in the mid-2010s. Britain had the same level of top 1% income share as Ireland in the late 1970s, but is now nearly on a level with Canada, where the top share increased from less than 9% in 1980 to almost 14%. Australia and New Zealand, with levels of inequality much lower

Figure 2.3.1

Top 1% national income share in Anglophone countries, 1920–2015



Source: Novokmet, Piketty & Zucman (2017). See wir2018.wid.world for data series and notes.

In 2014, 20% of national income was received by the Top 1% in the US.

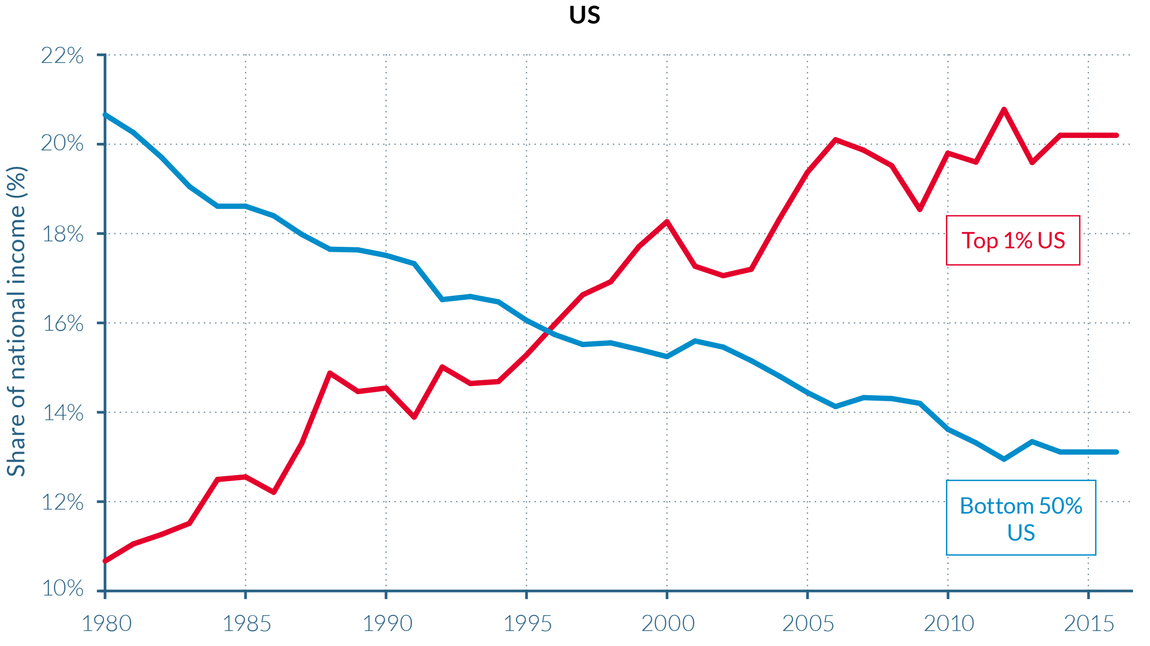
throughout the entire period (around 5% in the early 1980 and rising to less than 10%) also show a broadly similar pattern.[8] The impact of the financial crisis is visible on top-income shares, which exhibit a marked declined after 2007. Novel data suggest that top incomes have either recovered their shares or are progressively recovering them.

The rise in labor income inequality played an important role in the rise of inequality in Anglo-Saxon countries, and particularly in the United States before the turn of the century, as discussed in chapter 2.4. This phenomenon is owing to the "rise of super managers"—that is, the rise in super wages received by CEOs of large financial and nonfinancial firms. This evolution was also accompanied by an increased polarization of income between low-wage and high-wage firms. This contrasted with European countries, where the dynamics at the top of the distribution have been more moderate. New estimates also show that the upsurge in top incomes has mostly been a capital income phenomenon after 2000 in the United States, shedding new light on the process of unequal growth generation.

Our novel estimates also allow a better understanding of the dynamics at the bottom of the distribution—at least for certain countries. In the United States, the bottom 90% of the population benefited from a large share of growth in the three decades following the Second World War. Total per-adult pre-tax income growth for the bottom 50% and for the middle 40% was higher than 100%, while total growth for the top 10% earners was less than 80%. But since the 1980s, the bottom 50% was shut off from national income growth. While average per-adult pre-tax incomes increased by 60%, growth was close to zero for the bottom 50% of the population. The bottom 50% did benefit from a very modest post-tax income growth, thanks to redistribution, but this has been eaten up by rising health spending. Government provided little support to help low-income individuals cope with the situation.

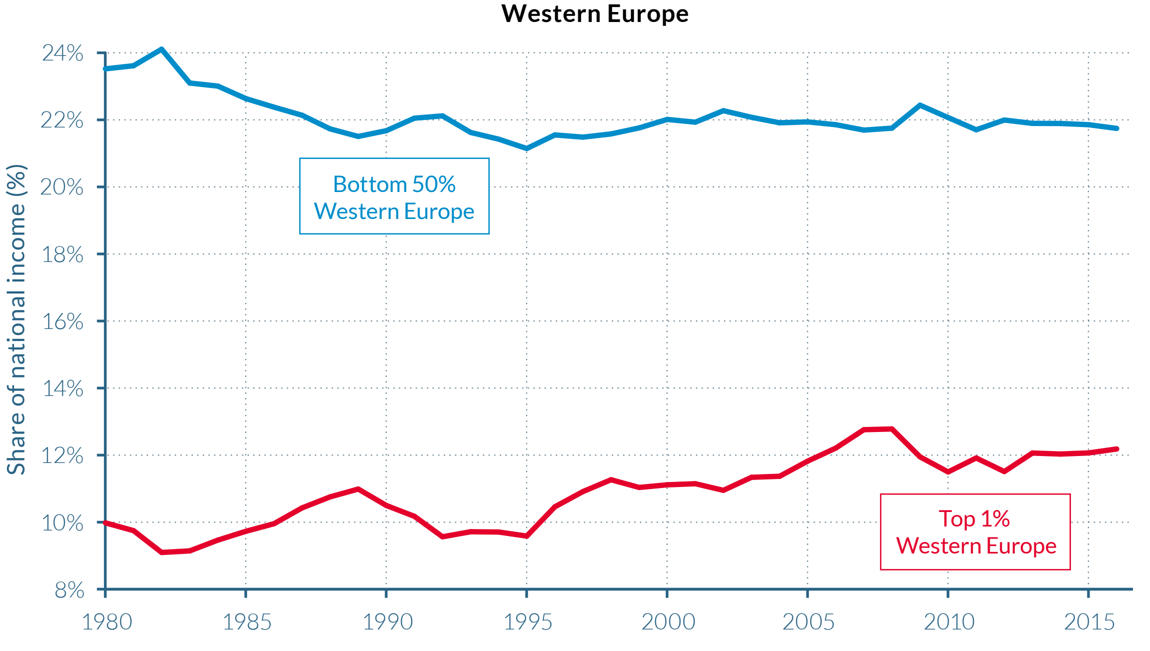
Figure 2.3.2a

Top 1% vs. Bottom 50% national income shares in the US and Western Europe, 1980–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 12% of national income was received by the top 1% in Western Europe, compared to 20% in the United States. In 1980, 10% of national income was received by the top 1% in Western Europe, compared to 11% in the United States.



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 22% of national income was received by the Bottom 50% in Western Europe.

The comparison of inequality trajectories between the United States and Western Europe is particularly striking. The two regions had similar levels of inequality in 1980 (top 1% share at 10–11% and bottom 50% share at 21–23%). However, today, the situations are radically different as the relative positions of the bottom 50% and top 1% group in the United States have been inverted (see **Figure 2.3.2a**).

Inequality in enlarged Europe (with a population of 520 million) is now substantially smaller than in the United States (320 million)

We also compare in **Figures 2.3.2b** through **2.3.2c** the evolution of income inequality between the United States, Western Europe, and enlarged Europe (that is, including Eastern Europe). Enlarged Europe includes ex-communist East European countries with lower average incomes than West European averages, leading to higher inequality levels. However, it is striking to see that inequality levels in enlarged Europe remain much smaller than in United States. In particular, in spite of Europe's bigger size and potential heterogeneity (520 million for enlarged Europe, 320 million for the United States), the bottom 50% income share is substantially larger in Europe: 20–22% of total income at the end of the period versus 12% in the United States.

This conclusion would likely be exacerbated if we were to compare enlarged Europe to enlarged North America (including not only Canada but also Mexico), which we plan to do in the near future as new data become available for Mexico. Another important issue for future research is to better understand which part of Europe's lower inequality level can be attributed to redistributive policies at the regional level (including EU regional development funds), as opposed to national factors (such as the relatively egalitarian legacy of Eastern European countries and the fact that the transition from communism was not as abrupt as in Russia).

Continental European countries were more successful in preventing the rise of incomes at the top and the stagnation of incomes at the bottom

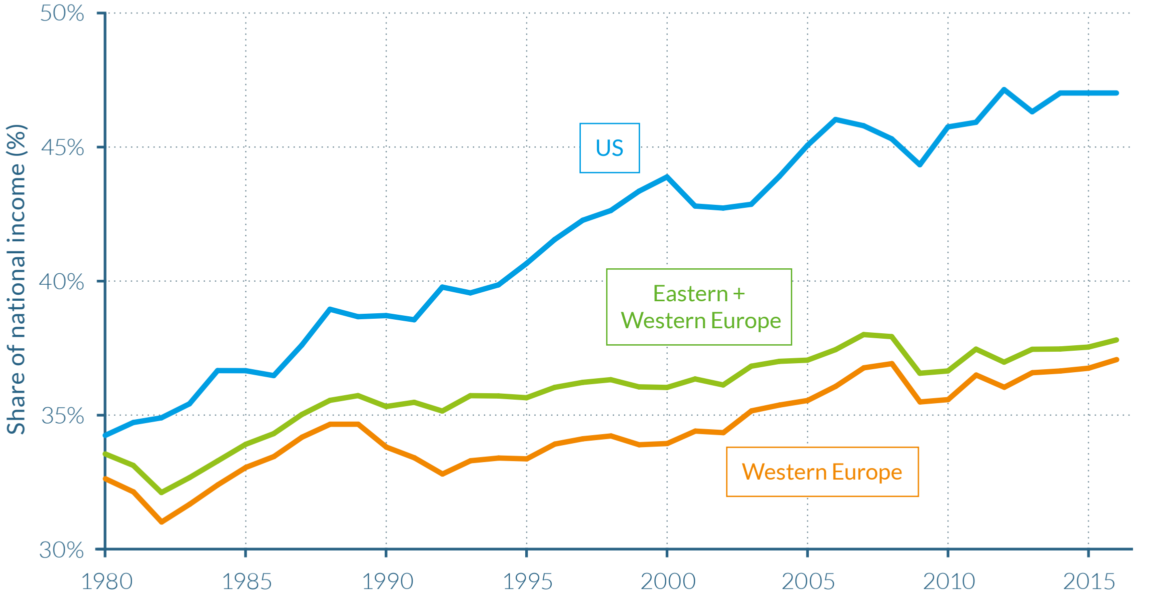
In western continental Europe, inequality has also been on the rise since the late 1970s, though both the levels of inequality and the rise in inequality were less striking than in the United States. The German top 1% income share rose from slightly less than 11% in the early 1980s to 13% today, as described in chapter 2.6. In France, the top 1% pre-tax income share increased from approximately 7% in 1983 to nearly 11% in 2014, as discussed in more detail in chapter 2.5. Spain displays a different picture. The impact of the financial crisis and the bursting of the real estate bubble in 2007–2008, which represented a substantial share of national income, severely hampered incomes at the bottom of the distribution, but also at the top: the top 1% income share decreased from close to 13% in 2006 to less than 9% in 2012, and still shows no sign of recovery. (**Figure 2.3.3**)

For France, new estimates also allow us to track the dynamics of growth at the bottom of the distribution. While growth was higher than average at the bottom 50% and middle 40% during the postwar period and up to the early 1980s, the situation was reversed afterwards. The "thirty glorious years"—as the high-growth 1950–1980 period is commonly referred to in France—continued after the 1980s, but only for the top income earners. This increase in inequality is characterized by rises in both labor and capital income. However, the bottom half of the population was not shut off from growth after the 1980s. This part of the population enjoyed close to average income growth rates—a strikingly different picture than in the United States.

Northern European countries had among the lowest levels of income inequality in the world in the early 1980s. Growth has been more unequal in these countries after 1980 than before, yet income concentration at the top of the distribution remains limited. Top 1%

Figure 2.3.2b

Top 10% national income share in Europe and the US, 1980–2016

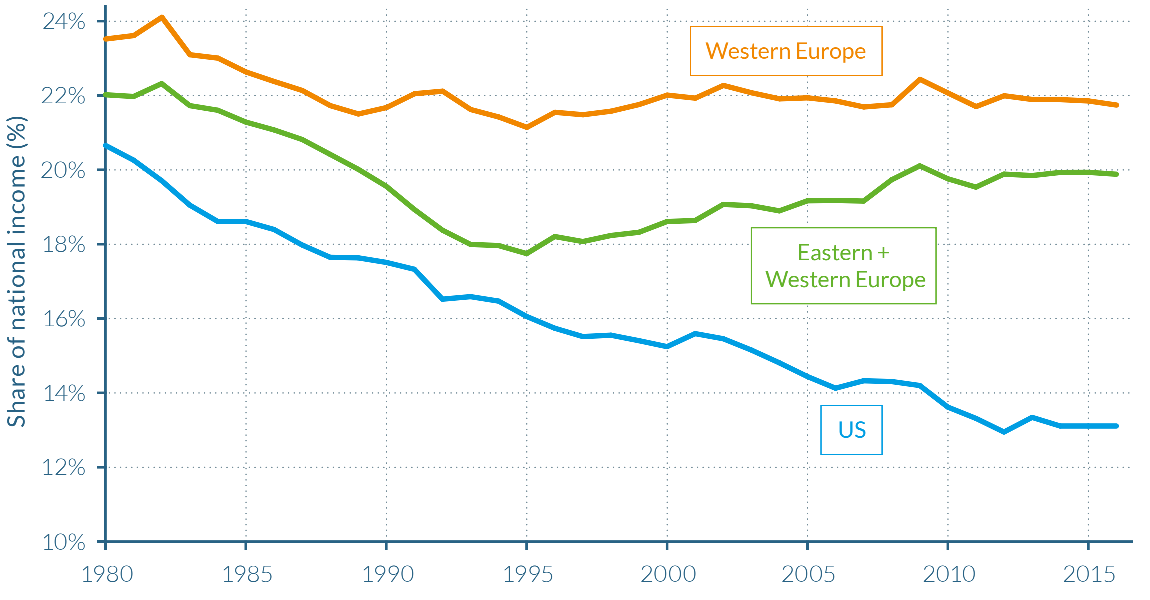


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 38% of national income was received by the Top 10% in Eastern and Western Europe.

Figure 2.3.2c

Bottom 50% national income share in Europe and the US, 1980–2016

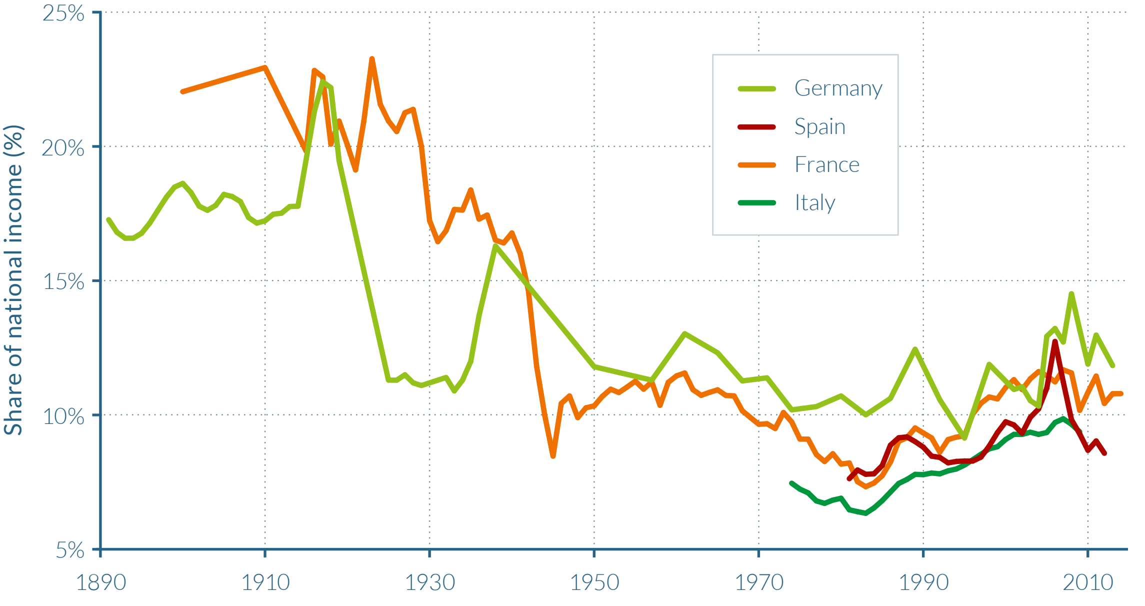


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 13% of national income was received by the Bottom 50% in the US.

Figure 2.3.3

Top 1% national income share in European countries, 1890–2014



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2014, 11% of national income was received by the Top 1% in France.

income earners capture less than 10% of total income in Denmark, Finland, Norway, and Sweden. In Denmark and in the Netherlands, the rise in top percentile share has been small, from about 5% to 6% since the 1980s. As we can see, many European countries have been able to generate relatively high average income growth rates and maintain the rise in income inequality (**Figure 2.3.4**).

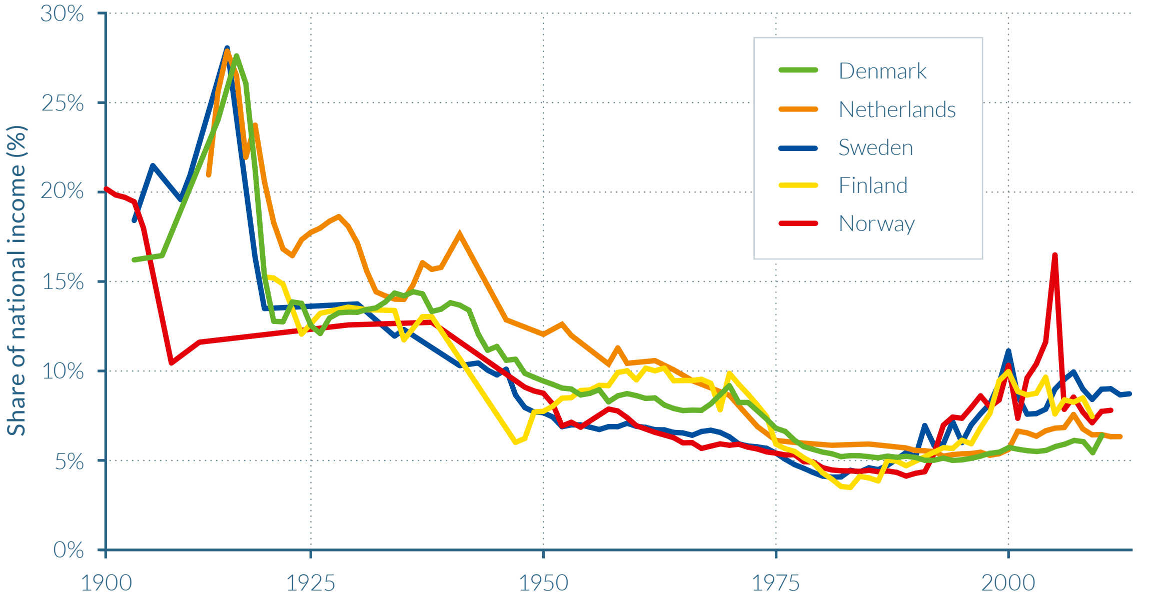
In Russia, China, and India, income inequality surged after the 1980s

Income concentration and wealth concentration were particularly high in tsarist Russia before the Soviet revolution of 1917 (see chapter 2.8 on Russia), and in colonial India (see chapter 2.9 on India). In Russia, the communist revolution led to an extreme compression of money incomes. During the entire communist period, the top 1% income share represented around 5% of national income, down to less than 4% in the seventies (see **Figure 2.3.5**). It is worth stressing, however, that this extremely low level of monetary inequality is partly artificial. Soviet inequality took other, non-monetary forms, such as privileged access to particular shops and vacation centers for the political elite, and brutal political repression for large segments of the population.

In India, the top percentile income share decreased from around 20% at the end of the colonial period to 6% in the early 1980s, after four decades of socialist-inspired policies aiming at reducing the economic power of the elite, including nationalizations, government control over prices, and extreme tax rates on top incomes. The implosion of the Soviet block and "shock policies" in Russia, and deregulation and opening policies in India from the 1980s onwards, contributed to strong increases in top percentile income shares. The top 1% share increased to 26% in 1996 in Russia and is now at 20%. In India, the top percentile is now around 22%.

The Chinese opening-up policies established from 1978 (discussed in chapter 2.7 on

Figure 2.3.4
Top 1% national income share in Northern European countries, 1900–2013



Source: WID.world (2017). See wir2018.wid.world for data series and notes.
In 2013, 9% of national income was received by the Top 1% in Sweden.

China), which included important privatization plans, had a lesser effect on inequality than reforms had in Russia or India. China shows a substantial rise in inequality (the top share rose from 6.5% to 14% in twenty years). However, as compared to Russia, China's transition to a liberalized, open economy was less abrupt and more gradual. Since 2006, inequality at the top has stagnated. In China and to a lesser extent in India, the rise in inequality occurred in the context of high average income growth, enabling important growth at the bottom of the distribution.

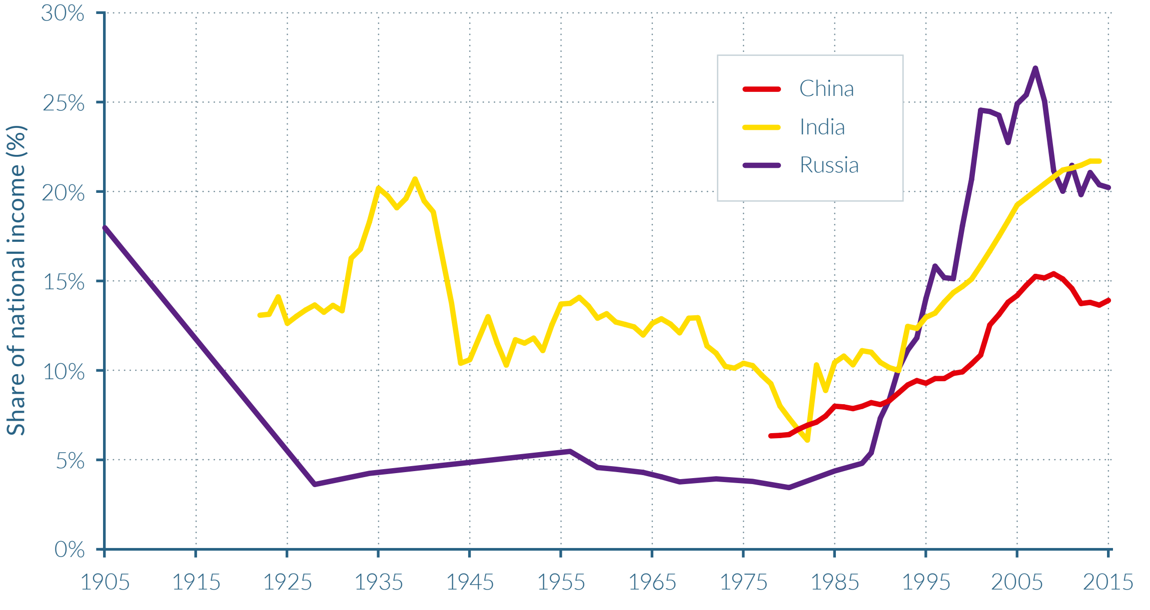
Brazil, South Africa, and the Middle East can be characterized as "extreme inequality" regimes: they have the highest inequality levels observed

In Brazil, South Africa, and the Middle East, income has been historically highly concentrated (see **Figure 2.3.6**). In Brazil, wage inequality has decreased over the past twenty years (in particular due to rising minimum wage) and there have been important and often lauded cash-transfer systems to the poor. However, due to a large concentration of business profits and capital incomes, the top 10% national income share reaches 55% in Brazil today and this value has not changed significantly for the past twenty years as is shown in chapter 2.11. Together with huge regional inequalities, the legacy of racial inequality still plays an important role; Brazil was the last major country to abolish slavery, back in 1887, at a time when slavery made up a very large fraction of the population, up to about 30% of the population in certain regions.

The extreme inequality evident in South Africa can obviously be linked to the historical legacy of the apartheid regime (only fully abolished in 1994), seen today in the country's dualistic economy and society. As discussed in chapter 2.12, the top 10% is largely made up of whites. This group earns more than 60% of national income and enjoys income levels similar to those of Europeans, while the bottom 90% live with incomes comparable to those of low-income African

Figure 2.3.5

Top 1% national income share in emerging countries 1900–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.
In 2015, 14% of national income was received by the Top 1% in China.

countries. But in contrast to Brazil and the Middle East, inequality increased significantly over the past decades in South Africa. The trade and financial liberalization that occurred after the end of apartheid, coupled with the failure to redistribute land equally, can help to explain these dynamics - yet more research will be required to better track and understand recent South African income inequality dynamics.

Despite its much larger racial and ethnocultural homogeneity, levels of inequality in the Middle East are similar to (or possibly even higher than) those in Brazil and South Africa, with a top 10% share above 60%. As discussed in chapter 2.10, regional income and wealth is largely concentrated in in the hands of a small group that is located in the Gulf countries and Saudi Arabia. This is yet another inequality-generating mechanism: the geography of oil property and the frontier system have led to extreme inequality in this region.

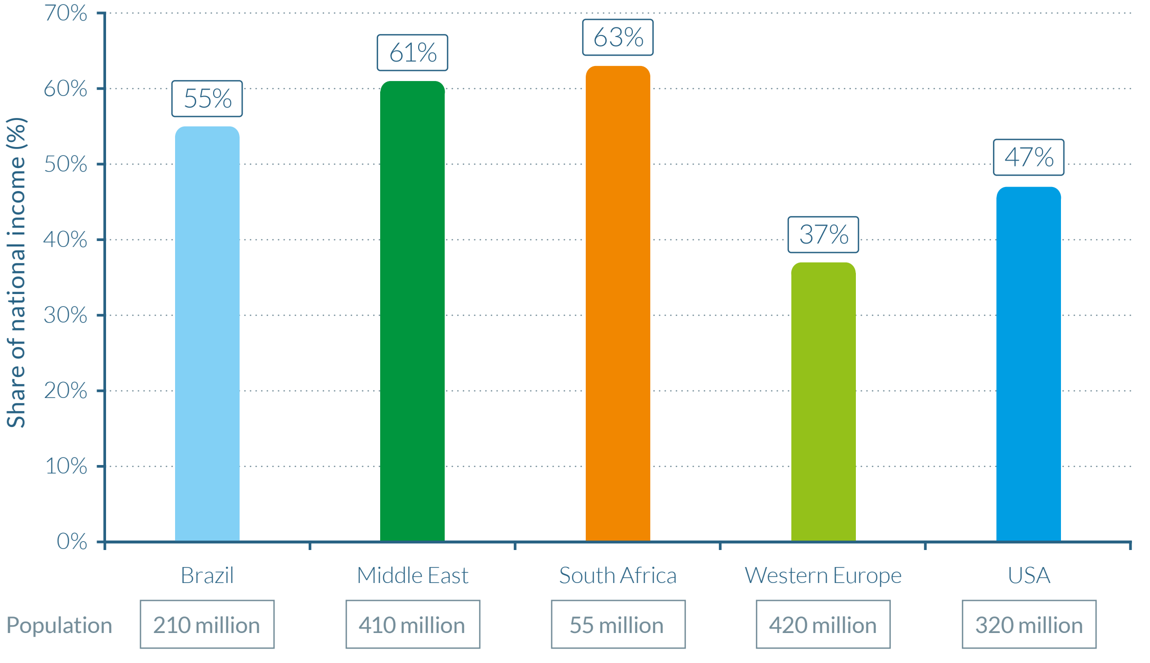
In low-income countries, inequality is likely to be higher than previously thought, but data is scarce

We still know very little about the evolution of income inequality in the rest of the developing and emerging world. The first explanation for this situation is that there is a lack of proper income-tax data, either because governments have not shared it, or because the data simply do not exist anymore, or because the data are still decentralized and not digitized.

In the absence of administrative data, most of what we know is based on survey estimates. As discussed in Part I, survey-based estimates of inequality can have a number of limitations. Surveys are often more sporadic in time, lack consistency with national accounts estimates, and miss top incomes. As demonstrated in this report, for numerous emerging countries, these weaknesses can lead to significant underestimation of inequality levels. (See chapters 2.7 and 2.12.) In Côte d'Ivoire, novel estimates show that the income share of the

Figure 2.3.6

Top 10% national income share in Brazil, the Middle East, South Africa and other countries, 2012–2016



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 61% of national income was received by the Top 10% in the Middle East.

top 1% is approximately 17% of the country's total income, contrary to the 12% previously estimated by surveys. WID.world work also shows that the share of income earned by the top 1% in China was at least twice as great as official estimates previously suggested. We are currently devoting great energies to accessing income tax data in other African countries, following the lead of Côte d'Ivoire, and hope to be able to report more findings in the near future. At this stage, however, we have only limited access to adequate data.

Collectively, these factors mean that we can assess the evolution of income inequality for only a few developing countries in the years before the 1980s, and over a short or interrupted time period. Given that most individuals earned below the first income-tax threshold, our analysis is also restricted to a tiny fraction of the population. Out of the nine sub-Saharan African countries for which we have historical income tax data, the income share earned by the top 1% can only be properly computed in two small countries—Mauritius and the Seychelles—and for only a few years in Zambia and Zimbabwe. For the remaining countries (Ghana, Kenya, Tanzania, Nigeria, and Uganda), the income-tax data encompass less than 1% of the estimated adult population. While this may appear surprising, it is worth remembering that in the early days of the US personal income tax (1913–1915), the proportion of taxpayers was 0.9%.

Nevertheless, some lessons can be drawn from this data. In Africa, from the mid-1940s until the early 1980s, the income share of the top 0.1% decreased in Zimbabwe, Zambia, Malawi, Kenya, Tanzania, and South Africa, following a trend similar to that of most rich countries. But compared to European levels over the same period, income inequality was much higher in these African countries, and even reached the most extreme levels. In 1950, the richest 0.1% of Zambia commanded a bit more than 10% of total national income. Income inequality was, however, seemingly lower in West African countries such as Nigeria and Ghana, where the top 0.1% averaged to 2.5% of total income between 1940 and 1960. Interestingly, this pattern of geographical differences in inequality is still evident in survey data that has been collected in recent decades.

Where it is possible to break down tax data by race or nationality, historical data in African countries demonstrate that most taxpayers were non-African—mainly Europeans, followed by Arabs, then Asians. This dominance is likely to have been mitigated in recent decades, but it is still important in former settlement colonies such as South Africa. Recent research on Côte d'Ivoire for the period 1985–2014 further illustrates how the aforementioned discrepancy between survey data and administrative data can be partly due to the undersampling of non-African individuals.[9]

Available data for Latin American countries show that income inequality in the region is generally higher than the levels seen in European and Asian countries. For example, recent data collected in Latin America indicate that the total income share of the top 1% in Argentina, Colombia, and Brazil is greater than 16%. Interestingly, when only survey data have been used to estimate inequality in the region, the results suggest that income inequality has decreased significantly, while WID.world estimates for Brazil and Colombia show that they have in fact remained stubbornly high.

In conclusion, the scarcity of available data makes it challenging to develop a conclusive picture of inequality levels in lower-income countries. From the data that are available, however, inequality estimations suggest that in most cases the distribution of income is more concentrated than previously thought in low-income countries. While important efforts have been made in the past years to produce and analyze consistent inequality estimates in emerging countries (which are presented for the first time together in this report) the study of the analysis of income inequality based on sound and consistent data in low-income countries is still only in its infancy.

2.4

INCOME INEQUALITY IN THE UNITED STATES

Information in this chapter is based on the article "Distributional National Accounts: Methods and Estimates for the United States," by Thomas Piketty, Emmanuel Saez, and Gabriel Zucman, forthcoming in the *Quarterly Journal of Economics* (2018).

- Income inequality in the United States is among the highest of all rich countries. The share of national income earned by the top 1% of adults in 2014 (20.2%) is much larger than the share earned by the bottom 50% of the adult population (12.5%).
- Average pre-tax real national income per adult has increased 60% since 1980, but it has stagnated for the bottom 50% at around $16 500. While post-tax cash incomes of the bottom 50% have also stagnated, a large part of the modest post-tax income growth of this group has been eaten up by increased health spending.
- Income has boomed at the top. While the upsurge of top incomes was first a labor-income phenomenon in 1980s and 1990s, it has mostly been a capital-income phenomenon since 2000.
- The combination of an increasingly less progressive tax regime and a transfer system that favors the middle class implies that, even after taxes and all transfers, bottom 50% income growth has lagged behind average income growth since 1980.
- Increased female participation in the labor market has been a counterforce to rising inequality, but the glass ceiling remains firmly in place. Men make up 85% of the top 1% of the labor income distribution.

Income inequality in the United States is among the highest of rich countries

In 2014, the distribution of US national income exhibited extremely high inequalities. The average income of an adult in the United States before accounting for taxes and transfers was $66 100, but this figure masks huge differences in the distribution of incomes. The approximately 117 million adults that make up the bottom 50% in the United States earned $16 600 on average per year, representing just one-fourth of the average US income. As illustrated by table 2.4.1, their collective incomes amounted to a 13% share of pre-tax national income. The average pre-tax income of the middle 40%—the group of adults with incomes above the median and below the richest 10%, which can be loosely described as the "middle class"—was roughly similar to the national average, at $66 900, so that their income share (41%) broadly reflected their relative size in the population. The remaining income share for the top 10% was therefore 47%, with average pre-tax earnings of $311 000. This average annual income of the top 10% is almost five times the national average, and nineteen times larger than the average for the bottom 50%. Furthermore, the 1:19 ratio between the incomes of the bottom 50% and the top 10% indicates that pre-tax income inequality between the "lower class" and the "upper class" is more than twice the (1:8 ratio) difference between the average national incomes in the United States and China, using market exchange rates.

Income is very concentrated, even among the top 10%. For example, the share of national income going to the top 1%, a group of approximately 2.3 million adults who earn $1.3 million on average per annum, is over 20%—that is, 1.6 times larger than the share of the entire bottom 50%, a group fifty times more populous. The incomes of those in the top 0.1%, top 0.01%, and top 0.001% average $6 million, $29 million, and $125 million per year, respectively, before personal taxes and transfers.

As shown by **Table 2.4.1**, the distribution of national income in the United States in 2014 was generally made slightly more equitable by the country's taxes and transfer system. Taxes and transfers reduce the share of national income for the top 10% from 47% to 39%, which is split between a one percentage point rise in the post-tax income share of the middle 40% (from 40.5% to 41.6%) and a seven percentage point increase in the post-tax income share of the bottom 50% (from 12.5% to 19.4%). The trend is also of relatively large proportionate losses in income shares as one looks further up the income distribution, indicating that government taxes are slightly progressive for the United States' richest adults.

National income grew by 61% from 1980 to 2014 but the bottom 50% was shut off from it

Income inequality in the United States in 2014 was vastly different from the levels seen at the end of the Second World War. Indeed, changes in inequality since the end of that war can be split into two phases, as illustrated by **Table 2.4.2**. From 1946 to 1980, real national income growth per adult was strong—with average income per adult almost doubling—and moreover, was more than equally distributed as the incomes of the bottom 90% grew faster (102%) than those of the top 10% (79%).[10] However, in the following thirty-four-year period, from 1980 to 2014, total growth slowed from 95% to 61% and became much more skewed.

The pre-tax incomes of the bottom 50% stagnated, increasing by only $200 from $16 400 in 1980 to $16 600 in 2014, a minuscule growth of just 1% over a thirty-four-year period. The total growth of post-tax income for the bottom 50% was substantially larger, at 21% over the full period 1980–2014 (averaging 0.6% a year), but this was still only one-third of the national average. Growth for the middle 40% was weak, with a pre-tax increase in income of 42% since 1980 and a post-tax rise of 49% (an average of 1.4% a year). By

Table 2.4.1

The distribution of national income in the US, 2014

		Pre-tax national income			Post-tax national income		
Income group	**Number of adults**	**Income threshold** *($)*	**Average income** *($)*	**Income share**	**Income threshold** *($)*	**Average income** *($)*	**Income share**
Full Population	234 400 000	–	66 100	100%	–	66 100	100%
Bottom 50%	117 200 000	–	16 600	12.5%	–	25 500	19.3%
Bottom 20%	46 880 000	–	5 500	1.7%	–	13 400	4.1%
Next 30%	70 320 000	13 100	24 000	10.9%	23 200	33 600	15.2%
Middle 40%	93 760 000	36 900	66 900	40.4%	45 000	68 800	41.6%
Top 10%	23 440 000	122 000	311 000	47.0%	113 000	259 000	39.1%
Top 1%	2 344 000	469 000	1 341 000	20.2%	392 000	1 034 000	15.7%
Top 0.1%	234 400	2 007 000	6 144 000	9.3%	1 556 000	4 505 000	6.8%
Top 0.01%	23 440	9 789 000	28 773 000	4.4%	7 035 000	20 786 000	3.1%
Top 0.001%	2 344	48 331 000	124 821 000	1.9%	35 122 000	90 826 000	1.4%

Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the average pre-tax income of the Top 10% was $311 000. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes. Post-tax national income is measured after all taxes, transfers, and government spending. All values have been converted to 2016 constant US dollars (accounting for inflation). For comparison, $1 = €0.8 = ¥3.3 at Market Exchange Rates, and $1 = €0.9 = ¥6.6 at Purchasing Power Parity. Numbers may not add up due to rounding.

Table 2.4.2

The growth of national income since World War II in the US, 1946–2014

	Pre-tax income growth		Post-tax income growth	
Income group	**1946–1980**	**1980–2014**	**1946–1980**	**1980–2014**
Full Population	95%	61%	95%	61%
Bottom 50%	102%	1%	129%	21%
Bottom 20%	109%	-25%	179%	4%
Next 30%	101%	7%	117%	26%
Middle 40%	105%	42%	98%	49%
Top 10%	79%	121%	69%	113%
Top 1%	47%	204%	58%	194%
Top 0.1%	54%	320%	104%	298%
Top 0.01%	76%	453%	201%	423%
Top 0.001%	57%	636%	163%	616%

Source: Piketty, Saez and Zucman (2018), available from WID.world

Between 1980 and 2014, the average pre-tax income of the Top 10% grew by 113%. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes. Post-tax national income is measured after all taxes, transfers, and government spending.

contrast, the average income of the top 10% doubled over this period, and for the top 1% it tripled, even on a post-tax basis. The rates of growth further increase as one moves up the income ladder, culminating in an increase of 636% for the top 0.001% between 1980 and 2014, ten times the national income growth rate for the full population.

The rise of the top 1% mirrors the fall of the bottom 50%

This stagnation of incomes of the bottom 50%, relative to the upsurge in incomes experienced by the top 1% has been perhaps the most striking development in the United States economy over the last four decades. As shown by **Figure 2.4.1a**, the groups have seen their shares of total US income reverse between 1980 and 2014. The incomes of the top 1% collectively made up 11% of national income in 1980, but now constitute above 20% of national income, while the 20% of US national income that was attributable to the bottom 50% in 1980 has fallen to just 12% today. Effectively, eight points of national income have been transferred from the bottom 50% to the top 1%. Therefore, the gains in national income share made by the top 1% have been more than large enough to compensate for the fall in income share of the bottom 50%, a group demographically fifty times larger. **Figure 2.4.1b** shows that while average pre-tax income for the bottom 50% has stagnated at around $16 500 since 1980, the top 1% has experienced 300% growth in their incomes to approximately $1 340 000 in 2014. This has increased the average earnings differential between the top 1% and the bottom 50% from twenty-seven times in 1980 to eighty-one times today.

Excluding health transfers, average post-tax income of the bottom 50% stagnated at $20 500

The stagnation of incomes among the bottom 50% was not the case throughout the postwar period, however. The pre-tax share of income owned by this chapter of the population increased in the 1960s as the wage distribution became more equal, in part as a consequence of the significant rise in the real federal minimum wage in the 1960s, and reached its historical peak in 1969. These improvements were supported by President Johnson's "war on poverty," whose social policy provided the Food Stamp Act of 1964 and the creation of the Medicaid healthcare program in 1965.

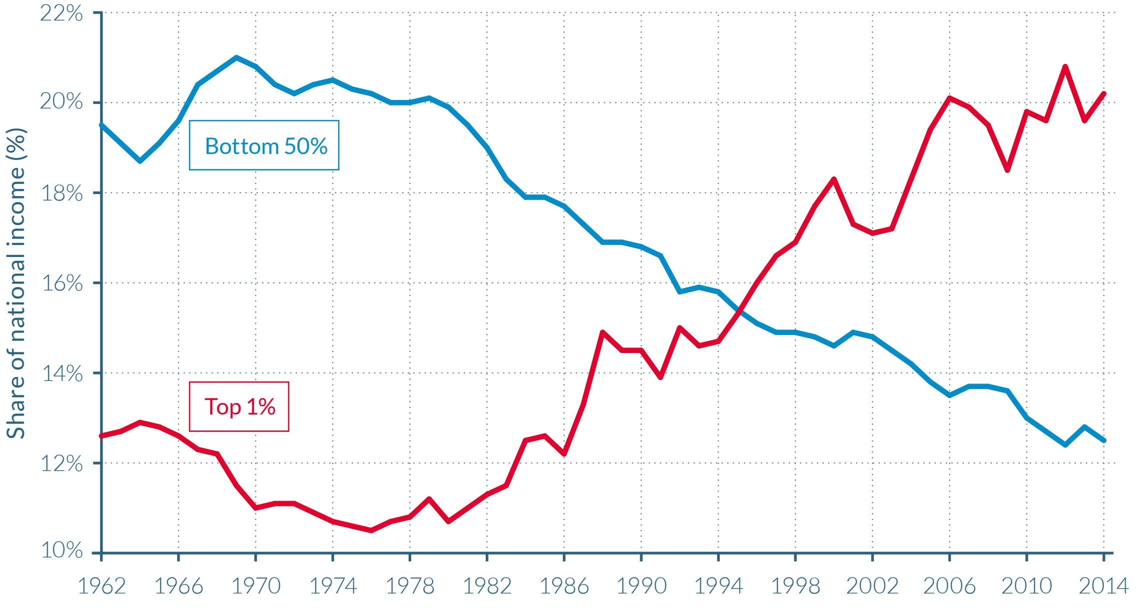
However, the share of both pre-tax and post-tax US income accruing to the bottom 50% began to fall notably from the beginning of the 1980s, and the gap between pre-tax and post-tax incomes also diverged significantly from this point onwards. Indeed, the data indicate that virtually all of the meager growth in the real post-tax income of the bottom 50% since the 1970s has come from Medicare and Medicaid. Excluding these two health care transfers, the average post-tax income of the bottom 50% would have stagnated since the late 1970s at just below $20 500 (see **Figure 2.4.2**). The bottom half of the US adult population has therefore been effectively shut off from pre-tax economic growth for over forty years, and the increase in their post-tax income of approximately $5 000 has been almost entirely absorbed by greater healthcare spending, in part as a result of increases in the cost of healthcare provision.[11] Furthermore, it is solely through the in-kind health transfers and collective expenditures that the bottom half of the distribution sees its income rise above its pre-tax level and becomes a net beneficiary of redistribution; up until the government ran large deficits during the 2008 Great Recession, the bottom 50% paid more in taxes than it received in individualized cash transfers.

Among the bottom 50%, the pre-tax income of working-age adults is falling

The stagnation in the incomes of the bottom 50% could in principle reflect demographic changes rather than deeper evolutions in the distribution of lifetime incomes. People's incomes tend to first rise with age—as workers

Figure 2.4.1a

Pre-tax income shares of the Top 1% and Bottom 50% in the US, 1962–2014



Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, 13% of national income was received by the Bottom 50% in the US. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes.

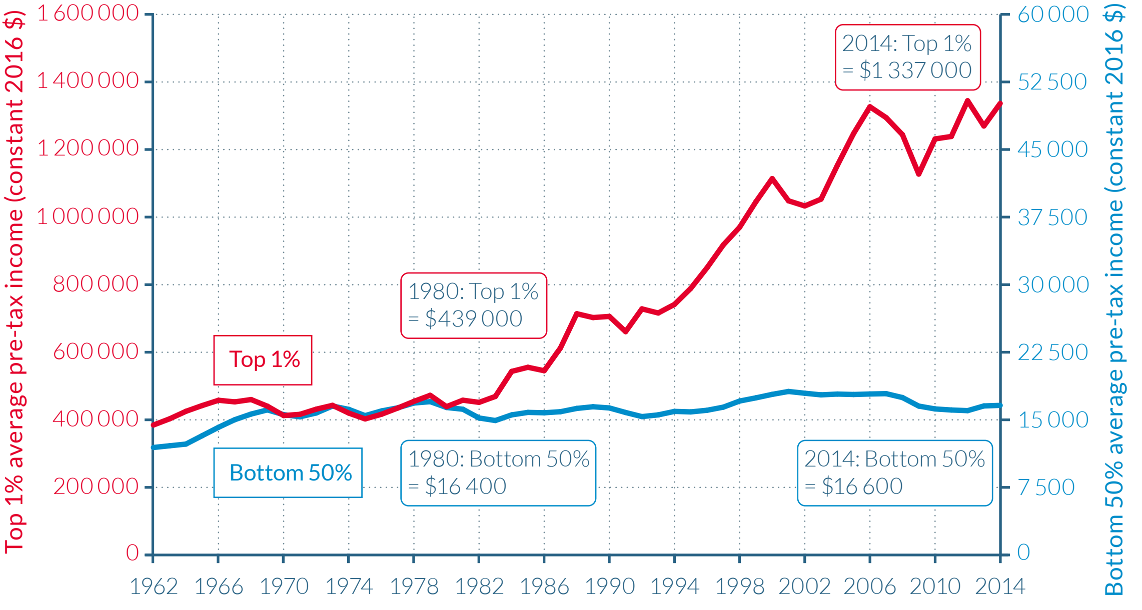
build human capital and acquire experience—and then fall during retirement. Population aging might therefore have pushed the bottom 50% income share down. However, this is not the case for the United States. This can be shown by examining the bottom 50% of income earners within specific age categories such as 20–45 year olds, 45–65 year olds, and 65+ year olds, as in Figure 2.4.3.

Figure 2.4.3a shows that the average pre-tax income of working-age adults in the bottom 50% has collapsed since 1980, falling by 20% for adults aged 20–45 and by 8% for those between aged 45–65. It is only for the elderly (aged 65+) that pre-tax income has been rising, due to increases in social security benefits and private pension distributions. **Figure 2.4.3b** shows that these trends are even more pronounced on a post-tax basis. The average income of bottom 50% income earners among those aged 65+ has grown by 70% since 1980s and now exceeds the average income of bottom 50% income earners among all adults. Indeed, all the growth in the post-tax incomes of the bottom 50% is attributable to this increase in income for the elderly.[12] For the working-age population in the bottom 50%, the increase in post-tax income since 1980 has been essentially nil.

Three key insights can be drawn from the evolution of bottom 50% incomes in the United States. First, as the income of all working-age groups within the bottom 50% has collapsed—including experienced workers above 45 years old—it is unlikely that the cumulative income that someone from the bottom 50% group has earned across their lifetime has grown much since the 1980s. Secondly, the stagnation in the incomes of the bottom 50% is not due to population aging. To the contrary, at the bottom half of the income spectrum, the elderly's incomes are the only ones rising. Thirdly, despite the rise in means-tested benefits, government redistribution has not enhanced income growth

Figure 2.4.1b

Pre-tax incomes of the Top 1% and Bottom 50% in the US, 1962–2014

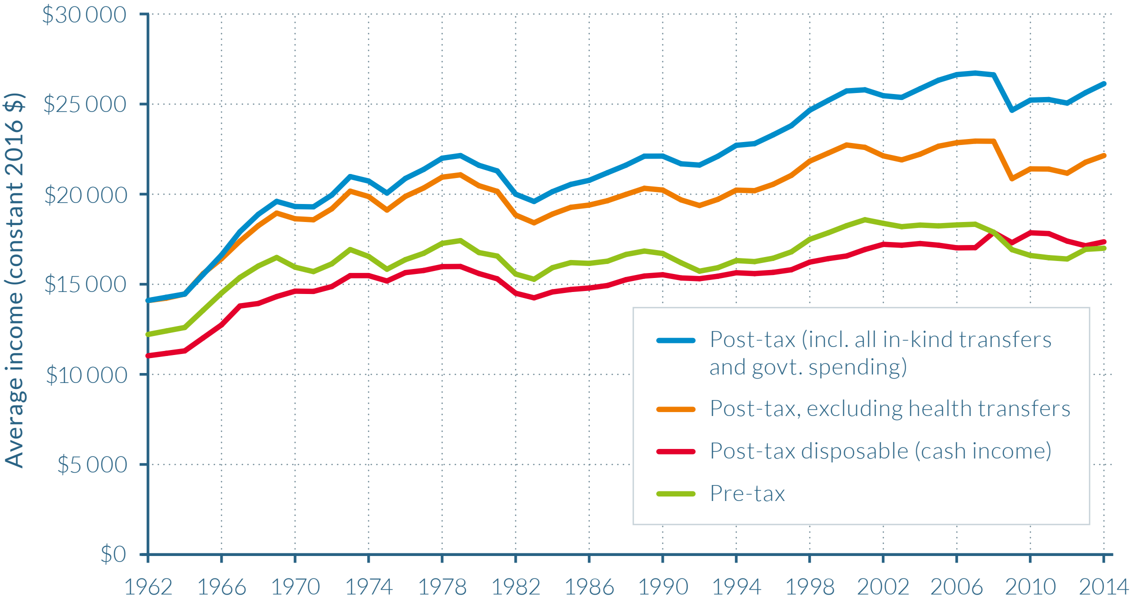


Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the average pre-tax income of the Top 1% was $ 1 337 000. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes.

Figure 2.4.2

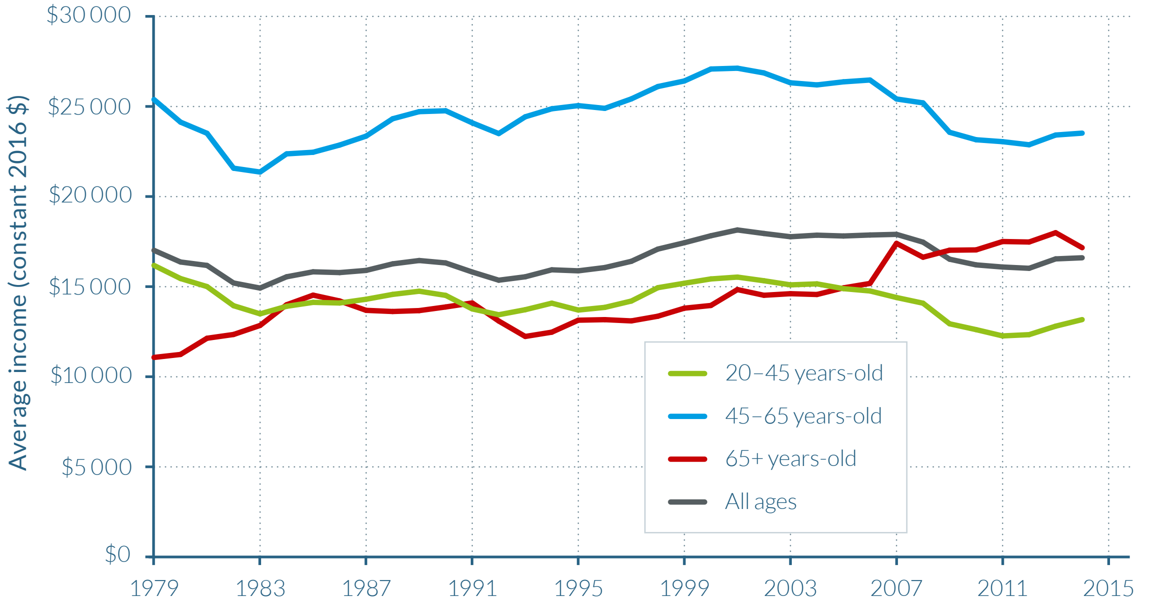
Pre-tax and post-tax income of the Bottom 50% in the US, 1962–2014



Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the average post-tax disposable income of the Bottom 50% was $ 17 400. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes. Post-tax national income is measured after all taxes, transfers, and government spending. All values have been converted to 2016 constant US dollars (accounting for inflation). For comparison, $1 = €0.8 = ¥3.3 at Market Exchange Rates, and $1 = €0.9 = ¥6.6 at Purchasing Power Parity.

Figure 2.4.3a
Pre-tax income of the Bottom 50% by age group in the US, 1979–2014



Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the average pre-tax income of the Bottom 50% aged 20 to 45 years old was €13 200. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes. All values have been converted to 2016 constant US dollars (accounting for inflation). For comparison, $1 = €0.8 = ¥3.3 at Market Exchange Rates, and $1 = €0.9 = ¥6.6 at Purchasing Power Parity. Numbers may not add up due to rounding.

for low- and moderate-income, working-age Americans over the last three decades. This, along with the real level of pre-tax inequality, indicates that there are clear limits to what taxes and transfers can achieve in the face of such massive changes in the pre-tax distribution of income as have occurred in the United States since 1980. This combination of factors supports the view that policy discussions should focus on how to equalize the distribution of primary assets, including human capital, financial capital, and bargaining power, rather than merely focus on ex-post redistribution.

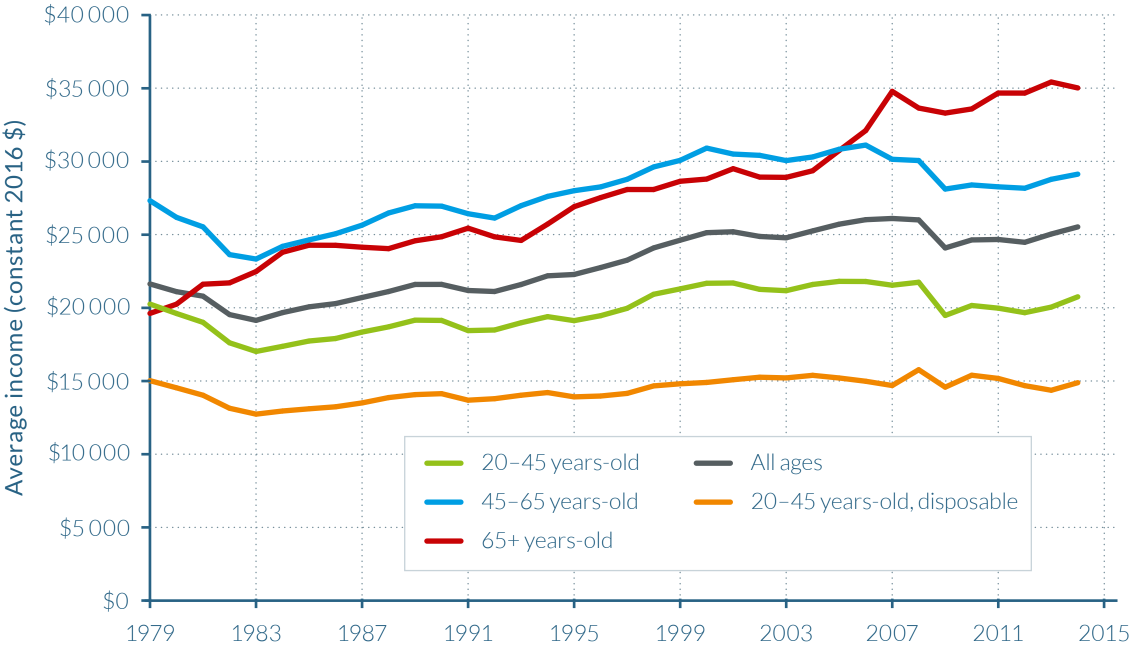
Pre-tax income inequality has risen notably since the 1980s, slightly more than post-tax income inequality

The trends described above should also be put into their longer historical context. An analysis of data going as far back as 1917 indicates that there have been considerable changes in income inequality in the United States over the last century. As shown in **Figure 2.4.4**, the share of national income going to the top 10% has followed a U-shaped curve over the last century. On a pre-tax basis, the top 10% income share today is almost as high as it was at its peak in the late 1920s.

The shares of income attributed to top earners, after accounting for taxes and transfers, have also followed a U-shaped evolution over time, though they exhibit a less marked upward swing in recent decades than do the pre-tax figures. This difference is mainly due to the smaller size of government a century ago, and lower tax rates relative to the present day, which meant the difference between pre- and post-tax incomes was less pronounced in the early 1900s. Pre-tax and post-tax shares of income started diverging after 1933 as President Roosevelt's New Deal impacted the top 1% and policies to raise money for

Figure 2.4.3b

Post-tax income of the Bottom 50% by age group in the US, 1979–2014

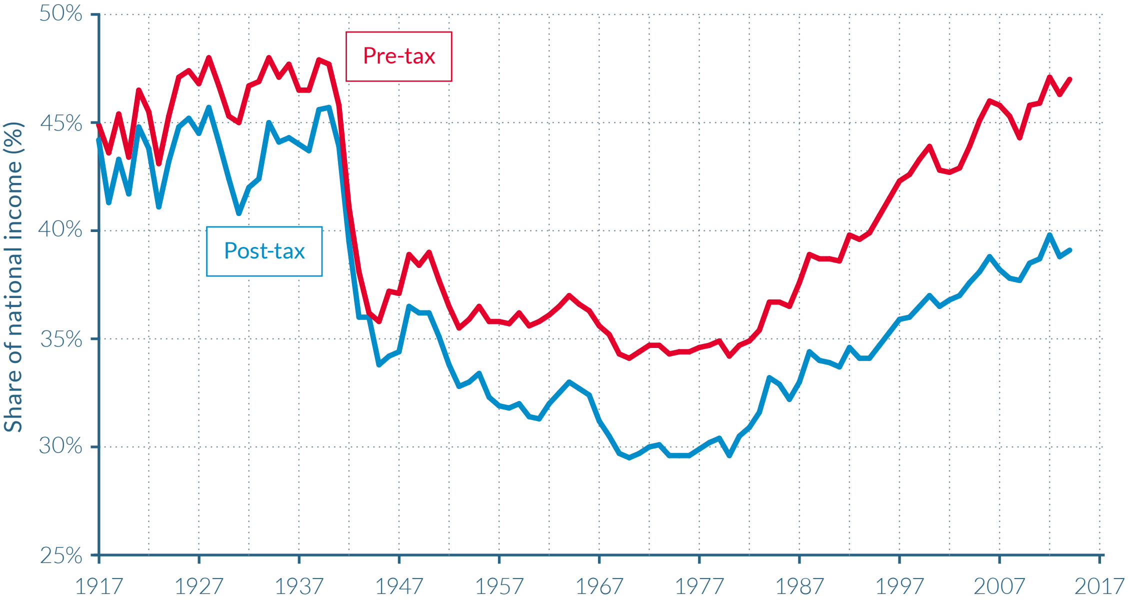


Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the average post-tax disposable income of the Bottom 50% aged 20 to 45 years old was €14 900. Post-tax national income is after all taxes, transfers, and government spending. All values have been converted to 2016 constant US dollars (accounting for inflation). For comparison, $1 = €0.8 = ¥3.3 at market exchange rates, and $1 = €0.9 = ¥6.6 at purchasing power parity.

Figure 2.4.4

The "U-shaped evolution" of the national income share of the Top 10% in the US, 1917–2014

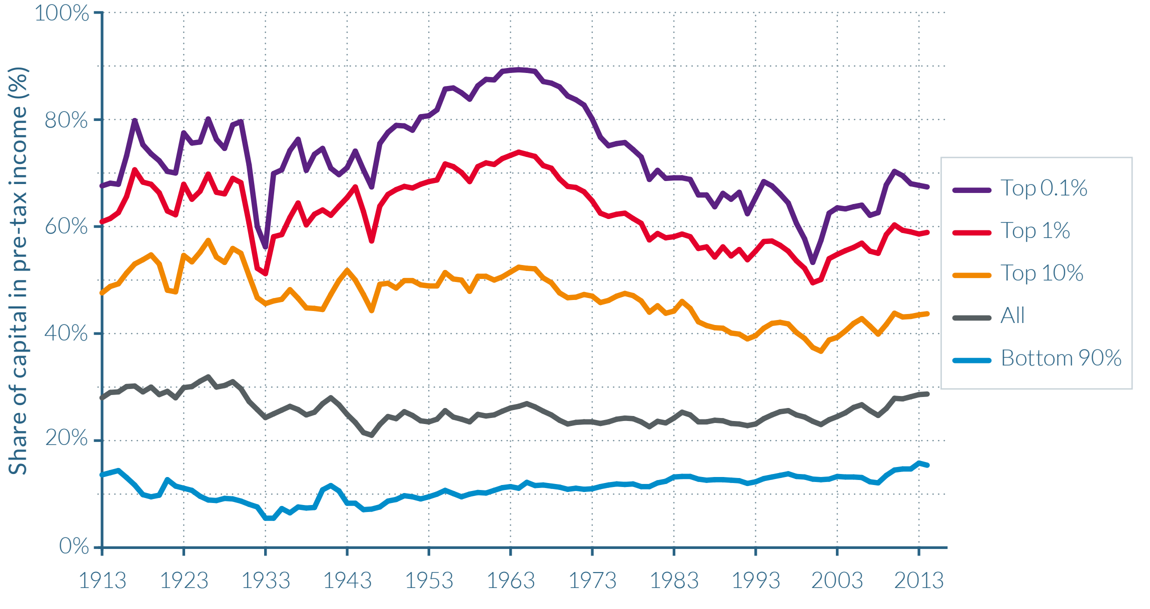


Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, 39% of post-tax national income was received by the Top 10%. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes.

Figure 2.4.5

The share of capital in pre-tax income in the US, 1913–2014



Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the share of capital in the pre-tax income of the Top 10% was 44%. Total pre-tax income is the sum of capital income and labor income. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes.

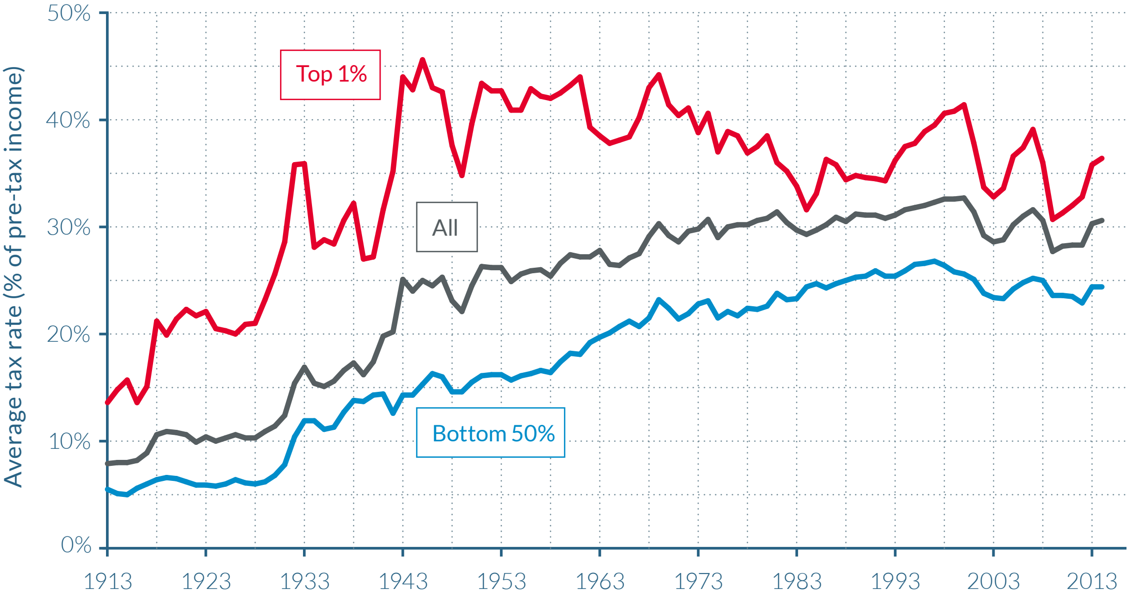
Second World War–related spending led to significant increases in federal income taxation of the top 10%.

Although post-tax inequality has increased significantly since 1980, it has risen at a slower rate than pre-tax inequality. As can be seen in **Figure 2.4.4**, the share of total income attributable to the top 10% rose from 30% to 40% post-tax, and from 35% to 47% pre-tax between 1980 and 2014. Significant tax increases implemented in 2013 for those with the largest incomes may have played a role in the slower growth of post-tax top-income shares relative to pre-tax income shares over the last few years. Overall, redistributive policies have prevented post-tax inequality from returning all the way to pre–New Deal levels (as discussed in more detail below). Further reducing taxes on top earners, as envisioned by the current administration and congress, could sharply increase post-tax income inequality in coming years. (**Box 2.4.1**)

Despite fluctuations, the share of aggregate capital in total pre-tax income has remained relatively stable over the last century. Significantly larger concentrations of earnings continue to be derived from capital, rather than labor, as one moves up the income distribution. The vast majority of Americans have earned little capital income over the last century, with the bottom 90%—which includes both the middle and lower-income classes—rarely receiving more than 10% of their income from capital before the 1970s (see **Figure 2.4.5**). The rise of pension funds (which now account for 36% of all household wealth) has helped to increase the share of capital in the pre-tax income of the bottom 90%, rising to approximately 16% in 2014. While lower than their highs of over 50% in the mid-60s, the top 10% income earners still derive over 40% of their incomes from capital in 2014; this figure was almost 60% for the top 1%, and 70% for the top 0.1% in 2014.

Figure 2.4.6

Average tax rate by pre-tax income group in the US, 1913–2014



Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the average tax rate on the incomes of the Top 1% was 36%. Pre-tax national income is measured after the operation of pension and unemployment insurance systems (which cover the majority of cash transfers), but before direct income and wealth taxes. Taxes include all forms of taxes at the federal, state, and local level. Tax rates are expressed as a fraction of pre-tax income.

Fluctuations in the share of income coming from capital have been remarkable for those with the highest incomes. Early in the twentieth century, the top 0.1% derived 70%–80% of its income from capital, but this share collapsed to just over 50% during the Great Depression when corporate profits slumped, before rebounding in the 1950s and 1960s to around 90%. As described in Piketty's *Capital in the Twenty-First Century*, top executive compensation and labor incomes hit an historical low during the postwar decades.[13] They then rose very rapidly from the 1970s through the late 1990s, culminating in 2000 when the capital share of the top 0.1% reached a low point of 49%. Since the turn of the twenty-first century, however, capital has bounced back, with a surge in profits from corporate equities. The share of capital income in national income grew from 22% to 29% between 2000 and 2014, and indeed almost all of the 0.6% average yearly growth of income per adult in the United States over this period was a result of the rise in capital income; labor income per adult grew by 0.1% per year while capital income per adult grew by 2.2% per year. This rise in wealth inequality led to an increase in capital income concentration, which then reinforced wealth inequality itself as top capital incomes were saved at a high rate. Consequently, as the twenty-first century progresses, the working rich of the late twentieth century may increasingly live off their capital income, or could be in the process of being replaced by their offspring who can live off their accumulated inheritance.

Taxes have become less progressive over the last decades

The progressivity of the US tax system has declined significantly over the last few decades, as illustrated in **Figure 2.4.6**. The country's macroeconomic tax rate (that is, the share of total taxes in national income including federal, state, and local taxes) increased from 8% in 1913 to 30% in the late

1960s, and has remained at the latter level since. Effective tax rates have become more compressed, however, across the income distribution. In the 1950s, the top 1% of income earners paid 40%–45% of their pre-tax income in taxes, while the bottom 50% earners paid 15–20%. The gap in 2014 was much smaller. In 2014, top earners paid approximately 30%–35% of their income in taxes, while the bottom 50% of earners paid around 25%. The main factor explaining why the effective tax rates paid by the top 1% have declined over time is the fall in corporate and estate taxes; in the 1960s, the top 1% paid close to 20% of its pre-tax income in corporate and estate taxes, while by 2014, this had fallen to approximately 10%.

The 2013 tax reforms partly reversed the long-run decline in top tax rates. The surtaxes introduced by the Affordable Care Act, and the expiration of the 2001 Bush tax cuts for top earners, together increased marginal tax rates for the richest on their capital income (+9.5 percentage points) and labor income (+6.5 percentage points).[14] These increases were the largest hikes in top tax rates since the 1950s, exceeding those implemented by the Clinton administration in 1993. The effective tax rate paid by top 1% earners has risen by approximately four percentage points between 2011 (32%) and 2013 (36%), and is now back to its level of the early 1980s.[15] Still, it is worth noting that inequality was much lower in the 1980s and

Box 2.4.1

Measuring pre-tax and post-tax income inequality

In this chapter, we present estimates of pre- and post-tax income inequality for the USA, which are two complementary concepts for the analysis of inequality. Comparing pre- and post-tax income inequality allows to better assessing the impact of personal taxes and in-kind transfers on the dynamics of income inequality.

In the WID.world database, pre-tax income refers to incomes measured before personal income and wealth taxes and in-kind transfers (typically health transfers) but after the operation of the pension and employment insurance systems (as well as after Social security and disability transfers in the case of the United States).

In contrast, post-tax income refers to incomes measured after all taxes (in particular, after direct personal and wealth taxes) and after all government transfers (cash and in-kind).

It is important to note that pensions and unemployment insurance represent the vast majority of cash transfers in the United States and more generally in rich countries. Therefore our notion of pre-tax income inequality (which we used in previous chapters to make international comparisons) already includes most cash redistribution.

In practice, other cash transfers tend to be relatively small. For instance, in the case of the United States, pre-tax income is virtually equal to post-tax cash income for the bottom 50%, at around $16 500 in 2014—and this figure has remained more or less the same since 1980. This means that the poor contribute about as much to taxes than they benefit from them in cash transfers (other than pensions and unemployment insurance) and this has not changed in fourty years.

That being said, it is critical to study post-tax inequality and not only pre-tax inequality, first because in-kind transfers (in particular access to free education and health services) play a very important role for bottom groups, and next because post-tax incomes can be substantially smaller than pre-tax incomes at the top of the distribution (at least in countries with highly progressive tax systems).

Unfortunately, the United States is the only country for which complete pre- and post-tax that the long-run declines in corporate-tax and estate-tax revenues continue to exert downward pressure on effective tax rates at the top. Compared to the period between 1940 and 1960, when the level of taxation of the top 1% was consistently above 40%, the average tax rate as a percentage of pre-tax income was more than five percentage points lower in 2014, and ten percentage points lower than before the financial crisis.

In contrast to the overall fall in tax rates for top earners since the 1940s, taxes on the bottom 50% have risen from 15% to 25% between 1940 and 2014. This has been largely due to the rise of payroll taxes paid by the bottom 50%, which have risen from below 5% in the 1960s to more than 10% in 2014. Indeed, payroll taxes are now much more important than any other taxes—federal or state—borne by the bottom 50%. In 2014, payroll taxes amounted to 11% of pre-tax income, significantly above the next largest items: federal and state income taxes, which made up 7% of pre-tax income, and sales taxes, at 5%.[16] Although payroll taxes finance transfers including Social Security and Medicare, which in part go to the bottom 50%, their increase also contributes to the stagnation of the post-tax income of working-age Americans who make up a notable proportion of the bottom 50% of the income distribution.

income inequality estimates are available in this Report. Would focusing on post-tax income inequality in other countries modify the general conclusions of the Report?

Based on the findings of this chapter and on preliminary results for other countries, it seems likely that focusing on post-tax incomes would tend to comfort our main conclusions.

For instance, the magnitude of in-kind education and health transfers tends to be higher in Europe than in the United States, particularly for the bottom 50%, so our conclusion about higher inequality in the US is likely to be magnified when we move from pre-tax to post-tax inequality.

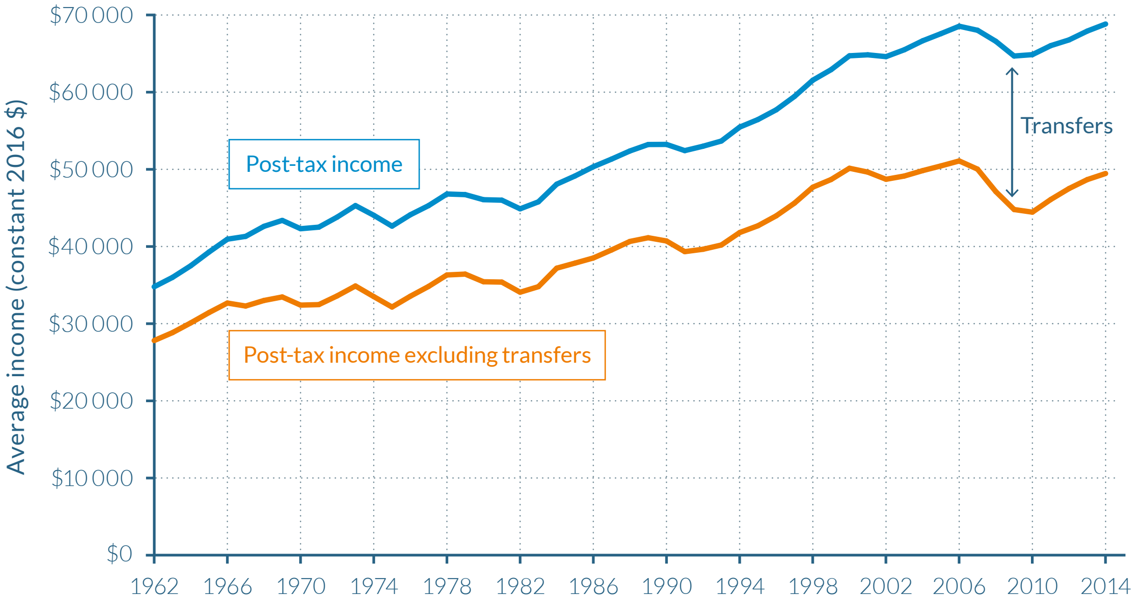
Next, we know that tax progressivity was reduced, rather than increased, in most countries since the 1980s (see chapter 5.2). Taking into account post-tax estimates therefore tends to reinforce the rise in inequality observed in pre-tax series. In France, for instance, effective tax rates are lower for the very rich than for the middle class, and new tax legislations will further decrease these rates for the richest (see chapter 2.5).

In emerging countries, the tax and transfer systems are generally less developed and less progressive than in the United States and Europe (as discussed in chapter 5.2, there are no estate taxes in emerging countries, while the poor pay high taxes on some basic consumption goods such as energy), so the gap between extreme inequality countries and other regions discussed in chapter 2.1 may in fact be reinforced with post-tax estimates.

The exact magnitude of these variations remains unknown at this stage. The WID.world consortium is currently producing novel post-tax income inequality estimates for various parts of the world (in particular for Europe and Latin America), but taking into account consistently all forms of incomes, taxes and transfers of all individuals in a given country over long time periods requires tremendous efforts. This is an exciting agenda for economic research and future editions of this Report will present new results and progresses made along these lines.

Figure 2.4.7

Post-tax income of the Middle 40% in the US, 1962–2014: The role of transfers



Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the average post-tax income of the Middle 40% was €68 800. Post-tax national income is measured after all taxes, transfers, and government spending. All values have been converted to 2016 constant US dollars (accounting for inflation). For comparison, $1 = €0.8 = ¥3.3 at market exchange rates, and $1 = €0.9 = ¥6.6 at purchasing power parity.

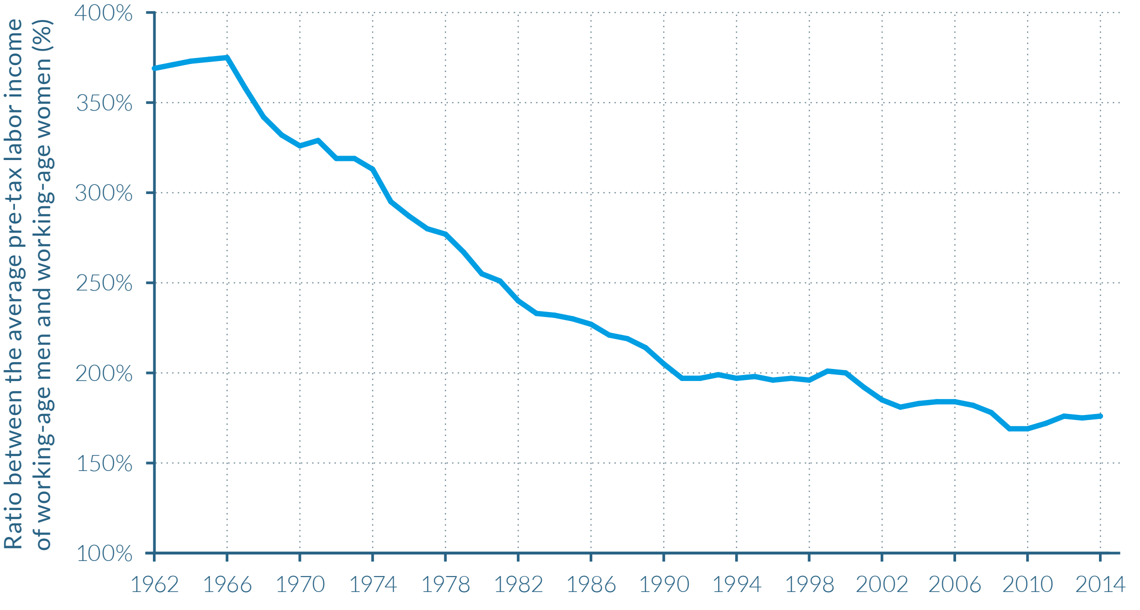
Transfers essentially target the middle class, leaving the bottom 50% with little support in managing the collapse in their pre-tax incomes

While taxes have steadily become less progressive since the 1960s, one major evolution in the US economy over the last fifty years has been the rise of individualized transfers, both monetary and in-kind. Public-goods spending has remained constant, at around 18% of national income, but transfers—other than Social Security, disability, and unemployment insurance, which are already included in calculations of pre-tax income—increased from around 2% of national income in 1960 to 11% in 2014. The two largest transfers were Medicaid and Medicare, representing 4% and 3%, respectively, of national income in 2014. Other important transfers include refundable tax credits (0.8% of national income), veterans' benefits (0.6%), and food stamps (0.5%).

Perhaps surprisingly, individualized transfers tend to target the middle class. Despite Medicaid and other means-tested programs which go entirely to the bottom 50%, the middle 40% received larger transfers in 2014 (totaling 16% of per-adult national income) than the bottom 50% of Americans (10% of per-adult national income). With the top 10% of income earners receiving approximately 8% of per-adult national income in transfers, there is an inverted U-shaped relationship between post-tax income and transfers received (when Social Security benefits are included in transfers). These transfers have been key to enabling middle-class incomes to grow, as without them, average income for the middle 40% would not have grown at all between 1999 in 2014. (See **Figure 2.4.7**) By contrast, transfers have not been sufficient to enable the incomes of the bottom 50% to grow significantly and counterbalance the collapse in their pre-tax income.

Figure 2.4.8

Difference in the pre-tax labor income between working-age men and women in the US, 1962–2014



Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the average pre-tax labor income of men aged 20-64 years old was 1.76 times greater (76% higher) than the average pre-tax labor income of women aged 20-64 years old. Pre-tax labor income is composed of wages as well as pensions, social security, and unemployment insurance benefits, minus the corresponding contributions.

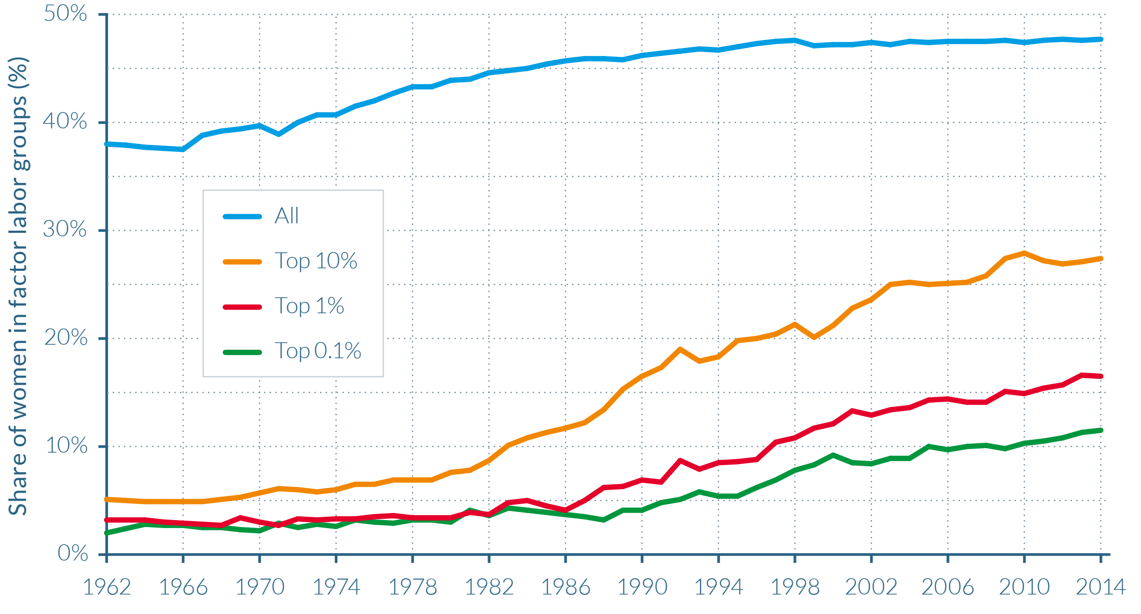
The reduction in the gender wage gap has been an important counterforce to rising US inequality

The reduction in the gender gap has been an important force in mitigating the rise in inequality that has largely taken place after 1980. To examine this process, the data must be analyzed on an individual rather than on a tax-unit basis (such as a couple or a family). The overall gender gap has been almost halved over the last half-century, but it has far from disappeared. The more comprehensive way to measure the gender gap is to compute the ratio of average labor income of working-age men (aged 20–65) to average labor income of working age women (aged 20–65), regardless of whether and how much they work. As illustrated in **Figure 2.4.8**, this income ratio has fallen from highs of 3.7:1 in the 1960s to approximately 1.75:1 in 2014.

Still, considerable gender inequalities persist, particularly at the top of the labor income distribution, as illustrated by **Figure 2.4.9**. In 2014, women accounted for close to 27% of the individuals in the top 10% of the income distribution, up 22 percentage points from 1960. Their representation, however, grows smaller at each higher step along the distribution of income. Women make up only 16% of the top 1% of labor income earners (a 13 percentage point rise from the 1960s), and only 11% of the top 0.1% (an increase of 9 percentage points). There has been only a modest increase in the share of women in top labor income groups since 1999. The glass ceiling is still far from being shattered.

Figure 2.4.9

Share of women in the employed population by labor income group in the US, 1962–2014



Source: Piketty, Saez and Zucman (2018). See wir2018.wid.world for data series and notes.

In 2014, the share of women in the employed population was 48%. Factor labor income excludes pensions, social security, unemployment insurance benefits, and corresponding contributions.

2.5

INCOME INEQUALITY IN FRANCE

Information in this chapter is based on "Income Inequality in France, 1900–2014: Evidence from Distributional National Accounts (DINA)," by Bertrand Garbinti, Jonathan Goupille-Lebret and Thomas Piketty, 2017. WID.world Working Paper Series (No. 2017/4).

- In 2014, the share of total pre-tax income received by the bottom 50% earners was 23%, while the share of the top 10% was 33%. Although income inequality in France was by no means insignificant in 2014, it sharply contrasts with the situation a century ago. In 1900, the top 10% of the income distribution received half of total French national income.
- Income inequality decreased significantly between the start of the First World War and the end of the Second World War due to the fall of top capital incomes resulting from the destruction of physical capital, the damaging impact of inflation, and the effects of nationalizations and rent-control policies.
- The struggle between labor and capital to share the fruits of growth between 1945 and 1983 characterized a turbulent period for income inequality, rising until 1968, when civil unrest pressured the government into reducing wage differentials.
- Austerity measures introduced in 1983, including the end of indexing wages to inflation, started a trend of rising inequality. Wage differentials and returns to capital increased thereafter.
- While gender pay gaps have consistently fallen since the 1970s, women made up just 30% of the top 10% of French earners in 2012, and if current trends continue, women cannot expect to make up a proportion of the top 10% equal to men until 2102.

In 2014, the top 10% French earners captured 33% of national income

In 2014, the average national income per adult in France was €33 400. This average, however, disguises significant variations among groups within the distribution. The bottom 50% earned around €15 000 on average in 2014, notably less than half the national average, and thus their share of total French income was less than a quarter (22.5%). The middle 40% had an annual average income of almost €37 500, and accordingly held a 45% share of national income, while the top 10% received approximately €109 000, more than three times the national average. These relative differences grow ever larger for the richest, with the top 1% having an 11% share in national income, and the top 0.1% and 0.01% having incomes 37 and 129 times the national average, as shown in **Table 2.5.1**.

Income inequality in France has varied significantly since the start of the twentieth century

While income inequality in France is by no means insignificant today, it has fallen notably since 1900. At the beginning of the twentieth century, the top 10% of the income distribution (which can be thought of as the "upper class") received 50% of total national income, while the middle 40% (the so-called "middle class") had around 35%. Meanwhile, the bottom 50% (the "lower class") had less than 15% of national income. The increased shares for the middle (+10 percentage points) and lower class (+8 percentage points) between 1900 and 2014 have thus come at the expense of the richest in roughly equal amounts. This reduction in inequality has taken place, however, in a haphazard and disorderly manner, undergoing numerous evolutions over the last century that are the result of a complex mix of historical events and political decisions.

To better comprehend recent developments in income inequality in France, it is first important to analyze how average income evolved from 1900 to 2014. Per-adult national income has risen approximately sevenfold over the last century in France, from around €5 500 in the year 1900. However, this growth in national income per adult was far from steady. Between 1900 and 1945, per-adult national income declined on average

Table 2.5.1
The distribution of national income in France, 2014

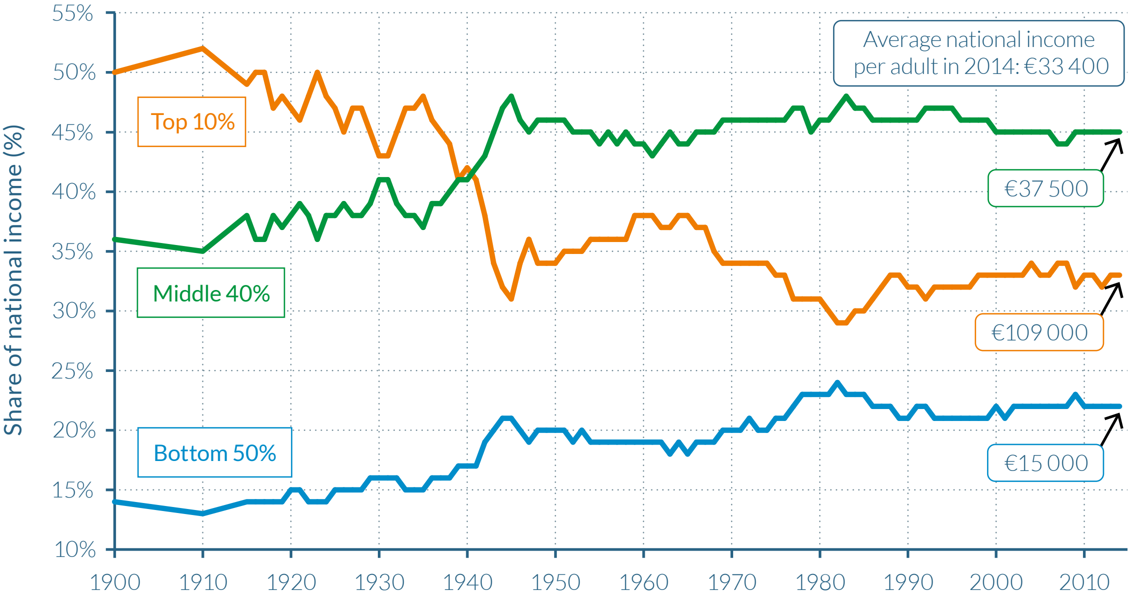
Income group	Number of adults	Income threshold (€)	Average income (€)	Income share
Full Population	51 722 000	–	33 400	100%
Bottom 50%	25 861 000	–	15 000	22.5%
Middle 40%	20 689 000	26 600	37 500	44.9%
Top 10%	5 172 000	56 100	109 000	32.6%
Top 1%	517 000	161 400	360 600	10.8%
Top 0.1%	51 700	544 600	1 234 400	3.7%
Top 0.01%	5 200	2 002 000	4 318 600	1.3%
Top 0.001%	500	6 976 500	13 175 100	0.4%

Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, 33% of national income was earned by the Top 10% in France. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ¥4.4. PPP accounts for differences in the cost of living between countries. Values are net of inflation. Numbers may not add up due to rounding.

Figure 2.5.1

Incomes shares in France, 1900–2013: The rise of the lower and middle classes



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, 33% of national income was earned by the Top 10% in France. In the same year, the average income of the Top 10% was €109 000, over three times the national average per adult. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ¥4.4. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

by -0.1% per year, but then increased at an average of 3.7% during the postwar period until 1980; dubbed *les trente glorieuses*. These "thirty glorious years" were followed by a period in which per-adult national incomes grew four times slower than previously, averaging 0.9% per annum from 1980 to 2014. This pattern was not unique to France, however. Similar trends were experienced in most European countries and Japan, and to a lesser extent in the United States and in the UK, where the shocks created by the First and Second World Wars were less damaging than in Continental Europe.

The evolution of income inequality over the last century can be broken down into three broad periods. The first of these periods was from the start of the First World War to the end of the Second World War. As visualized in **Figure 2.5.1**, the share of income of the top 10% of earners fell abruptly during the 1914–1945 period, from more than 50% of total income on the eve of the First World War to slightly above 30% of total income in 1945. This decline was mainly due to the collapse of capital income, which was hit by a number of negative shocks. Capital income generally makes up a significantly higher proportion of income for the richest 10% of the population, and particularly the top 1%, than it does for other groups. Both wars involved the destruction of capital stocks, and bankruptcies were not infrequent. They led to a collapse in gross domestic product (GDP), which lost 50% of its value between 1929 and 1945. Inflation reached record levels (the price index was multiplied by more than a hundred between 1914 and 1950), severely penalizing individuals with bond holdings and, more broadly, with fixed income assets. The control of rents during the period of inflationism led to a tenfold fall in their real value, and additionally, nationalization and the high level of taxation of certain assets in 1945 contributed to a sharp fall in capital income. The result for the top 1%—that is, those earning the most income from capital—was to see their share of national income halved in around thirty years.

The second period, between 1945 and 1983, was characterized by a struggle between labor and capital to share the fruits of growth, which reached very high levels (+3.3% per year on average). From 1945 to 1968, the inequality in wages that had existed before the world wars was rebuilt and the share of capital in the French economy also rose, leading to a period of rising income inequality. As illustrated by **Figure 2.5.1**, the income share of the top 10% had risen from around 30% to 38% during this twenty-three-year period, while the share of the bottom 50% fell from approximately 23% to 17%. Following the events of May 1968, however, this trajectory of rising inequality abruptly stopped.

May 1968 was a volatile period of civil unrest in France, punctuated by demonstrations, general strikes, and protester occupations of universities and factories across the country. The French government, under Charles De Gaulle's presidency, introduced a number of conciliatory policies in the following month in an attempt at appeasement, including a boost in the real minimum wage of approximately 20%. This marked the beginning of a period of steady increases in the minimum wage and of the purchasing power of the poor between 1968 and 1983. The purchasing power of those with lower wages rose substantially more than did GDP, which itself grew by a noteworthy 30%. These factors led to a compression in the distribution of wages and reduced income inequality more generally. In the early 1980s, the top 10% had their lowest share of pre-tax national income recorded, at 30%, while the middle 40% had an historic high of approximately 48%, and the bottom 50% accounted for 23%. However, the rise in unemployment that started during the mid-1970s also marked the beginning of a new period.

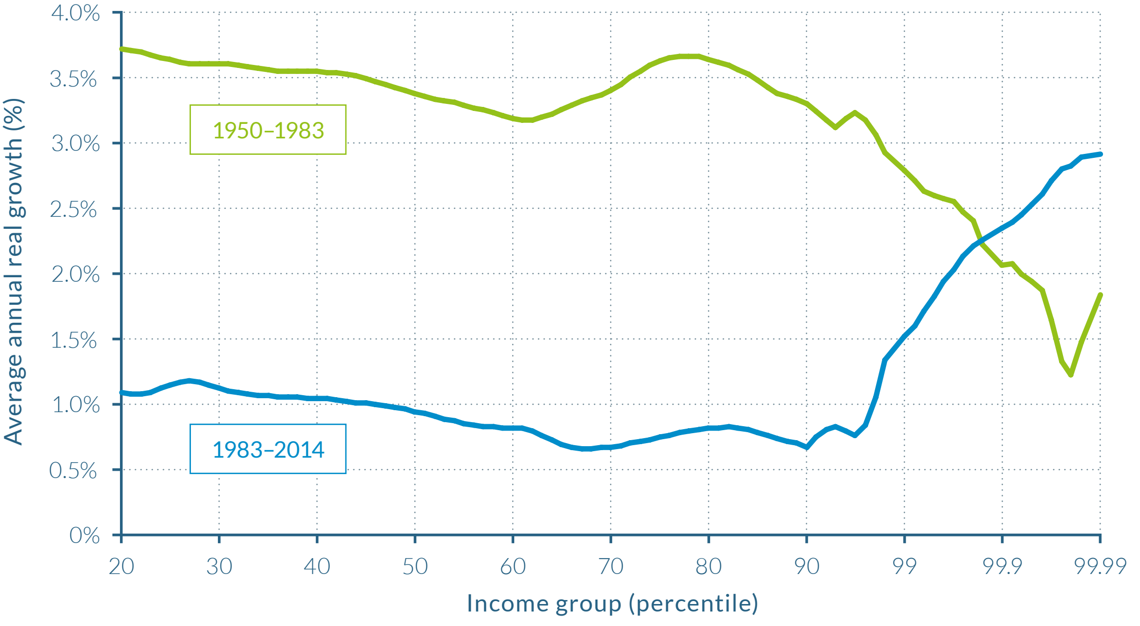
The third period, marked by a substantial reduction in income growth rates (1% per year on average), began in 1982–1983 when successive governments decided to end the policy of indexing wages to prices and therefore reduced the rate of wage increases for the low-paid.[17] This was initially part of an austerity program known as the *tournant de la rigueur* (austerity turn), introduced by President Mitterrand's then newly elected left-wing government. The program was an attempt to combat high inflation rates and rapid deteriorations in the budget and trade deficits between 1981 and 1983 that could have seen France leave the European Monetary System. Taxes were also increased, subsidies to state-owned enterprises were reduced, and social security and unemployment insurance payments were restrained.[18] The overall effect of these policy choices was an increase in the pay gaps between those who earned the lowest wages and others. During this period, inequality was relatively stable except at the top of the distribution. Very top incomes increased substantially.

The end of the "thirty glorious years" for the bottom 95%, but not for those at the top

One way to better understand the magnitude of the turning point that occurred in the 1980s is to look at the total growth curve by income group. That is, we can ask: What was the change in the average income of each group over the different time periods? Between 1983 and 2014, average national income per adult rose by 35% (1% per annum) in real terms in France. However, actual total growth was not the same for all income groups, as illustrated by the impressive upward slope on the right hand of the 1983–2014 growth curve in **Figure 2.5.2**. Total growth between 1983 and 2014 was 31% on average (0.9% per annum) for the bottom 50% of the distribution, 27% for next 40% (0.8% per annum), and 49% for the top 10% (1.3% per annum). Moreover, total growth remained below the economy-wide average until the ninety-ninth percentile, and then rose steeply, up to as much as 98% growth over the thirty-one-year period (2.2% per annum) for the top 0.1% and 144% for the top 0.001% (2.9% per annum).

Figure 2.5.2

Average annual real growth by income group in France, 1950–2014



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

Between 1950 and 1983, the 50th percentile of the population experienced a 3.4% average annual increase in their real income, while between 1983 and 2014 their real income increased by 0.9% on average per year.

The contrast between 1950–1983 and 1983–2014 in terms of the total growth rates of income groups is particularly stark. As **Table 2.5.2** and **Figure 2.5.2** show, growth rates were very high for the bottom 99% of the population during the "thirty glorious years" between 1950 and 1983, at around 200%, while growth for the top 1% was markedly lower at 109% (2.3% per annum). Growth rates were even lower at the very top, at around 80% (1.8% per annum) for the top 0.1 and 0.01%.

Another way to measure these diverging evolutions is to compare the shares of total economic growth going to the different income groups. Between 1950 and 1983, 25% of total growth went to the bottom 50% of the population, versus only 6% to the top 1%. Between 1983 and 2014, 21% of total growth went to the bottom 50%, as much as the share of growth which went to the top 1%.

Summing up, although the rise of inequality was less pronounced in France (and to a large extent in Europe) than in the United States, the break between the 1950–1983 period, when bottom groups enjoyed larger growth than the top, and the 1983–2014 period, when the exact opposite pattern prevailed, is very visible.

Recent growth at the top is due to higher salaries and returns on capital assets

As a result of the unequal distribution of growth, the share of income attributed to the top 1% has seen a notable increase between 1983 and 2007, rising from less than 8% of total income to over 12% over this period—that is, rising by over 50%. Between 2008 and 2013, the income share of the top 1% fluctuated between 10% and 12%, remaining significantly larger than when income inequality was at its lowest point in the early eighties (see **Figure 2.5.1**). As stated above, this trend of rising inequality among the highest earners is even more pronounced for

Table 2.5.2
Income growth and inequality in France, 1900–2014

	1900–1950			1950–1983			1983–2014		
Income group	Average annual growth rate	Total cu-mulated growth	Share of total cu-mulated growth	Average annual growth rate	Total cu-mulated growth	Share of total cu-mulated growth	Average annual growth rate	Total cu-mulated growth	Share of total cu-mulated growth
Full Population	**1.0%**	64%	100%	**3.3%**	194%	100%	**1.0%**	35%	100%
Bottom 50%	**1.8%**	144%	30%	**3.7%**	236%	25%	**0.9%**	31%	21%
Middle 40%	**1.5%**	108%	61%	**3.4%**	204%	48%	**0.8%**	27%	37%
Top 10%	**0.2%**	11%	8%	**2.9%**	157%	27%	**1.3%**	49%	42%
Top 1%	0.6%	37%	16%	3.1%	178%	21%	0.9%	33%	21%
Top 0.1%	-0.5%	-23%	-8%	2.3%	109%	6%	2.2%	98%	21%
Top 0.01%	-1.1%	-44%	-7%	1.7%	75%	1%	2.8%	133%	8%
Top 0.001%	-2.0%	-63%	-5%	1.8%	83%	0%	2.9%	144%	3%

Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.
Between 1900 and 1950, the share of national income growth captured by the Top 10% was 8%.

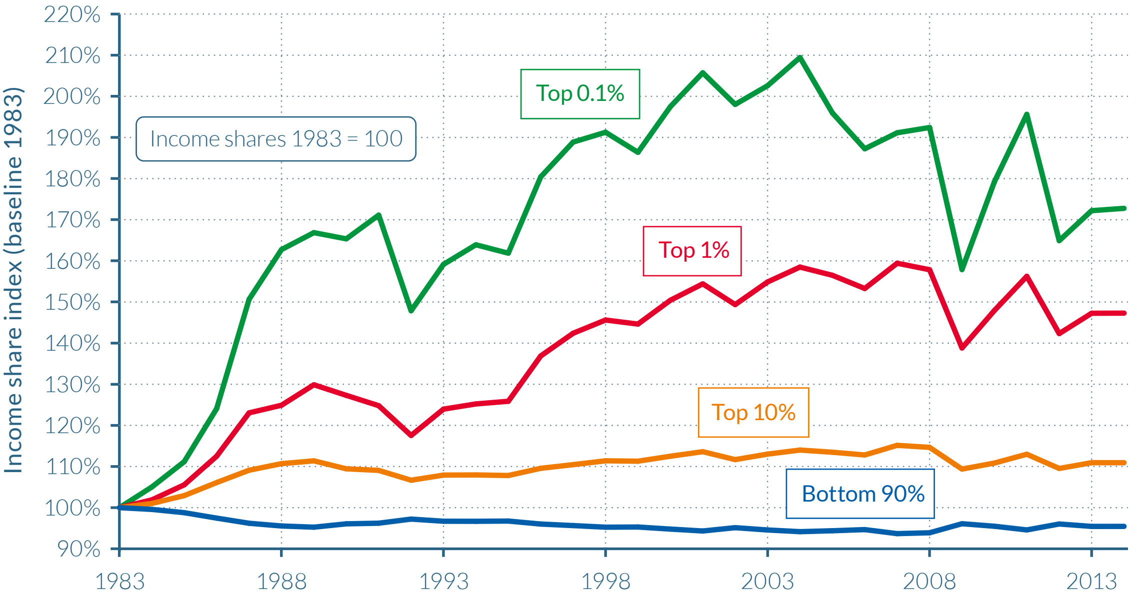
the top 0.1% and the top 0.01% (see **Figure 2.5.3**). The difference between the average national income before tax and those of top earners has almost doubled over the preceding thirty years. The top 0.1% average income increased from 21 times above average in 1983 to 37 times in 2014, while the figure increased from 71 times average to 129 times for the top 0.01%.

Why has there been a rise in top incomes over the recent period? In the case of France, top earners have experienced significant increases in their incomes from both labor and capital. Between 1983 and 2013, the labor income of the top 0.01% rose 53%, while their capital income increased by 48%. It is difficult for standard explanations based on technical change and the changing supply and demand of skills to explain rising income concentration at the very top, whether around the world or in France specifically.[19] The rise of labor incomes at the top is more likely to be the result of evolutions in institutional factors governing pay-setting processes for top managerial compensation, including changes in corporate governance and the decline of unions and collective bargaining processes. Evolutions in top marginal tax rates have also likely had an impact on labor income inequality. Reduced top income tax rates can affect wage-setting at the top; as top earners expect less taxes, they may be more inclined to ask for increases in wages.[20] Top income tax rates were above 60% during the *trente glorieuses* and rose to 70% in the early 1980s. They fell to about 50% in the late 2000s. Effective tax rates (total taxes paid on total income) are actually inferior for very top income groups than for the middle class.[21] Recent tax legislation supported by the current government are about to further reduce tax rates at the top, in particular due to reduction in tax rates on capital.

Increases in top labor income inequality have in certain cases been correlated with increases in top capital income inequality. Top managers, for example, have benefitted first from very high labor incomes through

Figure 2.5.3

Rising top inequality in France, 1983–2013



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

The share of income going to the Top 1% in 2013 grew by 34% relative to its 1983 value, while the share going to the Top 0.1% in 2013 grew by 60%.

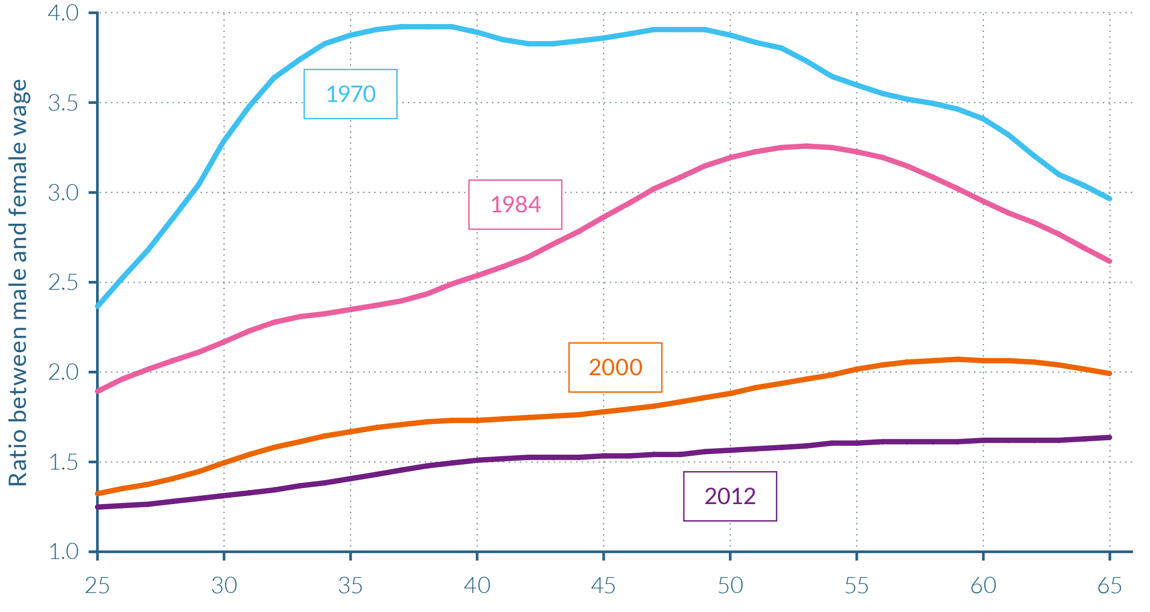
large bonuses or stock options (some of which have been largely mediatized) and then from very high capital incomes derived from improvements in the price of the stocks that they have come to own. Top capital incomes have also been rising due to the rising share of macroeconomic capital in a context of declining labor bargaining power and privatization policies.

Gender pay gaps may be falling, but men are still paid approximately 50% more than women

While income inequality has increased since the 1980s, gender gaps have been declining since the 1970s. Still, gender gaps remain very high in France today. In the 1970s (the "age of patriarchy") men earned 3.5 to 5 times the labor income of women, and women's labor force participation rate was around 45%. The share of working women rose dramatically to 80% in 2012 and the women-to-men pay ratio decreased to 1:1.5 on average. There are, however, strong variations in gender income gaps over age groups. As can be seen in **Figure 2.5.4a**, in 2012, men earned 1.25 times more on average than women at the age of 25, and 1.64 times more at age 65.

Gender inequalities are also particularly high among higher paying jobs. Despite moderate improvements since 1994, women still do not have equal access to them. In 2012, the female share of the top 50% of earners was 42%, while women made up just 30% and 12% of the top 10% and top 0.1% earners, respectively. If current trends continue, women can expect to make up the same proportion as men of the top 10% and top 0.1% shares by 2102 and 2144, respectively. (See **Figure 2.5.4b**)

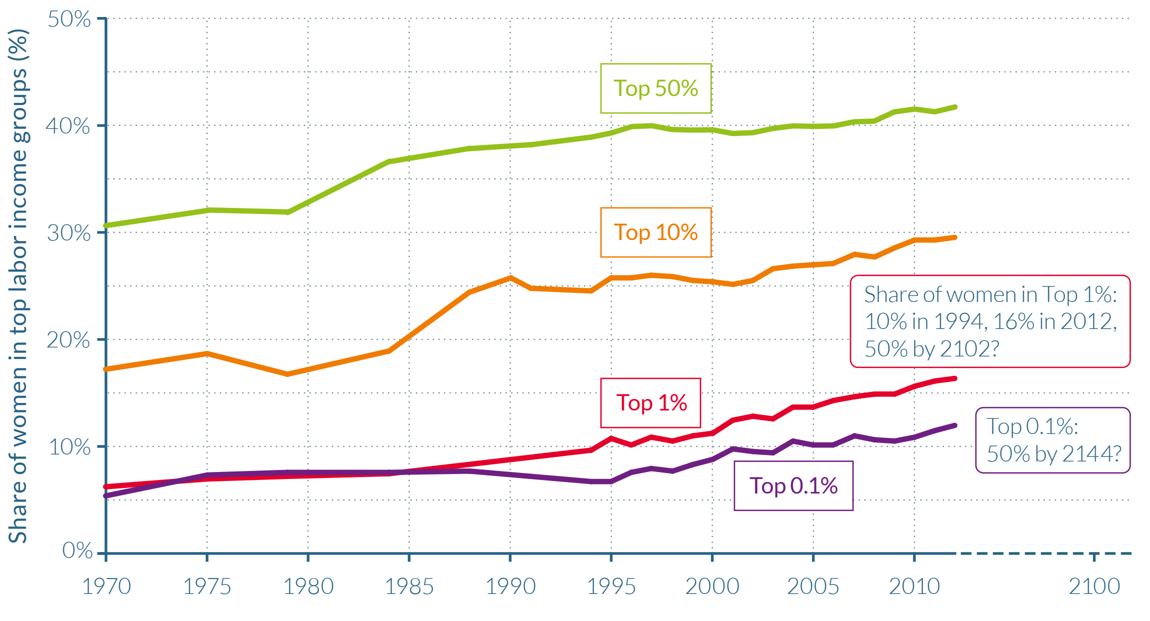
Figure 2.5.4a
Gender gap by age in France, 1970–2012



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2012, the average labor income of 40-year-old men was 1.5 times higher than for 40-year-old women.

Figure 2.5.4b
Share of women in top labor income groups in France, 1970–2012



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2012, the share of women in the total working population of the Top 1% was 16%.

2.6

INCOME INEQUALITY IN GERMANY

Information in this chapter is based on "Top incomes in Germany, 1871–2013," by Charlotte Bartels, 2017. WID.world Working Paper Series (No. 2017/18).

- In 2013, the share of total income received by the bottom half of the population was 17%, while the share of the top decile was 40%. In 1913, the share of the top 10% was also 40%.The top 1% is, however, lower today than in 1913 (18% versus 13%).
- The top 1% increased sharply between the creation of the Reich in 1871 and the establishment of the Weimar Republic in 1918. It then decreased dramatically when social policies were implemented by the Weimar Republic. The Nazi prewar period is associated with economic recovery and favorable policies for large businesses, and saw temporary surges in top incomes. The top 1% share was then reduced to 10–12% during the 1950–1990 period and has been on the rise since reunification.
- Top income earners in Germany have been business owners throughout the twentieth century and up to the present. As most German firms are family owned, with some family members more involved than others, it is difficult to judge how much of top incomes are labor incomes and which part is "pure" capital income (with limited labor input). Starting in the 1980s, however, highly qualified employees have increasingly entered top-income groups.
- In Germany, high income concentration of the industrialization period dropped as soon as the 1920s and fluctuated around this level throughout the postwar period. This contrasts with other rich countries like United States, the United Kingdom, and France, where the Second World War brought strong and lasting reductions in income concentrations at the top.

Investigating the evolution of inequality using German income tax data has a long tradition, as particularly Prussian and Saxon tax data are internationally praised for their accuracy. Simon Kuznets partly drew his famous hypothesis of rising inequality in the early phase of industrialization from Prussian income tax data. The early introduction of modern income taxation in German states at the end of the nineteenth century offers a special opportunity to compute inequality series from the industrialization phase until today.

The series presented in this chapter are based on pre-tax income data from historical German income-tax statistics collected by Charlotte Bartels. One should note, however, that the impressive length of the period covered in Germany comes with a price, in that changing territories are covered by the series. The two world wars of the twentieth century, the division of Germany after the Second World War, and its reunification in 1990 leave the researcher with income tax systems applying across time to quite differently sized territories and populations.

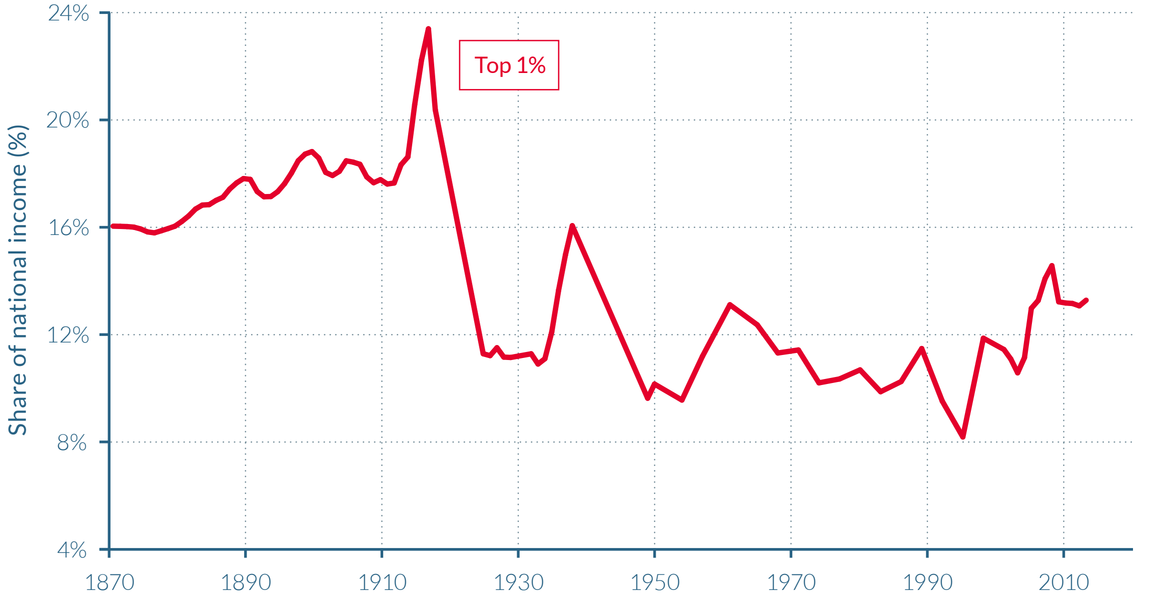
Long-run German income inequality dynamics can be split into five periods

The evolution of income inequality from 1871 to 2013 can be split into five periods. **Figure 2.6.1** shows the evolution of the top 1% income share from 1871 to 2013. The first period starts with the foundation of German Reich in 1871, which unified German states, and ends with the First World War. The top percentile was the greatest beneficiary of this industrialization period. Its income share moderately increased from 16% in 1871 to 18% in 1913 and then rose to 23% during the First World War. The sharp increase observed during that war might have been the result of extraordinarily high profits from military spending. By 1918, authorities managed to restrict those profits, which contributed to bringing the top 1% share back down to 20% of national income.

The second period includes the years of the Weimar Republic (1918–1933), which brought a variety of inequality-reducing policies, including an increase in the top marginal tax rate from 5% to 60% in Prussia, the introduction of unemployment insurance, and employment law including employment protections. Strong unions and the rise of collective bargaining contributed to an increase in wages which resulted in lower labor income inequality. Hyperinflation eroded financial assets and greatly reduced capital incomes during this period. Additionally, industrial firms generated very low profits throughout the 1920s, if any at all, and mostly did not pay out dividends. As a consequence, the top percentile's income share decreased significantly from 20% in 1918 to 11% in 1925 and remained at the latter level until 1933.

The third period starts with the Nazi's seizure of control in 1933 and ends at the eve of the Second World War in 1938. After 1938, the Statistical Office stopped publishing income tax statistics so it is impossible to know how income distribution changed during the Second World War. This prewar Nazi period is marked by an extraordinary increase in the top percentile's income share from 11% in 1934 to 17% in 1938, contrasting with the initial anti-big-business rhetoric of the Nazi party. In contrast, to the top percentile, the P95–P99 group (the top 5% richest, minus the very top 1%) gained only moderately during this period. As in most rich countries, economic recovery after the Great Depression started in 1932 in Germany. Industrial firms saw their profits rise sharply between 1933 and 1939. Ferguson and Voth find evidence that firms with strong ties to the Nazi party disproportionately benefited from the recovery, which probably contributed to further concentration of incomes at the top.[22] The larger firms across all sectors were more likely to form connections with the Nazi government, but this was particularly the case for the rearmament industry.

Figure 2.6.1
Top 1% income share in Germany, 1871–2013



Source: Bartels (2017). See wir2018.wid.world for data series and notes.
In 2013, the Top 1% national income share was 13%.

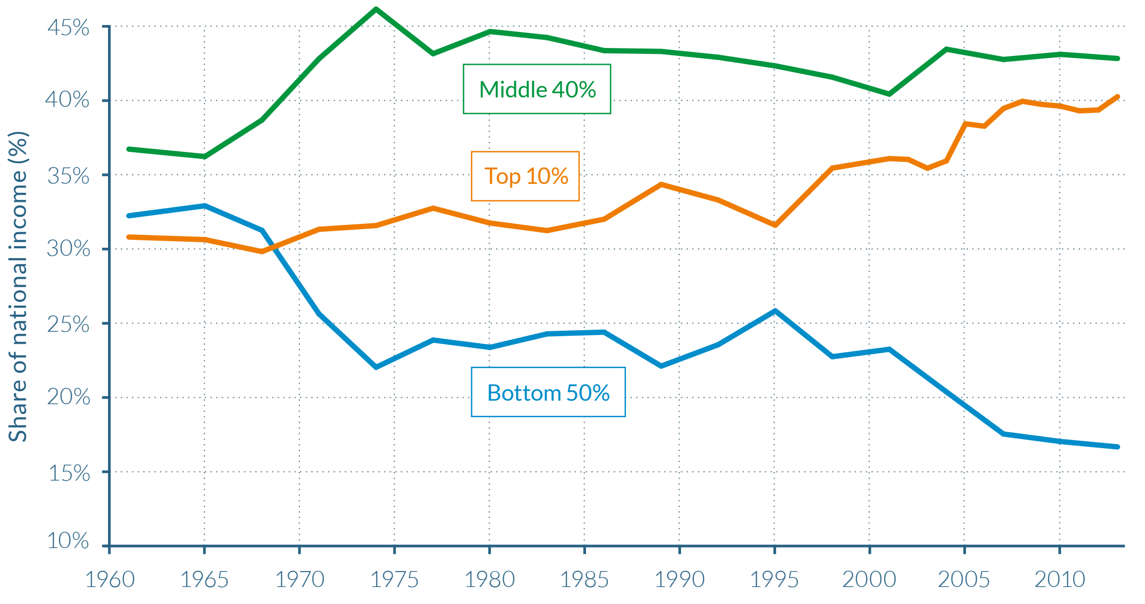
The post-war period is marked by a relatively stable but high top percentile income share

The German postwar period is characterized by a comparably high income concentration at the top, paralleled by a rather compressed wage distribution. From the mid-1950s until the 1980s, the top percentile's share oscillates between 11% and 13%. This is higher than the top percentile's share in postwar United States, United Kingdom, or France in the same period. This finding is particularly striking as the policies (especially nationalizations and rent control) after the Second World War and destructions during the Second World War are generally seen as long-lasting equalizing forces both in Germany and in other war-participating countries. The currency reform in 1948 eradicated capital incomes from financial assets for the second time in the twentieth century, while leaving business assets and real estate untouched. Savings accounts were reduced to about a tenth of their former value. As rents were heavily regulated, top incomes stemmed from business profits. On the other hand, strong labor demand and the high national income growth rates of the German *Wirtschaftswunder* coincided with powerful unions, low unemployment, and a rather compressed wage distribution. The bottom 50% then received a third of total income, as **Figure 2.6.2** shows. It was not until the 1980s that top wage earners increasingly entered top-income groups and the wage distribution became increasingly unequal. With the oil crises and the onset of mass unemployment, the share of the bottom 50% decreased to less than a fifth of national income. The fall of the bottom half was mirrored by an increase of the middle 40%, who received slightly more than 40% of national income beginning in the 1970s.

Income inequality is rising at the top since reunification

The fifth and last period corresponds to reunified Germany. Political unification on October 3, 1990, brought the eastern states

Figure 2.6.2
Income shares in Germany, 1961–2013



Source: Bartels (2017). See wir2018.wid.world for data series and notes.

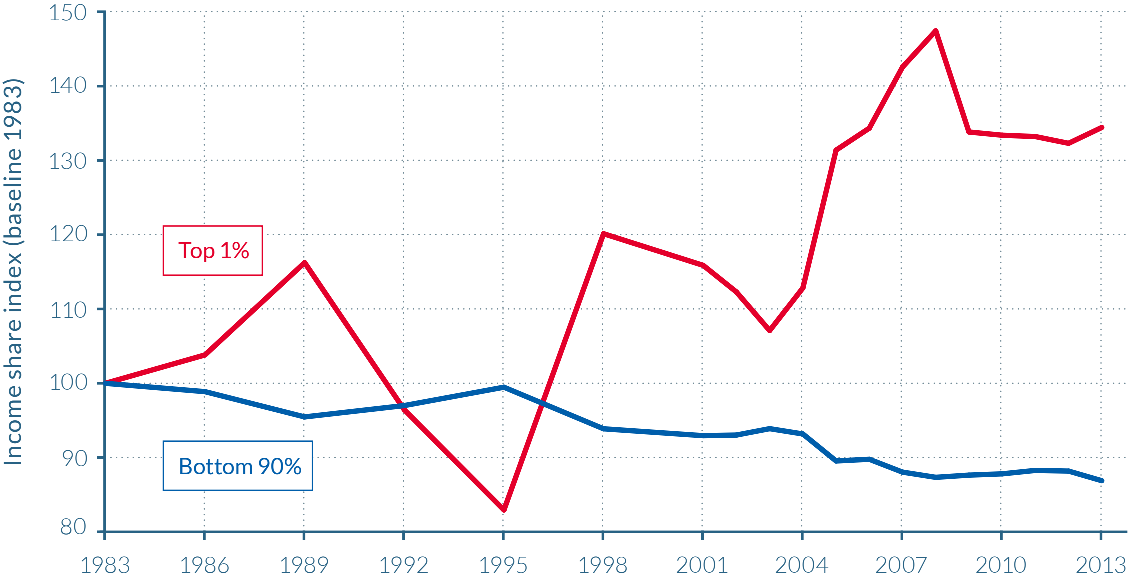
In 2013, the Top 10% national income share was 40%.

of Berlin, Brandenburg, Mecklenburg–Western Pomerania, Saxony, Saxony-Anhalt, and Thuringia into the Federal Republic of Germany. The first years after reunification were marked by exceptionally high national income growth rates for the reunified German economy. Industrial production quickly collapsed in the East and unemployment rose accordingly. Those keeping their jobs benefitted from an unprecedented jump in real wages, thanks to bargaining by the Eastern German labor unions that aimed to reach parity with West German wage levels in 1994. Taking these effects together, the top percentile's income share fell sharply, whereas the bottom 50% gained in the first years following reunification. The start of the new millennium marked another turning point; the share of the bottom half declined significantly from 22% in 2001 to 17% in 2013, a trend that went hand in hand with the growth of the low-income sector.

The top 10% income group quite steadily increased its income share over the entire postwar period. Highly qualified employees like engineers, lawyers, and doctors have benefitted from high wage growth and have been increasingly present in top-income groups. However, very top incomes are still exclusive to business owners, and profits fluctuate with business cycles. The top percentile's share is volatile, as shown in **Figure 2.6.3**. It suffered large shocks in the German unification crisis in the mid-1990s, the burst of the new economy bubble in the early 2000s, and the Great Recession in 2009. But despite the large drop after the Great Recession, the top percentile's income share still grew by almost 40% between 1983 and 2013, while the bottom 90% share fell by 10%. In 2013, while the average income in Germany was €36 200, the top 10% earned €146 000, the middle 40% earned €39 000, and the bottom 50% earned €12 000.

Figure 2.6.3

Income inequality in Germany, 1983–2013



Source: Bartels (2017). See wir2018.wid.world for data series and notes.

The share of income going to the Top 1% in 2013 grew by 35% relative to its 1983 value, while the share going to the Bottom 90% in 2013 fell by 13%.

2.7

INCOME INEQUALITY IN CHINA

Information in this chapter is based on "Capital Accumulation, Private Property and Rising Inequality in China, 1978–2015," by Thomas Piketty, Li Yang, and Gabriel Zucman, 2017. WID.world Working Paper Series (No. 2017/6).

▷ China's opening-up policies established from the late 1970s onwards were followed by unprecedented rises in national income, but also significant changes to the country's distribution of income.

▷ While the top 10% and bottom 50% both shared 27% of national income in 1978, they diverged dramatically thereafter, with the former experiencing a substantial increase to 42% by 2015 and the latter a substantial decrease to 15%.

▷ The top 10% of the income distribution enjoyed total growth rates higher than the national average (approximately 1 200% versus 800%), while the bottom 50% and middle 40% experienced slower growth (400% and 700%, respectively).

▷ The urban-rural gap in national income has grown considerably between 1978 and 2015 due to a rise in urban incomes and population. Despite this rising gap, it is mainly inequality within regions that has spurred the growth of inequality at the national level.

Chinese average incomes grew ninefold since 1978

The Communist Party of China, then led by Deng Xiaoping, implemented a series of policies in the People's Republic of China starting in December 1978 to reform and open up the Chinese economy, as the Party sought a new economic model based on the principle of "socialism with Chinese characteristics." The transition away from the communist model of the previous decades ushered in gradual but nevertheless wide-reaching reforms, expanding geographically from special economic zones in coastal cities towards inland provincial regions, and in sectoral waves. During the first stage of reform, market principles were introduced into the agricultural sector through the de-collectivization of production. While foreign investment and entrepreneurship were permitted under state guidance, the vast majority of industry remained state-owned until the mid-1980s. The following decades saw a second stage of deeper reforms implemented. Soviet-style central planning in industry was dismantled through the privatization and contracting out of state-owned enterprises, though the state maintained its control of monopolies in some sectors, including banking and petroleum. Furthermore, liberalization of markets over this period saw the lifting of price controls and the reduction of protectionist policies and regulations, aiding the dramatic growth of the private sector. These changes were particularly evident in the country's housing market. The private housing stock rose from roughly 50% in 1978 to over 95% in 2015. For other forms of domestic capital, the public share declined, though it is still around 50%.

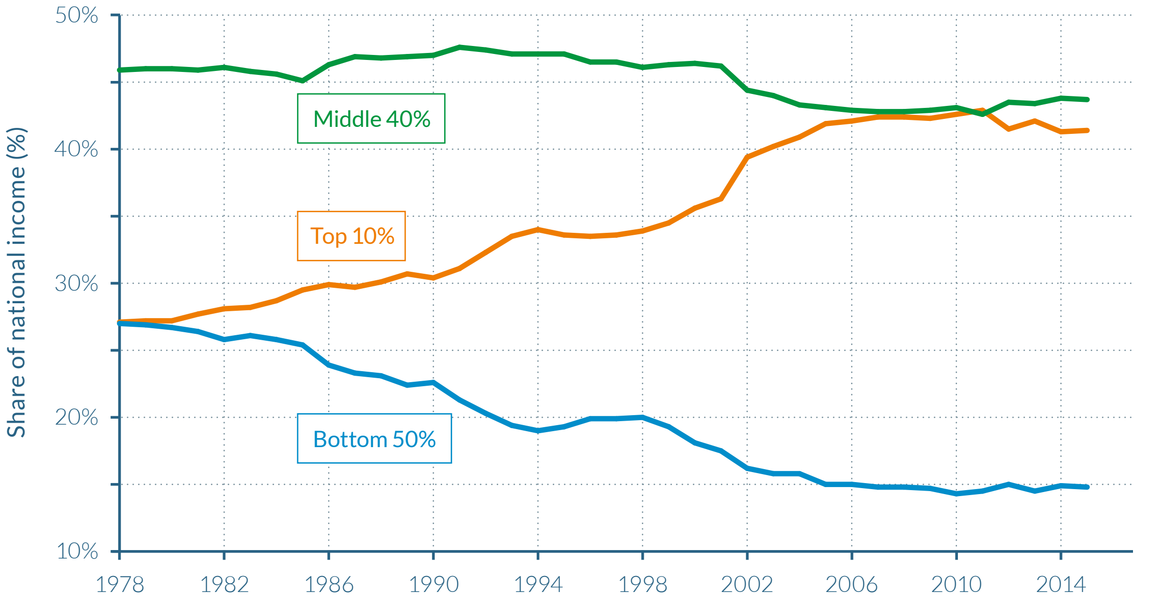
The subsequent impacts of these privatization and opening reforms have been of great interest worldwide, particularly given the significant growth the country has experienced over the last forty years and its accompanying improvements in poverty rates. Indeed, between 1978 and 2015, China moved from a poor, low-income country to the world's leading emerging economy. Despite the decline in its share of world population, China's share of world national income increased from less than 3% in 1978 to 19% in 2015, and real per-adult national income multiplied more than ninefold. Indeed, average national income adult was about €1 400 per year in 1978 (less than 15% of global average), but exceeded €13 100 in 2015 (close to 90% of the global average).

In a recent paper, Thomas Piketty, Li Yang, and Gabriel Zucman analyze how this exceptional growth was distributed across the Chinese population (reported below), and the impact that privatization policies had on the country's capital-income ratios (see chapter 3.3 of the report).[23] To form distributional national accounts, the authors combine survey data, national accounts, and recently released income tax data on high-income taxpayers. They find a significant increase in per-adult pre-tax income inequality from 1978 to 2015.[24] These results largely increase existing official inequality statistics and probably represent a lower bound to inequality, as they remain imperfect.

The shares of the top 10% and bottom 50% diverged after the opening-up reforms

As China began its privatization process (as also discussed in chapter 3.4 on Chinese public and private wealth dynamics), the share of national income going to the top 10% of the population was 27%, equal to the share going to the bottom 50%. Put in another way, these groups captured the same amount of total income, but the former had a population five times smaller than the latter. The average income of the bottom 50% was thus one-fifth of the top 10%. In 1978, the income share of the middle 40% represented just over 46% of national income; their average income was only slightly higher than the national average. The past four decades show a large divergence in the shares of the bottom 50% and the top 10% income earners (see **Figure 2.7.1**).

Figure 2.7.1
Income shares in China, 1978–2015



Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.
In 2015, the Top 10% national income share was 41%.

The income share of the bottom 50% in 2015 was just below 15%, a twelve-percentage-point fall since 1978. The share of the top 10% had increased to 41%. In 2015, the average income of the bottom 50% (€3 900 or ¥17 000) was approximately 13.5 times smaller than that of the richest 10% in 2015 (€54 500 or ¥238 000). The bottom 50% consequently earned roughly 3.4 times less than the average national income per adult in China of €13 100 or ¥57 000 in 2015, while the top 10% earned around four times more than the average income. The share of national income going to the middle 40% is only marginally different than in 1978 at almost 44%. The average income of this middle class (€14 400 or ¥63 000) was slightly higher than the average Chinese adult's income in 2015. (**Table 2.7.1**)

Income inequality stabilized after 2006

While the incomes of the top 10% and the bottom 50% in China began to diverge in 1978, the greatest divergence took place from 1998 to 2006. This coincided with the eight-year period that saw the Chinese government introduce a new set of policies for the privatization of state-owned enterprises, mainly in the tertiary sector. Part of the resulting effect was a reduction in the bottom 50% share of national income from 20% to 15%, and an increase in the share of the top 10% from around 34% to 43%. Income inequality apparently stabilized thereafter, with the shares of all three of the main income groups in 2015 remaining pretty much similar to their levels in 2006. This stabilization of inequality since 2006 should be regarded with caution as it could partly reflect data limitations, due in particular to the lack of national data made available on high-income taxpayers since 2011.[25] Still, this trend is considered valid by a number of researchers who speculate that a turnaround took place around 2006 as a result of two factors: new policies that reflected changing priorities towards more equitable growth; and the slowdown of structural transformations, such as a shrinking rural labor force, which caused wages to grow more rapidly than output.[26]

Comparing Piketty, Yang, and Zucman's inequality series to the survey-based estimates used by the Chinese government, two remarks are in order. First, the official survey data also show a strong rise in the national income share of the top 10% and a strong decline in the top 50% income share from 1978 to 2015. Second, both the level and the rise of inequality are larger in the aforementioned corrected series than in the official series. The top 10% income share rises 14 percentage points over the observed period (from 27% to 41% of national income)—which is 6 percentage points more than that seen in the official statistics—while the upward correction for the top 1% sees their share of total income for 2015 rise to 14%, versus 6.5% in the raw surveys. Most of the difference between these estimates and the raw surveys comes from the finer level of precision among top income earners enabled by income tax data. In 2015, for example, the raw surveys identify the income share of the top 1% to be 6.5%, but this reaches 11.5% after factoring in data from high-income taxpayers, and 14% following the inclusion of undistributed profits and other tax-exempt income.

Since 1980, Chinese top-income groups benefitted from quadruple-digit growth rates

The new data series constructed by Piketty, Yang, and Zucman on the distribution of national income also allow a decomposition of national income growth by income group. This in turn enables a quantitative assessment of the extent to which various groups of the population have benefitted from the enormous growth China has experienced since 1980. (See **Table 2.7.2** and **Figure 2.7.2**)

Average national income per adult has grown close to ninefold between 1980 and 2015, corresponding to an average annual increase of 6.4% and a total growth rate of 780%. This growth has not been equally shared; the higher the income level, the higher the rate of growth over the time period considered. Growth for the bottom 50% over the period was 390%, while it was 730% for the middle 40%, and 1 230% for the top 10%. Within the top 10%, growth

Table 2.7.1

The distribution of national income in China, 2015

Income group	Number of adults	Income threshold (€)	Average income (€)	Income share
Full Population	1 063 543 000	–	13 100	100%
Bottom 50%	531 771 000	–	3 900	14.8%
Middle 40%	425 417 000	7 800	14 400	43.7%
Top 10%	106 354 000	27 000	54 500	41.4%
Top 1%	10 635 000	79 000	183 000	13.9%
Top 0.1%	1 064 000	244 000	828 000	6.3%
Top 0.01%	106 000	1 411 000	4 207 000	3.2%
Top 0.001%	11 000	6 868 000	17 925 000	1.4%

Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the average income of the Top 1% was €183 000 (¥800 000). All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ¥4.4. PPP accounts for differences in the cost of living between countries. Values are net of inflation. Numbers may not add up due to rounding.

Table 2.7.2

Income growth and inequality in China, 1980–2015

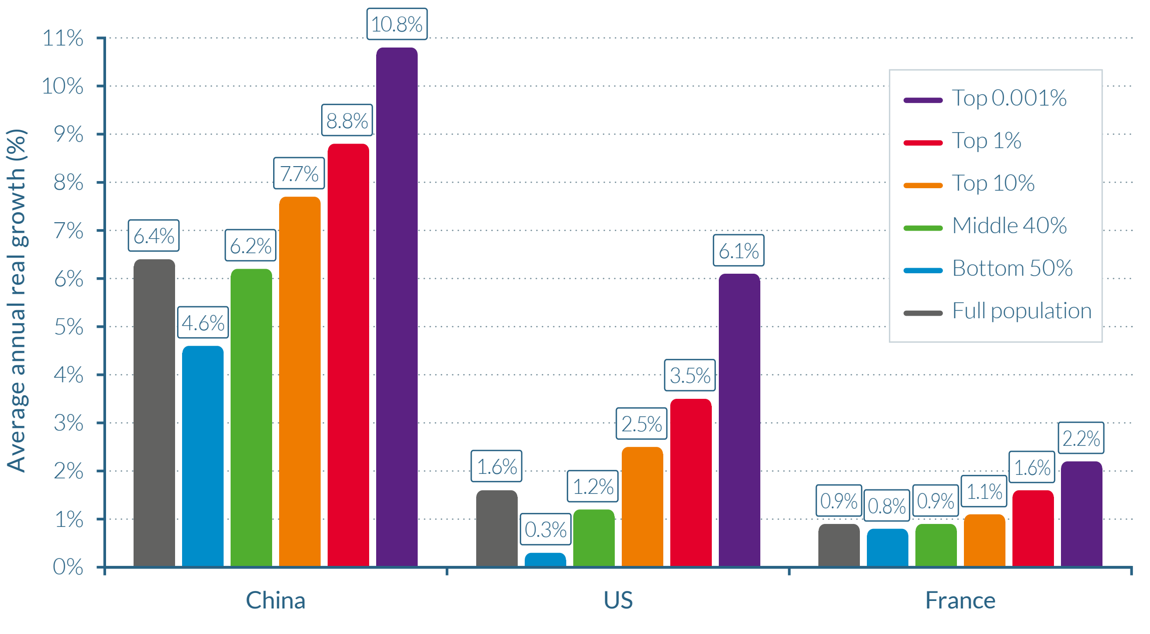
	China		US		France	
Income group	**Average annual growth rate**	**Total cumulated growth**	**Average annual growth rate**	**Total cumulated growth**	**Average annual growth rate**	**Total cumulated growth**
Full Population	**6.4%**	776%	**1.4%**	63%	**0.9%**	38%
Bottom 50%	**4.6%**	386%	**0.1%**	3%	**0.8%**	33%
Middle 40%	**6.2%**	733%	**1.0%**	44%	**0.9%**	35%
Top 10%	**7.7%**	1232%	**2.3%**	124%	**1.1%**	46%
Top 1%	8.8%	1800%	3.3%	208%	1.6%	77%
Top 0.1%	9.5%	2271%	4.2%	325%	1.7%	81%
Top 0.01%	10.2%	2921%	5.0%	460%	1.9%	91%
Top 0.001%	10.8%	3524%	5.9%	646%	2.2%	110%

Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

Between 1980 and 2015, the average pre-tax income of the Top 10% in China grew by 1232%. Values are net of inflation.

Figure 2.7.2

Average annual national income growth by income group in China, France and the US, 1980–2015



Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

Between 1980 and 2015, the average pre-tax income of the Bottom 50% in China grew at an average of 4.6% per year, against 0.3% in the US. Values are net of inflation.

was also unequally shared. The top 1% experienced total income growth of 1 800%—a huge figure, but notably less than the increases of over 2 270%, 2 920%, and 3 520% for the top 0.1%, top 0.01%, and top 0.001%, respectively.

By contrast, average national income per adult rose by just 63% and 38% in the United States and France over the same period, respectively—approximately fourteen and twenty-one times less than in China. The difference in income growth across the distribution was also markedly different at the bottom of the distribution; the cumulative national income growth of the bottom 50% was 3% for Americans, while for French citizens, it rose at 33%, i. e. less than the average. However, the same pattern, by which income growth rates rise more quickly the higher up the distribution one goes, was evident for all countries.

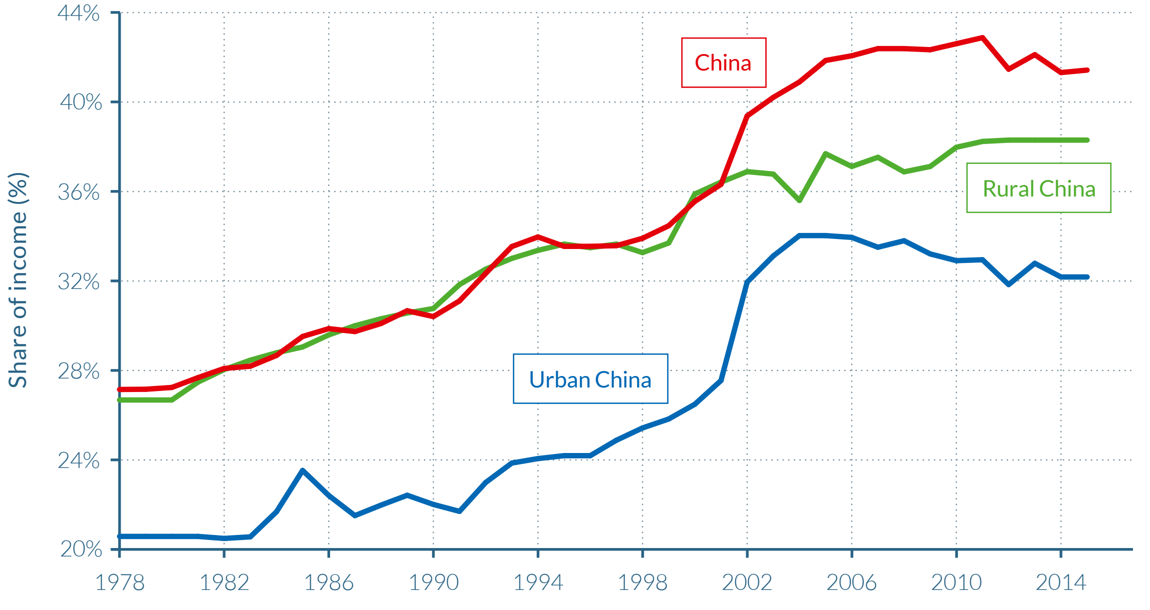
The urban-rural gap continues to grow, but it is within-region inequality that spurs overall growth in inequality

What role has the urban-rural gap played in the evolution of Chinese inequality? This question is important as inequality could be driven mainly by growing differences between cities and rural areas and not by inequality among individuals within areas. Policy implications are indeed dependent on which force dominates in the mix. To answer this question, it is first important to identify how the populations of urban and rural areas has changed post 1978, as this will in part determine the urban and rural shares in national income. In the urban areas of China, the adult population rose from 100 million in 1978 to almost 600 million in 2015. During this same period, the adult rural population remained roughly stable, rising from 400 million in 1978 to almost 600 million by the mid-1990s, before declining to less than 500 million in 2015. Secondly, the income gap between urban and rural China has always been large and it has grown over time. Urban households earned twice as much income on average as rural households in 1978, but in 2015 they earned 3.5 times as much. Thus, while the urban share in the adult population has grown from 20% in 1978 to 55% in 2015, the urban share in national income has increased from 30% to 80%.

Despite the increase of inequality both in urban and rural China, the level of income inequality in China as a whole is markedly higher at the national level (where the bottom 50% captures only 15% of total income) than it is within rural China (where the figure is 20%) or urban China (25%) considered alone.[27] As evidenced in the previous sections, the trend for the top 10% largely mirrored that of the bottom 50%, but in the opposite direction, with rising income shares for the top 10%. Combining this data also demonstrates that there has always been more inequality within rural areas than within urban China, and this will remain the case if current trends continue. (**Figure 2.7.3**)

Figure 2.7.3a

Income share of the Top 10% in rural and urban China, 1978–2015

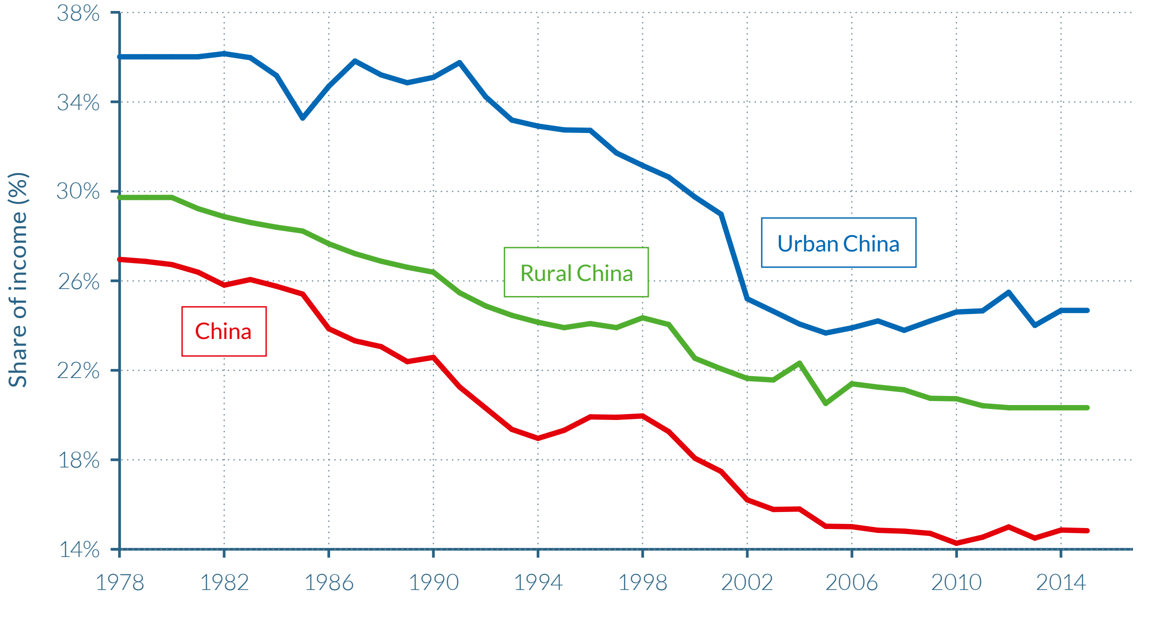


Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 10% income share in rural China was 38%.

Figure 2.7.3b

Income share of the Bottom 50% in rural and urban China, 1978–2015



Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the Bottom 50% income share in rural China was 20%.

2.8

INCOME INEQUALITY IN RUSSIA

Information in this chapter is based on “From Soviets to Oligarchs: Inequality and Property in Russia 1905–2016,” by Filip Novokmet, Thomas Piketty, and Gabriel Zucman, 2017. WID.world Working Paper Series (No. 2017/9).

- ▷ Russia’s transition from a communist to a capitalist economic model after 1989 brought about a large divergence in the income shares and growth rates of different income groups.
- ▷ The share of national income attributable to the bottom 50% has fallen from 30% in 1989 to less than 20% today, while the share of the top 1% has rocketed upwards from around 25% to over 45% of national income.
- ▷ Russia’s rapid and chaotic “shock therapy” of privatization, capital flight, and the rise of offshore wealth, along with high inflation and a new market environment, have contributed to the rise of top Russian incomes since 1989.
- ▷ Today’s inequality levels are comparable, and somewhat higher, than those observed during the tsarist period. The Russian Revolution led to a significant redistribution of income, with the top 1% share of national income falling from 18% in 1905 to less than 4% in 1928.
- ▷ The most equitable distribution of income in Russia’s recent history followed the introduction of comparatively liberal de-Stalinization policies from 1958 onwards, with large investments in education and infrastructure.

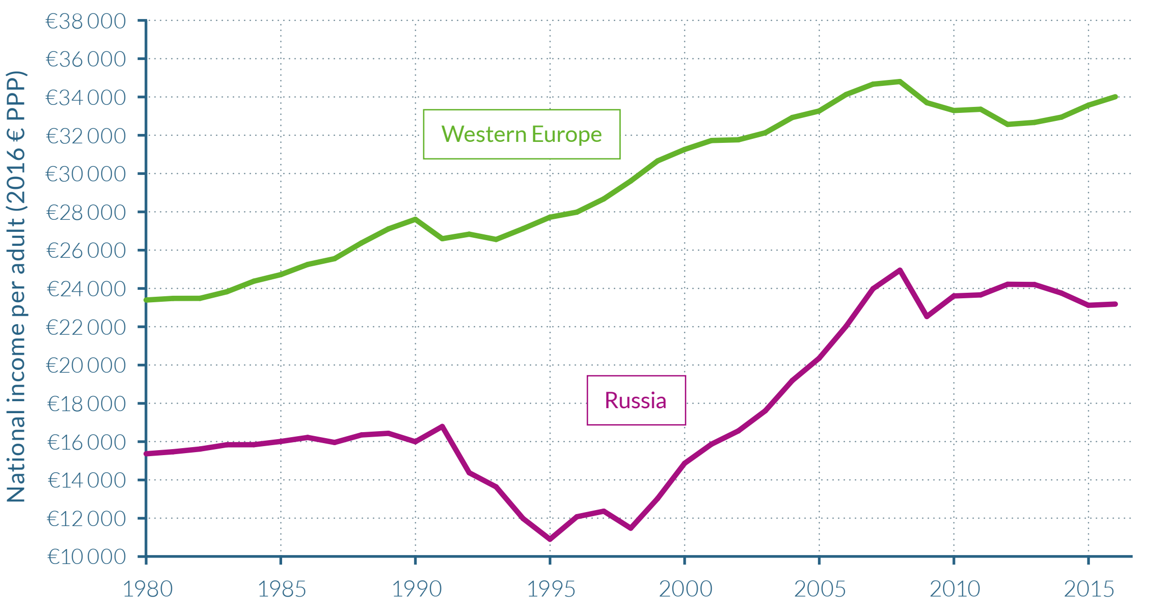
Since the 1990s, Russia's convergence towards Western European levels of GDP has been far from smooth

Since the fall of the Soviet Union in 1990–1991, Russia has experienced dramatic economic and political transformations. National income and gross domestic product fell abruptly from 1992 to 1995, when inflation skyrocketed, but then started to recover during 1998 and 1999, ushering in a decade of robust growth. The world financial crisis and the fall in oil prices interrupted this process in 2008–2009 and, since then, growth has been sluggish. However, there is little doubt that average incomes are significantly higher in Russia today than they were in 1989–1990. Indeed, the gap between Russia's per-adult national income and the West European average narrowed from approximately 60–65% of the West European average in 1989–1990, to around 70–75% in mid-2010.[28] This can be seen in **Figure 2.8.1**.

While average national income per adult in Russia reached almost €23 200 in 2016, this figure hides considerable variations in its distribution. The lowest-earning 50% of the adult population—a group of almost 115 million people—earned just under €7 800 on average in 2016, close to three times less than the national average. The middle 40% also received less income than the national average, earning approximately €21 700. The richest 10% of the population earned considerably more, however, receiving over €105 500 on average in 2016. These differences in income left Russia with a very high concentration of income among the country's richest individuals. The share of national income attributable to the top 10% was 45.5% in 2016, making it considerably larger than that of the bottom 50% (17%) and the middle 40% (37.5%). The top 1% earners capture more than 20% of national income. The average income of the 1.15 million adults in the top 1% was approximately €470 000 in 2016 whereas the top 0.01% and top 0.001% had average

Figure 2.8.1

Average national income per adult in Russia and Western Europe, 1980–2016



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2016, the average national income per adult was €23 200 in Russia. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ₽28.3. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

incomes of €12.1 million and €58.6 million, respectively—over 523 times and 2527 times greater than the Russian national average. (See **Table 2.8.1**.)

The best available estimates indicate that Russia's per-adult national income stagnated at around 35–40% of West European levels between 1870 and the First World War, but this ratio rose spectacularly to a high of 65% in the aftermath of Second World War as the Soviet state implemented its modernization strategy of rapid industrialization and mass investment in basic education. As depicted by **Figure 2.8.2**, Russia's relative position plateaued at around 55–65% of West European levels between 1950 and 1990—and while Russian living standards stagnated between the 1950s and 1980s, substantial improvements were experienced in Western Europe and the United States. Together with rising shortages and general frustration among the comparatively highly educated population, the relative sluggishness of living standard improvements arguably contributed to the complex social and political processes that eventually led to the fall of the Soviet Union.[29]

Yet the consequences of these dramatic transformations of the distribution of income and wealth are not well documented or well understood, particularly following the fall of the Soviet Union. There is no doubt that income inequality has increased substantially since 1989–1990—at least in part because monetary inequality was unusually, and to some extent artificially, low under Communism—but there has been little empirical work to measure the exact magnitude of the increase and how this compares to change in other countries. It is to these points and many others that Novokmet, Piketty, and Zucman's recent paper seeks to respond, by creating distributional national accounts for Russia that combine national accounts, survey, and wealth and fiscal data, including recently released tax data on high-income taxpayers, in essentially the way described earlier in this report.

"Shock therapy" transition policies drastically increased the top 10% share of national income

The striking rise in income inequality after the fall of the Soviet Union was dramatic in terms

Table 2.8.1
The distribution of national income in Russia, 2016

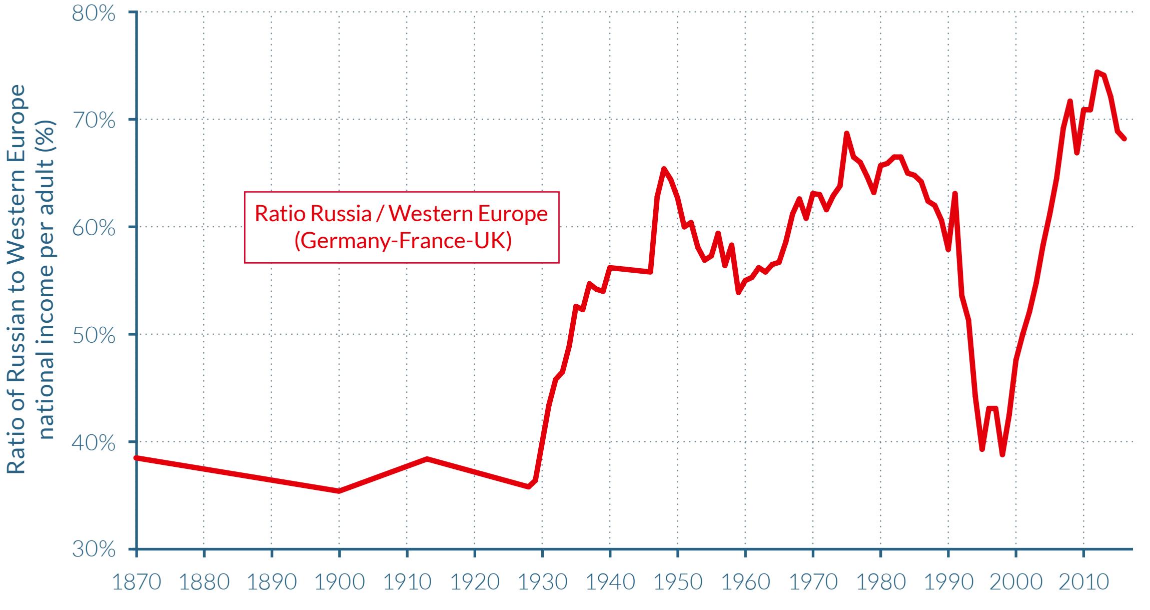
Income group	Number of adults	Income threshold (€)	Average income (€)	Income share
Full Population	114 930 000	–	23 180	100%
Bottom 50%	57 465 000	–	7 880	17.0%
Middle 40%	45 972 000	14 000	21 700	37.5%
Top 10%	11 493 000	36 300	105 500	45.5%
Top 1%	1 149 300	133 000	469 000	20.2%
Top 0.1%	114 930	638 000	2 494 000	10.8%
Top 0.01%	11 493	3 716 000	12 132 000	5.2%
Top 0.001%	1 149	18 770 000	58 576 000	2.5%

Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2016, the average pre-tax income of the Top 10% was €105 500. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ₽28.3. PPP accounts for differences in the cost of living between countries. Values are net of inflation. Numbers may not add up due to rounding.

Figure 2.8.2

Ratio between national income per adult in Russia and Western Europe, 1870–2016



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2016, the national income per adult in Russia was 68% of the national income per adult in Western Europe. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ₽28.3. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

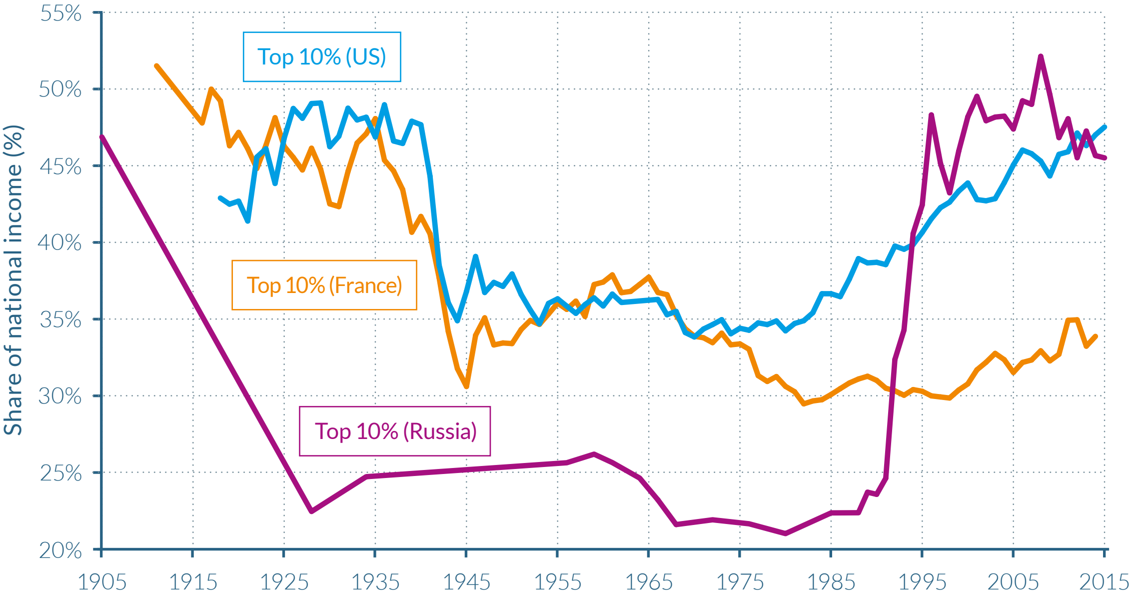
of both speed and quantitative change. This period was shaped by a “shock therapy” and “big-bang” model of transition from the previously planned, state-led economy to one that was to be led by free-market principles.[30] With this came the privatization of the significant wealth of Russia’s state-owned enterprises and the liberalization of prices and capital and labor markets, among many other political and economic changes. According to benchmark estimates provided by Novokmet, Piketty, and Zucman, the income share of the top 10% rose from less than 25% in 1990–1991 to more than 45% in 1996 (see **Figure 2.8.3**), while the income share of the top 10% rose moderately from 39% to 41% in the United States, and remained at around 30%–31% in France.

Privatizations were partly done through a voucher privatization strategy, whereby citizens were given books of free vouchers that represented potential shares in any state-owned company. However, voucher privatization of state-owned enterprises took place very quickly, with the ownership of over fifteen thousand firms transferred from state control between 1992 and 1994.[31] This happened, moreover, within such a chaotic monetary and political context that small groups of individuals were able to buy back large quantities of vouchers at relatively low prices, and also in some cases were able to obtain highly profitable deals with public authorities—for example, via the infamous loans-for-shares agreements.[32] Together with capital flight and the rise of offshore wealth, this process arguably led to much higher level of wealth and income concentration in Russia than in other ex-communist countries.

The transformation of the labor market from state-led to market-led also led to an increase in income inequality through higher inequality of labor income.[33] In communist Russia, unemployment was virtually nonexistent with only small wage differentials used to reward differential inputs and to motivate effort. This

Figure 2.8.3

Top 10% income share in France, Russia and the US, 1905–2015



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 10% income share in Russia was 46%.

ensured generally egalitarian inequality outcomes as compared to market economies. When the transition toward free markets began, however, a significant amount of unemployment was created as workers moved from the state to the private sector. Both state and private employment fell with the closure of state and private enterprises, while the imposition of hard budgets created intensely unfavorable conditions for investment and hiring, and left very little support for those seeking unemployment benefits—all of which hit the lowest earners the hardest. Given the abundance of excess labor and greater concentration of wealth, the labor market transition and the privatization process favored owners of capital to the detriment of labor.[34]

Price liberalization also saw the consumer price index multiply by nearly five thousand between 1990 and 1996. Inflation was particularly high in 1992 and 1993 (when it hit 1 500% and 900%, respectively) after official price liberalization occurred on January 1, 1992. While these episodes of hyperinflation affected the whole of the Russian economy—national income per adult fell from approximately €17 000 in 1991 to €11 000 in 1995—it was the poorest who were hit the hardest. A large part of the bottom 50% of the income distribution was made up of pensioners and low-wage workers whose nominal incomes were not fully indexed to price inflation, and this resulted in massive redistribution and impoverishment for millions of Russian households, particularly among the retired population. The share of national income accruing to the bottom 50% collapsed, dropping from about 30% of total income in 1990–1991 to less than 10% in 1996.

Concurrent with the rapid collapse in the share of incomes for the poorest 50% of the population, a more gradual and continuous process of rising top 1% income shares can be observed. The income share of the top 1% grew from less than 6% in 1989 to approximately 26% in 1996. This was a huge turnaround in just over seven years; note that the income share of the bottom 50% was five times greater than that of the top 1% in 1989, but by 1996, it was almost two times smaller. Meanwhile, the middle 40% appear to have been relatively unaffected by the initial transition reforms; their share of national income saw only a muted fall over the same period, from approximately 46% to 43%.

Following the 1996 reelection of President Boris Yeltsin, income shares began to stabilize for Russia's poorest 50% of the population. The income share of the bottom 50% rose over five percentage points between 1996 and 1998 as low-end pensions and wages benefited from a gradual recovery process between 1996 and 2015. They never fully returned, however, to their 1990–1991 relative income share. The top 10% share fell from around 48% to 43% between 1996 and 1998, before averaging around 47% until 2015. This latter period saw consistent rises in the income share of the top 10% in the United States, and by 2015, income concentration was higher than in Russia. The top 10% income share also rose in France, but very steadily to a more modest 34% by 2015.

This twelve-year period also saw strong macroeconomic growth, with Russia's per-adult national income more than doubling from around €12 000 in 1996 to approximately €25 000 in 2008.[35] However, it was the top 10% who were to be the main beneficiaries of this growth, as their share of national income rose from 43% to 53% across the ten years leading up to 2008. This upward trend for the top 10% was the opposite of that experienced by the middle 40%, whose share of national income fell from almost 40% in 1998 to 35% in 2008. The world financial crisis and precipitous drop in oil prices interrupted Russian national income growth in 2008–2009, and economic activity remained sluggish after that—only to fall again in 2014–2015, partly due to the international sanctions that followed the Russian military intervention in Ukraine. Average per-adult national income fell by over €2 000 in 2008–2009 before recovering rather lethargically to just over €24 000 in 2013, and then falling back down to €23 000 in 2015–2016. The richest part of the population experienced the largest fall in their share of national income as a result of the crisis, as the top 10% income share lost six percentage points in the two years leading up to 2010. It later settled to just over 45% in 2014–2015. The bottom 50% and middle 40% experienced four-percentage-point rises in their respective shares of national income, to approximately 18% and 39%, respectively.

Considering the period 1989–2016 together, average per-adult national income in Russia increased by 41%—that is, by approximately 1.3% per year. However, as a result of the dynamics described above, the different income groups have enjoyed widely different growth experiences. On average, the bottom earners benefited from very small or negative growth over the twenty-seven-year period (-0.8% per year and -20% over the entire period for the bottom 50%), due principally to the inflation-induced loss of incomes before 1996. The middle 40% had positive but very modest average growth of just 0.5% per year, and thus their incomes grew by 15% over the period. The experience of the top 10%, meanwhile, has been vastly different. Indeed, as **Table 2.8.2** shows, the growth in income these groups saw only increases as one looks further up the income distribution. The average per-adult incomes of the top 10% grew by 3.8% per year between 1989 and 2016, providing the 11.5 million top earners with a cumulative income growth of 171%. Moreover, it is almost solely this top 10% that has benefited from Russia's macroeconomic growth over the period. Their share in the country's growth has been 99%, as opposed to only 1% for the bottom 90%, made up of almost 103.5 million adults.

Figure 2.8.4 shows the annual and total growth rates over the period for different groups of the population. Interestingly, these figures show the same upward-sloping pattern as those constructed by The European Bank for Reconstruction and Development (EBRD).[36] They do, however, differ on two points. First, they show an even stronger tilt toward the top incomes due to a more precise estimation of top Russian incomes.[37] Second, there are meaningful differences in the income concepts employed.[38] The latter difference has a notable impact on the rate of total real growth over the 1989–2016

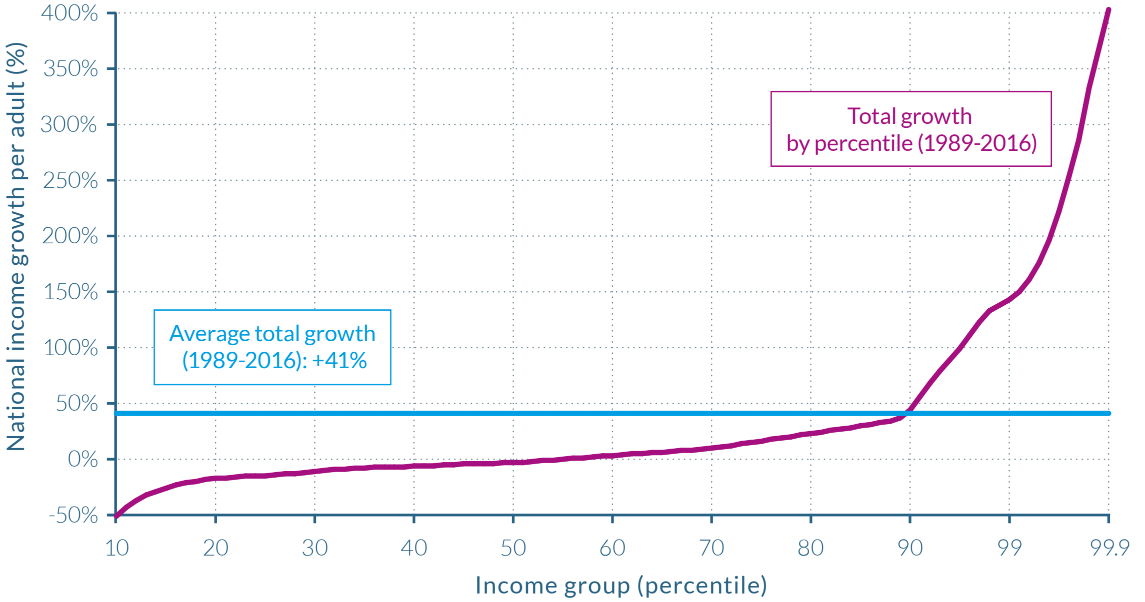
Table 2.8.2
Income growth and inequality in Russia, 1989–2016

Income group	Average annual real growth rate	Total cumulated real growth	Share in total macro growth
Full Population	1.3%	41%	100%
Bottom 50%	-0.8%	-20%	-15%
Middle 40%	0.5%	15%	16%
Top 10%	3.8%	171%	99%
Top 1%	6.4%	429%	56%
Top 0.1%	9.5%	1 054%	34%
Top 0.01%	12.2%	2 134%	17%
Top 0.001%	14.9%	4 122%	8%

Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

Between 1989 and 2016, the income of the Top 1% grew at an average rate of 6.4% per year.

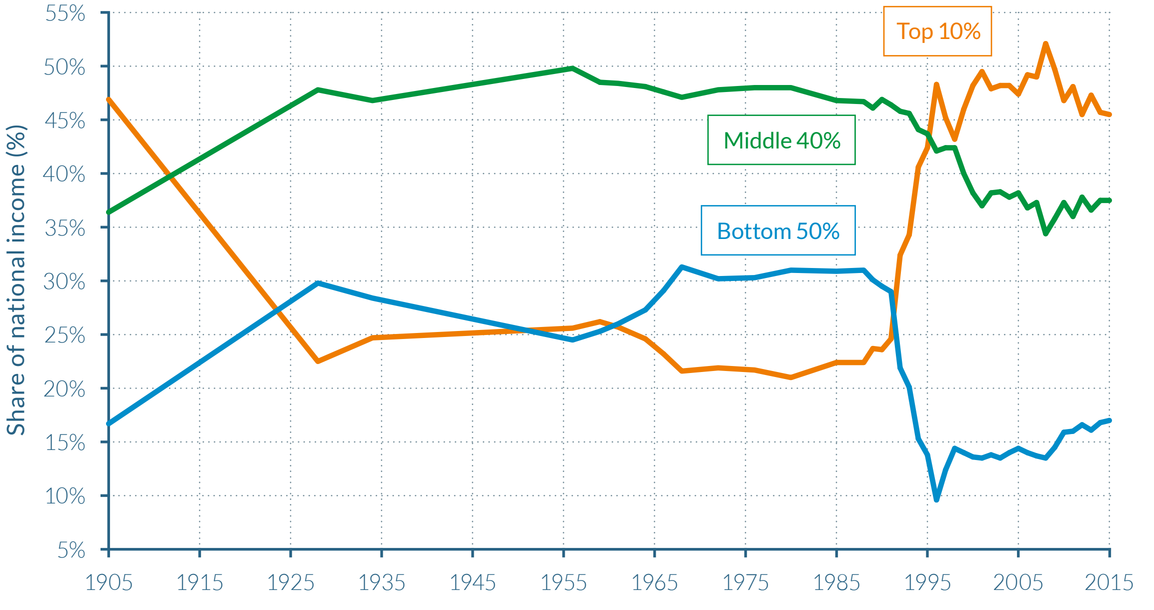
Figure 2.8.4
Total income growth by percentile in Russia, 1989–2016



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

Between 1989 and 2016, the average income of the percentile group p99p99.1 (the poorest 10% among the richest 1% of Russians) grew by 143%. Values are net of inflation.

Figure 2.8.5
Income shares in Russia, 1905–2015



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.
In 2015, the Top 10% share of national income was 46%.

period; the EBRD find this to be 70% rather than the 41% presented above. Such a difference is far from marginal. Consistent with the concepts used in this report and throughout WID.world, Novokmet et al. use national income rather than solely self-reported survey data. In doing so, they recognize the significant challenges of comparing real incomes for the Soviet and post-Soviet periods in a satisfactory manner. For example, if the researchers were to evaluate the welfare costs of shortages and queuing in 1989–1990, then it is possible that their aggregate growth figure might increase from 41% to 70%, or perhaps even more.

Long-run Russian inequality follows a U-shaped pattern

The changes in the distribution of income that took place in the post-communism period of 1989–2016 look very different from those that took place after 1905. In the tsarist Russia of 1905, the share of national income attributable to the top 10% was approximately 47%, while the bottom 50% share was about 17%, and the middle 40% share was 36%. Following the Russian Revolution of 1917, which dismantled the tsarist autocracy and paved the way for the creation of the Union of Soviet Socialist Republics (USSR) in 1922, these shares changed dramatically. By 1929, the top 10% earned just 22% of national income, twenty-five percentage points down from twenty-four years earlier. The loss in the share of national income of the top 10% was subsumed by an approximate thirteen-percentage-point rise in the share of the bottom 50% and middle 40% to almost 30% and 48% of national income, respectively, as seen in **Figure 2.8.5**. The top 1% income share, meanwhile, was somewhat below 20% in 1905 and dropped to as little as 4–5% during the Soviet period. The vast majority of growth up until 1956 (the start of the so-called de-Stalinization policies) was therefore shared by the bottom 90%, with mass investment in publication and the introduction of the five-year plans—plans that brought about the accumulation of capital resources through the buildup of heavy industry, the collectivization of agriculture, and the restricted manufacturing of consumer goods, all under state control.[39]

The death of Joseph Stalin in 1953 and the introduction thereafter of comparatively liberal policies known as de-Stalinization policies, which included the end of mass forced labor in Gulags, saw further changes to income shares that favored those earning lower incomes. The bottom 50% experienced gains in their share of national income from 24% in 1956 to 32% in 1968, while the share of the top 10% fell from 26% to 22% over the same period. Shares of national income then remained fairly constant for these groupings and for the middle 40% until 1989, and growth was thus relatively balanced between them, as illustrated by **Figure 2.8.6** and **Table 2.8.3**.

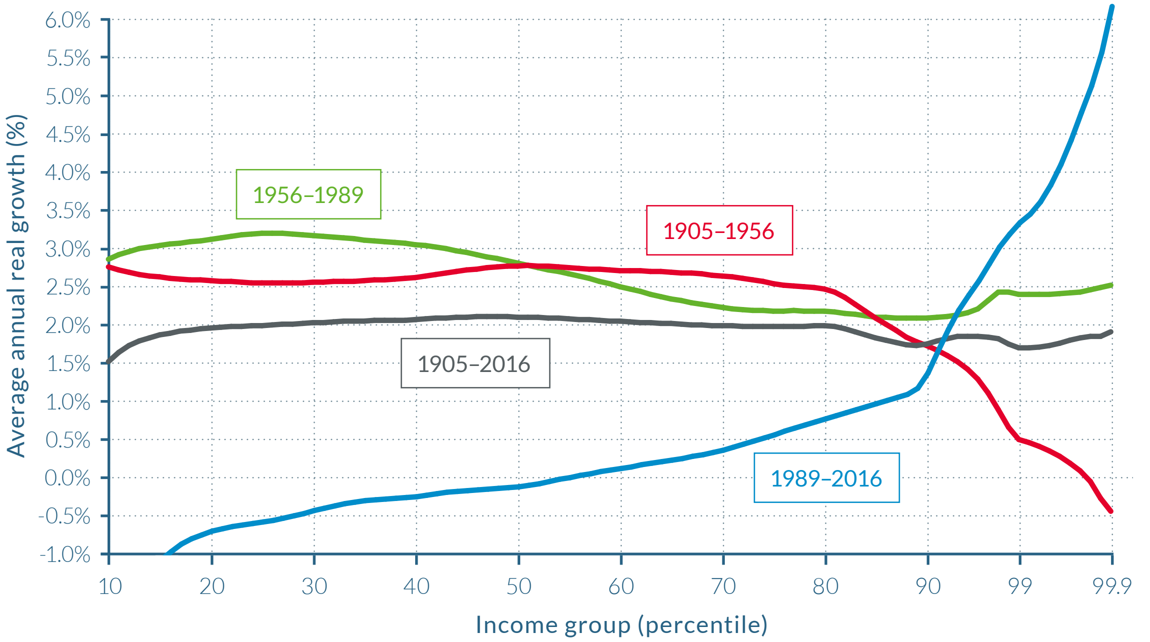
These figures reiterate the stark difference between living under the communist system and living after its end, in terms of the variance in average annual real growth rates experienced by income groups. Throughout 1905–1956 and 1956–1989, the bottom 50% and middle 40% saw their average annual real incomes increase by at least as much as those of the top 10%, and at considerably higher rates from 1905 to 1956. In this earlier period, growth notably favored both the bottom 50% and middle 40% (with 2.6% and 2.5% annual growth rates, respectively) over the top 10% (0.8%). From 1956 to 1989, the bottom 50% experienced an annual growth rate that was higher than in the preceding periods, but the difference with top groups was remarkably reduced. The top 19% grew at 2.3%—as much as the middle 40%. Interestingly, annual growth rates were increasingly negative within the top 1% income brackets between 1905 and 1956, but were then increasingly positive within these groups from 1956 to 1989. The real contrast, however, is in the post-1989 period, when the divergence in annual growth rates rose to 15.7 percentage points between the top 0.001% (14.9%) and the bottom 50% earners (-0.8%). Such a divergence in growth rates at different ends of the distribution has not been witnessed throughout the twentieth century, even during the socialization of the Russian economy.

More detailed data is required for more precise conclusions to be drawn

As already mentioned, there are a number of limitations in the data sources employed by Novokmet, Piketty, and Zucman, which suggests that while broad orders of magnitude can be considered reliable, small variations in inequality should not be viewed as precisely true. Indeed, their estimates suggest that inequality levels in tsarist and post-Soviet Russia are roughly comparable. But the lack of detailed income tax data—and the general lack of financial transparency—make their estimates for the recent period relatively imprecise, perhaps most importantly because their estimate for 1905 is at least as imprecise.[40] Thus, it seems safer to conclude only that inequality levels in tsarist Russia were very high and are comparable with the possibly even greater levels seen in post-Soviet Russia.

It is also worth stressing that the measures of monetary inequality depicted In **Figure 2.8.1** and **Figure 2.8.5** neglect non-monetary dimensions of inequality, which may bias comparisons of inequality over time and across societies. For example, inequalities in personal status and basic rights, including mobility rights, were pervasive in tsarist Russia, and persisted long after the official abolition of serfdom in 1861. Summarizing such inequalities with a single monetary indicator is clearly an oversimplification of a complex set of power relations and social domination. The same general remark applies to the Soviet period, when monetary inequality was reduced to very low levels under communism. However, the then relatively small difference between the incomes of the top 10% and bottom 50% did not prevent the Soviet elite from having access to superior goods, services, and opportunities. This could take different forms, including access to special shops and vacation facilities, which allowed the Soviet top 1% to enjoy living standards that in some cases might have been substantially higher than their annual incomes of four to five times the national average would have suggested. These factors should be kept in mind when making historical and international comparisons—in Russia or elsewhere.

Figure 2.8.6 / Table 2.8.3
Average annual real growth by percentile in Russia, 1905–2016



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

Between 1989 and 2016, the average income of the percentile group p99p99.1 (the poorest 10% among the richest 1% of Russians) grew at a rate of 3.3% per year on average. Values are net of inflation.

	Average annual real growth rates			
Income group	**1905–2016**	**1905–1956**	**1956–1989**	**1989–2016**
Full Population	1.9%	1.9%	2.5%	1.3%
Bottom 50%	1.9%	2.6%	3.2%	-0.8%
Middle 40%	2.0%	2.5%	2.3%	0.5%
Top 10%	1.9%	0.8%	2.3%	3.8%
Top 1%	2.0%	-0.3%	2.5%	6.4%
Top 0.1%	2.3%	-1.2%	2.7%	9.5%
Top 0.01%	2.5%	-2.1%	3.0%	12.2%
Top 0.001%	2.7%	-3.0%	3.3%	14.9%

Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

Between 1989 and 2016, the income of the Top 1% grew at an average rate of 6.4% per year.

2.9

INCOME INEQUALITY IN INDIA

Information in this chapter is based on the working paper “Indian Income Inequality, 1922–2014: From British Raj to Billionaire Raj?,” by Lucas Chancel and Thomas Piketty, 2017. WID.world Working Paper Series (No. 2017/11).

- ▷ Income inequality in India has reached historically high levels. In 2014, the share of national income accruing to India’s top 1% of earners was 22%, while the share of the top 10% was around 56%.
- ▷ Inequality has risen substantially from the 1980s onwards, following profound transformations in the economy that centered on the implementation of deregulation and opening-up reforms.
- ▷ Since the beginning of deregulation policies in the 1980s, the top 0.1% earners have captured more growth than all of those in the bottom 50% combined. The middle 40% have also seen relatively little growth in their incomes.
- ▷ This rising inequality trend is in contrast to the thirty years that followed the country’s independence in 1947, when income inequality was widely reduced and the incomes of the bottom 50% grew at a faster rate than the national average.
- ▷ The temporary end to the publication of tax statistics between 2000–2010 highlights the need for more transparency on income and wealth statistics that track the long-run evolution of inequality. This would allow for a more informed democratic debate on inequality and inclusive growth in India.

India entered the digital age without inequality data

India introduced an individual income tax with the Income Tax Act of 1922, under the British colonial administration. From that date up to the turn of the twentieth century, the Indian Income Tax Department produced income tax tabulations, making it possible to track the long-run evolution of top incomes in a systematic manner. Given the profound evolutions in India's economy since the country's independence, this provides a rich data resource for researchers to access.[41] Research has shown that the incomes of the richest—the "top incomes"—declined significantly from the mid-1950s to the mid-1980, but this trend was reversed thereafter, when pro-business, market deregulation policies were implemented.

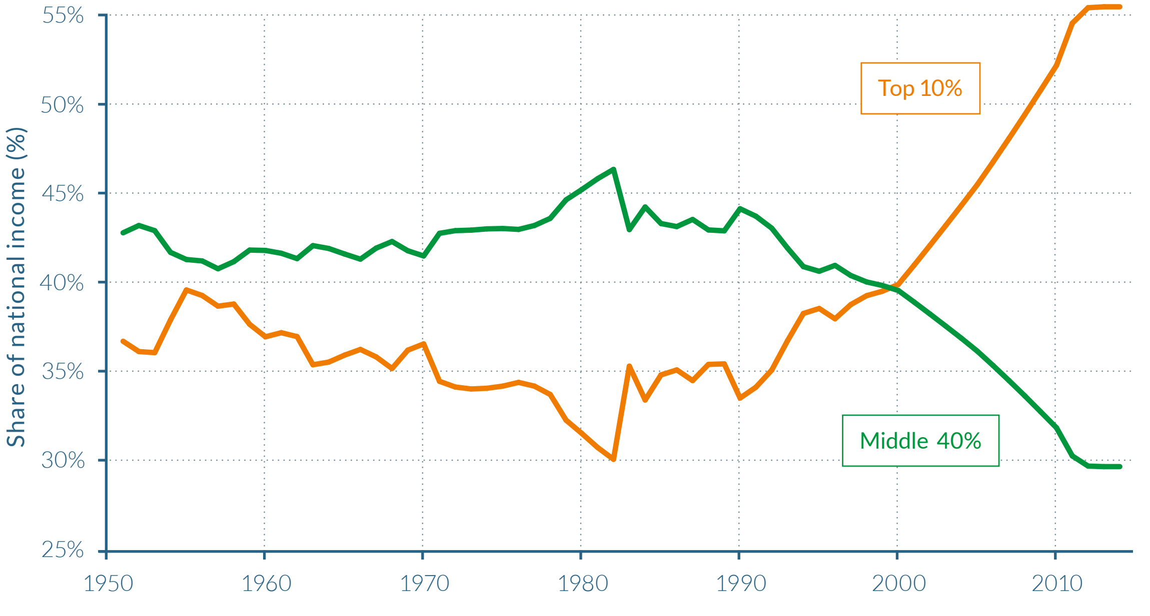
Little has been known, however, about the distributional impacts of economic policies in India after 2000, when real income growth was substantially higher than in previous decades. This is largely because the Indian Income Tax Department stopped publishing income tax statistics in 2000, but also because self-reported survey data often do not provide adequate information concerning the top of the distribution. In 2016, the Income Tax Department released tax tabulations for recent years, making it possible to track the evolution of income inequality during the high average income growth years post-2000.

Inequality rose from the mid-1980s after profound transformations of the economy

Over the past four decades, the Indian economy has undergone profound evolutions. In the late seventies, India was recognized as a highly regulated, centralized economy with socialist planning. But from the 1980s onwards, a large set of liberalization and deregulation reforms were implemented. Liberalization and trade openness became recurrent themes among Indian policymakers,

Figure 2.9.1a

Top 10% and Middle 40% income shares in India, 1951–2014



Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, the Top 10% national income share was 55%.

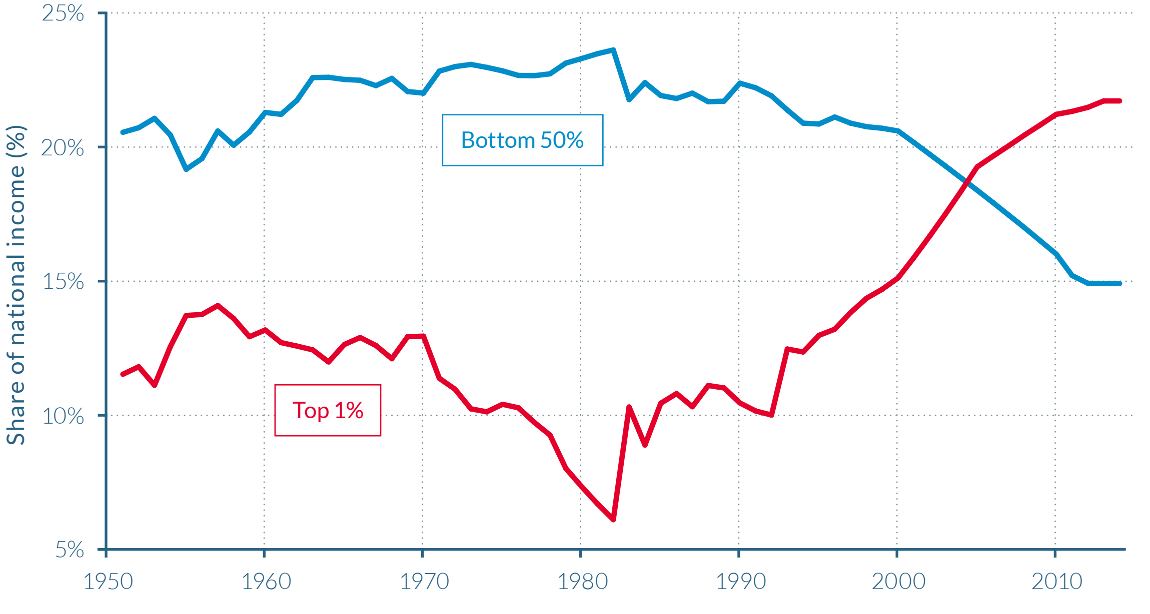
epitomized by the Seventh Plan (1985–1990) led by Prime Minister Rajiv Gandhi (1984–1989). That plan promoted the relaxation of market regulation, with increased external borrowing and increased imports. These free-market policy themes were then further embedded in the conditions attached to the International Monetary Fund's assistance to India in its balance of payment crisis in the early 1990s, which pushed further structural reforms for deregulation and liberalization. This period also saw the tax system undergo gradual transformation, with top marginal income tax rates falling from as high as 97.5% in the 1970s to 50% in the mid-1980s.

The structural changes to the economy along with changes in tax regulation, appear to have had significant impact on income inequality in India since the 1980s. In 1983, the share of national income accruing to top earners was the lowest since tax records started in 1922: the top 1% captured approximately 6% of national income, the top 10% earned 30% of national income, the bottom 50% earned approximately 24% of national income and the middle 40% just over 46% (see **Figure 2.9.1a** and **b**). But by 1990, these shares had changed notably with the share of the top 10% growing approximately 4 percentage points to 34% from 1983, while the shares of the middle 40% and bottom 50% both fell by 2 percentage points to around 44% and 22%, respectively.

What came to be known as the first set of economic reforms were implemented from 1991 to 2000 and in practice were the continuation of the mid 1980s policy shift. These reforms placed the promotion of the private sector at the heart of economic policies, via denationalizations, disinvestment of the public sector and deregulation (de-reservation and de-licensing of public companies and industries)[42], weighing the economy substantially in favor of capital above labor. These reforms were implemented both by the Congress government and its Conservative successors. As illustrated by **Figure 2.9.1**, these reforms were concomitant with a dramatic rise in

Figure 2.9.1b

Top 1% and Bottom 50% income shares in India, 1951–2014



Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, the Bottom 50% national income share was 15%.

Indian income inequality by 2000. The top 10% had increased its share of national income to 40%, roughly the same as that attributable to the middle 40%, while the share of the bottom 50% had fallen to around 20%.

These pro-market reforms were prolonged after 2000, under the 10th and subsequent five-year plans. The plans ended government fixation of petrol, sugar and fertilizer prices and led to further privatizations, in the agricultural sector in particular. Inequality trends continued on an upward trajectory throughout the 2000s and by 2014 the richest 10% of the adult population shared around 56% of the national income. This left the middle 40% with 32% of total income and the bottom 50%, with around half of that, at just over 16%.

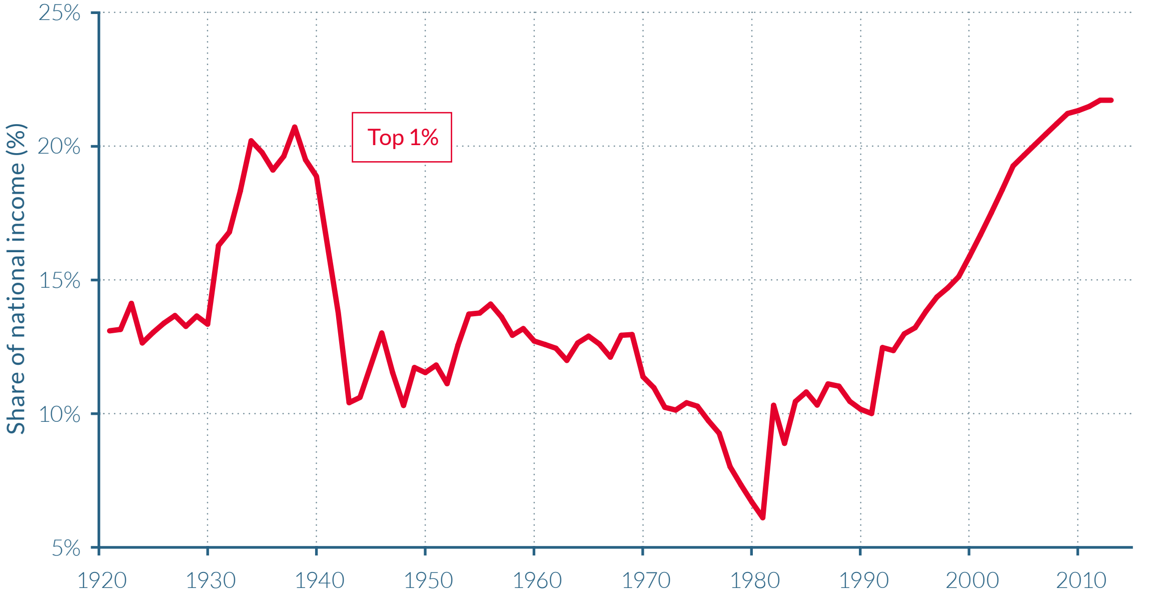
Indian inequality was driven by the rise in very top incomes

Inequality within the top 10% group was also high. The higher up the Indian income distribution one looks, the faster the rise in their share of the national income has been since the early 1980s. As depicted by **Figure 2.9.2**, the income share of India's top 1% rose from approximately 6% in 1982–1983 to above 10% a decade after, then to 15% by 2000, and further still to around 23% by 2014. The latest data thus shows that during the first decade after the millennium, the share of national income attributable to the top 1% grew to be larger than that pertaining to the bottom 50%. By 2014, the national income share of the bottom 50%—a group of approximately 390 million adults—was just two-thirds of the share of the top 1%, who totaled 7.8 million. An even stronger increase in the share of national income was experienced by the top 0.1% and top 0.01%, whose shares grew five-fold and tenfold, respectively, from 2% and 0.5% to almost 10% and 5%, between 1983 and 2014. Income growth rates at the very top were extreme, as shown by **Table 2.9.1**.

These evolutions are consistent with the dynamics of Indian wealth inequality, which

Figure 2.9.2

Top 1% income share in India, 1922–2014



Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

In 1922, the Top 1% national income share was 13%.

Table 2.9.1

Total income growth by percentile in China, France, India and the US, 1980–2014

Income group	India	China	France	US
Full Population	187%	659%	35%	61%
Bottom 50%	89%	312%	25%	1%
Middle 40%	93%	615%	32%	42%
Top 10%	394%	1 074%	47%	121%
Top 1%	750%	1 534%	88%	204%
Top 0.1%	1 138%	1 825%	161%	320%
Top 0.01%	1 834%	2 210%	223%	453%
Top 0.001%	2 726%	2 546%	261%	636%

Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

Between 1980 and 2014, the average income of the Top 10% grew by 394% in India. Values are net of inflation.

exhibit a strong increase in the top 10% wealth share in the recent period, in particular after 2002.[43] Highly unequal income growth at the top mechanically drives wealth inequality across the population, which in returns fuels income concentration.

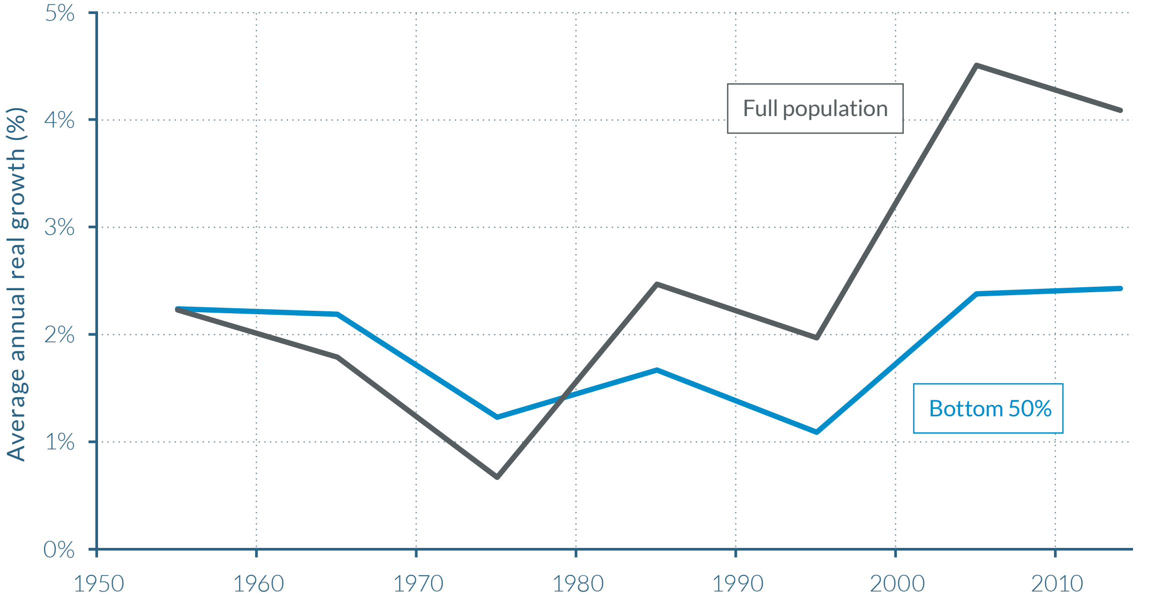
The recent surge in inequality mirrors inequality declines from the 1940s to the 1980s

After independence, Jawaharlal Nehru implemented a set of socialist policies, with strict government control over the economy, with an explicit goal to limit the power of the elite. The policies implemented by himself and his followers, including his daughter Indira Gandhi, up to the late 1970s, included nationalizations, strong market regulation and high tax progressivity. Nationalizations involved the railways and air transport in the early-1950s, oil in the mid-1970s and banking throughout the entire period, to cite but a few. Along with the transfer of private to public wealth and their implicit reduction in capital incomes, nationalizations brought government pay-scale setting with them that compressed wage distributions. In the private sector, incomes were constrained by extremely high tax rates: between 1965 and 1973, top marginal income tax rates rose from 27% to almost 98%. These changes may have discouraged rent-seeking behavior at the top of the distribution, which can be seen as an efficient strategy in the presence of excessive bargaining power and rent-seeking activity. The impact on income inequality was substantial, as the top 1% income share decreased from 21% before the second World War to approximately 10–12% in the 1950s and 1960s and fell further to 6% in the early 1980s.

Revisiting "Shining India's" income growth rates

How do these vast institutional and policy changes translate in terms of income growth rates for different groups of the population? As **Figure 2.9.3** illustrates, the average growth of real incomes has varied notably between the different groups in the income distribution since the 1950s. The annual real incomes of the bottom 50% grew at a faster rate than the countrywide average during the 1960s and 1970s when socialist central planning dominated the Indian economy, and at a notably higher pace than the growth experienced by those in the top 10% and top 1% of earners. However, this dynamic changed dramatically during the 1980s and has remained as such ever since. The 1980s saw a much higher

Figure 2.9.3a
Income growth in India, 1951–2014: Full population vs. Bottom 50%



Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

In the 2000s, the average income of the full population grew by 4.5% per year on average, while the average income of the Bottom 50% grew by 2.4% per year on average. Values are net of inflation.

Table 2.9.2
Income growth and inequality in India, 1951–1980

Income group	Total real per adult income growth	Share of growth captured by income group
Full Population	65%	100%
Bottom 50%	87%	28%
Middle 40%	74%	49%
Top 10%	42%	24%
Top 1%	5%	1%
Top 0.1%	-26%	-2%
Top 0.01%	-42%	-1%
Top 0.001%	-45%	-0.4%

Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

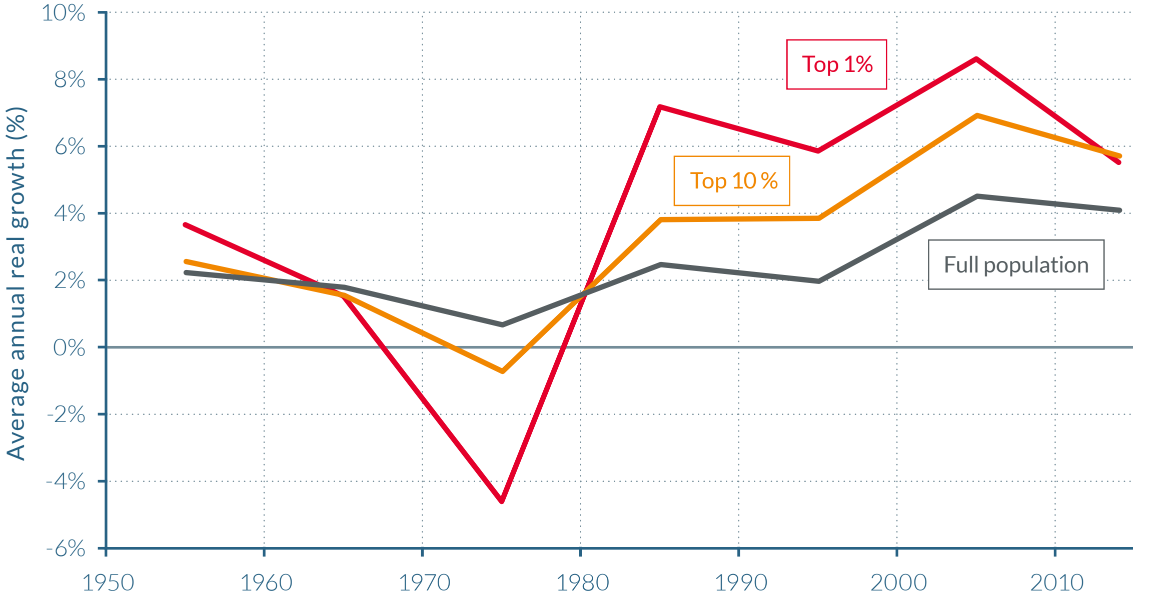
Between 1951 and 1980, the average income of the Top 1% grew by 5%. The Top 1% captured 1% of total growth over this period. Values are net of inflation.

average income growth rates than in the previous decades, but growth was only marginally higher for the bottom 90% of the population. High growth was in fact concentrated among the top 10%. This situation was prolonged throughout the 1980–2000s. During the 2000s, the annual real income growth of the top 1% was close to 8.5%, followed by the top 10% at around 7 % and the bottom 50% at less than 2.5 %. India's countrywide average was 4.5 % over the decade.

Table 2.9.2 shows the growth rate and the percentage of growth captured by different income groups in India between 1951–1980. During this period, the higher the group in the distribution of income, the lower the growth rate they experienced. Real per-adult incomes of the bottom 50% and middle 40% groups grew substantially faster than average income, increasing by 87% and 74% respectively, compared to the 65% growth of average income per adult. Furthermore, the top 0.1%, top 0.01% and top 0.001% income groups

Figure 2.9.3b

Income growth in India, 1951–2014: Full population vs. Top 10% vs. Top 1%



Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

In the 2000s, the average income of the full population grew by 4.5% per year on average, while the average income of the Top 1% grew by 8.7% per year on average. Values are net of inflation.

experienced a significant reduction in their real incomes, falling -26%, -42% and -45% respectively over the 30-year period. The bottom 50% group captured 28% of total growth between 1951 and 1980, while the middle 40% captured almost half of total growth.

It is particularly interesting to compare the pre-1980 with the post-1980 growth rates. From 1980 to 2014, the bottom 50% and middle 40% grew at 89% and 93%, respectively. Whereas average income growth is substantially higher after 1980, there is very little difference in growth rates for the bottom 50% and middle 40%. Since 1980, it is also striking that the top 0.1% earners captured more of the total growth than the bottom 50% (12% versus 11% of total growth). The top 0.1% of earners represented less than 800 000 individuals in 2014, this is equivalent to a population smaller to Delhi's IT suburb, Gurgaon. It is a sharp contrast with the 389 million individuals that made up the bottom half of the adult population in 2014.

At the opposite end of the distribution, the top 1% of Indian earners captured as much growth as the bottom 84%.

Table 2.9.3 illustrates the income levels and income thresholds for different groups and their corresponding adult population in 2014. The bottom 50% earned significantly less than the average income per adult, receiving less than one-third of the nationwide mean income before tax, while the average income of the middle 40% was around four-fifths the national average. Those in the top 10% earned five times the national average, and when one examines further up the income distribution, the same exponential trend as seen in the growth statistics is evident. The top 1% of earners, for example, received around €134 600 (₹ 3.12 million) per year on average, while the top 0.1% receive approximately €533 700 (₹ 12.4 million), 22 and 86 times the average income for Indian adults, respectively. For the top 0.001%, this ratio is 1871. (**Figure 2.9.4**)

Table 2.9.3

The distribution of national income in India, 2014

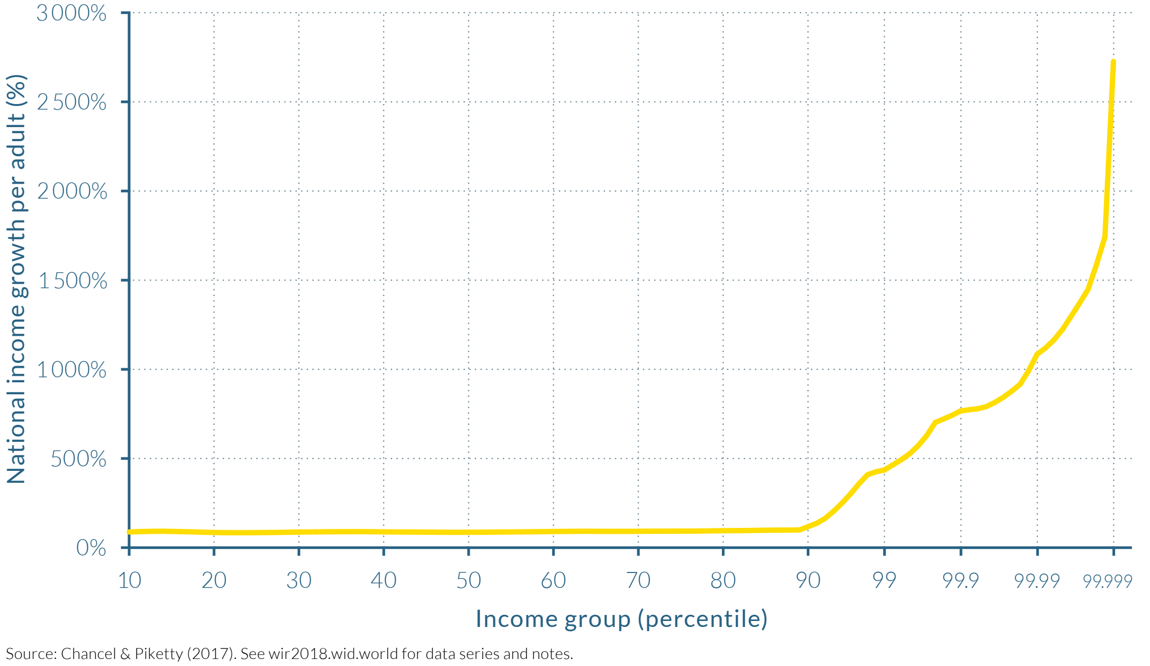
Income group	Number of adults	Income threshold (€)	Average income (€)	Comparison to average income (ratio)	Income share
Full Population	794 306 000	–	6 200	1	100%
Bottom 50%	397 153 000	–	1 900	0.3	15.3%
Middle 40%	317 722 000	3 100	4 700	0.8	30.5%
Top 10%	79 431 000	9 200	33 600	5	54.2%
Top 1%	7 943 000	57 600	134 600	22	21.7%
Top 0.1%	794 000	202 000	533 700	86	8.6%
Top 0.01%	79 400	800 100	2 377 000	384	3.8%
Top 0.001%	7 900	3 301 900	11 589 000	1871	1.9%

Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, the average income of the Top 10% was €33 600 (₹779 000). All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = ₹23. PPP accounts for differences in the cost of living between countries. Values are net of inflation. Numbers may not add up due to rounding.

Figure 2.9.4

Total income growth by percentile in India, 1980–2014



Source: Chancel & Piketty (2017). See wir2018.wid.world for data series and notes.

Between 1980 and 2014, the average income of the Top 0.001% grew by 2726%. Values are net of inflation.

2.10

INCOME INEQUALITY IN THE MIDDLE EAST

Information in this chapter is based on "Measuring Inequality in the Middle East, 1990–2016: The World's Most Unequal Region?" by Facundo Alvaredo, Lydia Assouad, and Thomas Piketty, 2017. WID.world Working Paper Series (No. 2017/16).

- The Middle East appears to be the most unequal region in the world, with the share of income accruing to the top 10 and 1% exceeding 60% and 25% of total regional income 2016. The levels of inequality remained extreme over the 1990–2016 period, with the top 10% income share varying between 60%–66% and a bottom 50% share consistently below 10%. These inequality levels are comparable to or higher than those observed in Brazil and South Africa.

- This high level of income concentration is due to both enormous inequality between countries, particularly between oil-rich and population-rich countries, and is also the result of very large inequality within countries.

- Inequality between countries is largely due to the geography of oil ownership and the transformation of oil revenues into permanent financial endowments. As a result, the income of the oil-rich Gulf countries made up 42% of the total regional income in 2016 despite only representing a small share of the total population (15% in 2016). The gap in per-adult national income between Gulf countries and the other countries is therefore extremely large.

- These new results also show that inequalities within countries are much larger than previously estimated. However, given the lack of data available, these estimations are likely to be substantially underestimated. The problem is particularly acute in the Gulf countries, for which the low official inequality statistics contradict important aspects of their political economy, namely the growing population share of low-paid foreign workers.

The Arab Spring's demands for greater social justice has led researchers to reexamine inequality in the Middle East

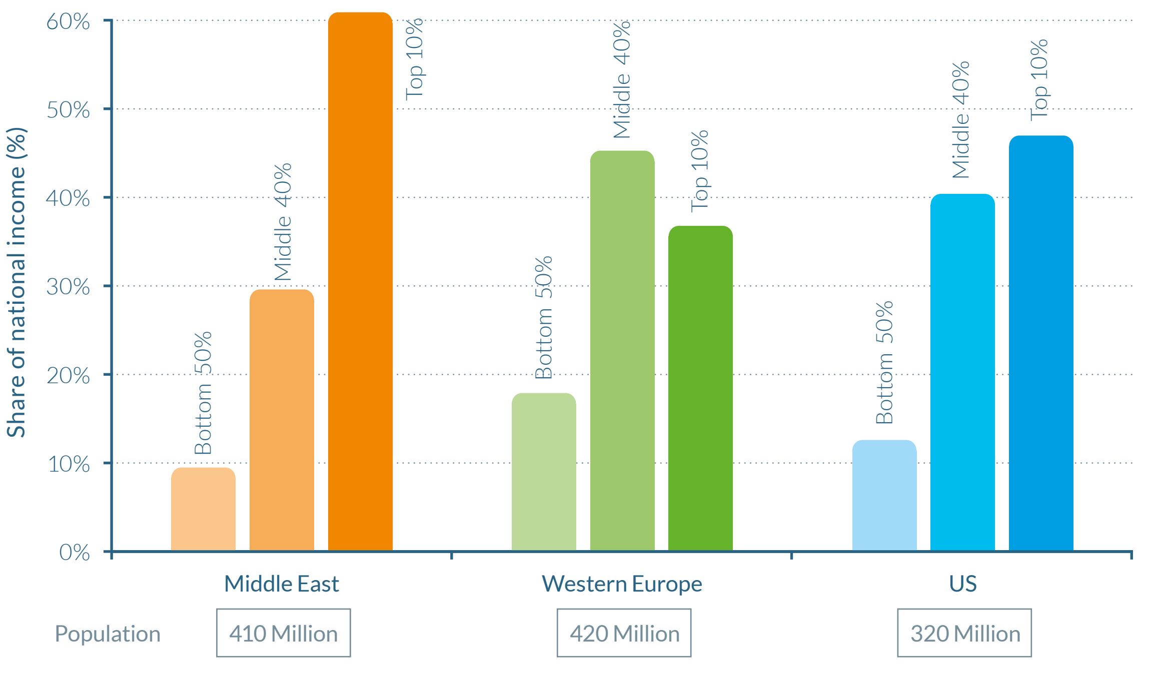
Following the Arab Spring movement, there has been renewed interest in inequality measurement in Middle East countries, as calls for greater social justice were amongst the leading demands of these popular movements. However, existing studies have argued that income inequalities within these countries do not seem to be particularly high by international standards, suggesting that the source of dissatisfaction might lie elsewhere. This somewhat surprising fact, coined "the Enigma of Inequality"[44] or the "Arab Inequality Puzzle"[45], has led to a growth in the literature on inequality in the region.

Among the literature seeking to address this surprising finding is a recent paper by Facundo Alvaredo, Lydia Assouad and Thomas Piketty. They argue that previous results, based on household survey data only, highly underestimate inequality and they offer novel estimates using the only fiscal data available in the region that has been recently released.

Inequality in the Middle East is among the highest of any region worldwide

Income inequality in the Middle East remains extremely high over the 1990–2016 period: the top 10% income share fluctuated at around 60%–66% of total income, while the share of the bottom 50% and middle 40% varied between 8%–10% and 27%–30% of total income, respectively. Regional income has largely been concentrated among the top 1% of the adult population, which receives 27% of total income, that is three times more than the bottom 50%, and approximately the same as the middle 40% of the population. Inequality in the Middle East is therefore among the highest of any region worldwide. (**Figure 2.10.1**)

Figure 2.10.1
Inequality in the Middle East, Western Europe and the US, 2012–2016



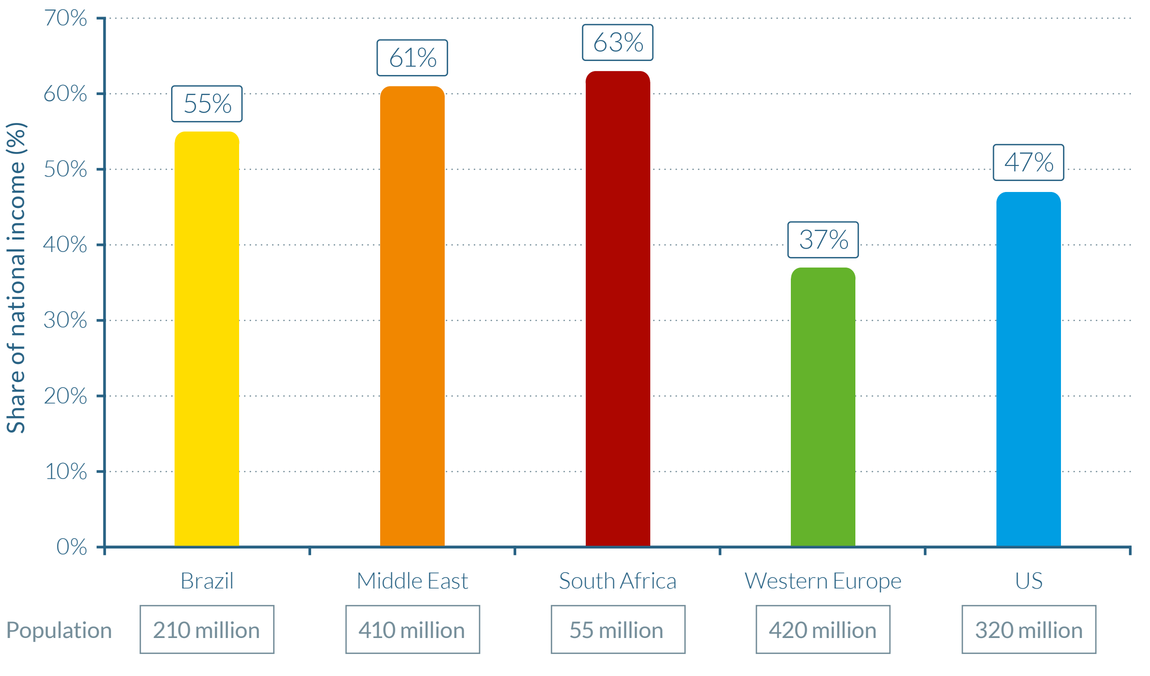
Source: Alvaredo, Assouad and Piketty (2017). See wir2018.wid.world for data series and notes.
In 2012-2016 (latest year available), the Top 10% income share in the Middle East was 61%.

Comparing the Middle East performance in terms of inequality with other countries in the World is legitimate and informative—at least as much as the usual inequality comparisons between nation-states. The total population of the region (about 410 million in 2016) is comparable to Western Europe (420 million) and the United States (320 million), and is characterized by a relatively large degree of cultural, linguistic and religious homogeneity. The authors find that the share of total income going to the top 10% income earners in the Middle East, is significantly greater than in the largest rich countries in Western Europe (36%) and the United States (47%) but also than in Brazil (55%), a country that is often described as one of the most unequal in the world. The only country for which higher inequality estimates can be currently found is South Africa, whose top 10% received approximately 65% of national income in 2012. (**Figure 2.10.2**)

While these results contradict the aforementioned studies, they are robust to different estimation techniques. When the income distribution is computed using purchasing power parity figures, which reflect the difference in the living standards of each country, inequality levels decline but not by a significant amount. Changing the geographical definition of the Middle East also has a relatively limited impact on inequality: by excluding Turkey from the analysis, a country whose average income is between those of the poorest countries—Egypt, Iraq, Syria, Yemen, etc.—and the oil-rich Gulf countries, inequalities unsurprisingly increase, but only by a small margin.

The origins of inequality are, however, distinctive amongst these different groups of countries. In the case of the Middle East, they are largely due to the geography of oil ownership and the transformation of oil revenues into permanent financial endowments, as we shall

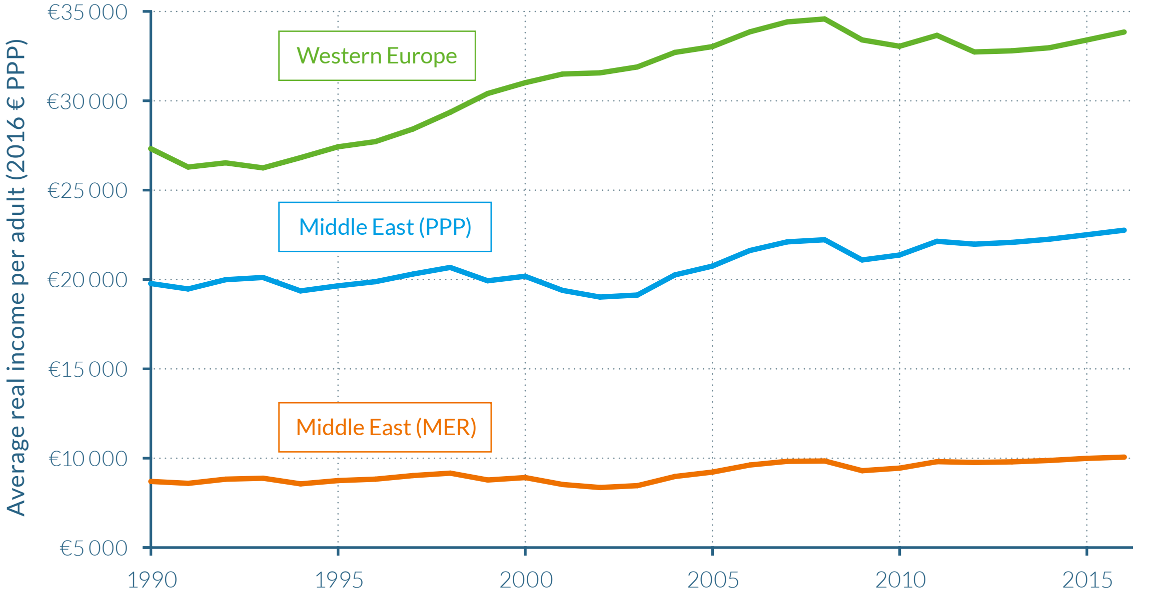
Figure 2.10.2
Top 10% income shares in the Middle East and other countries, 2012–2016



Source: Alvaredo, Assouad and Piketty (2017). See wir2018.wid.world for data series and notes.
In 2012-2016 (latest year available), the Top 10% income share in the Middle East was 61%.

Figure 2.10.3

Average income in the Middle East and Western Europe, 1990–2016



Source: Alvaredo, Assouad and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2016, average national income per adult in the Middle East was €22 800 in Purchasing Power Parity, and €10 060 at Market Exchange Rate. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

see below. In contrast, In Brazil, the legacy of racial inequality continues to play an important role together with huge regional inequalities (see chapter 2.11). Extreme inequality in South Africa is intimately related to the legacy of the Apartheid system (see chapter 2.12). It is striking to see that the Middle East, in spite of its much larger racial and ethnocultural homogeneity, has reached inequality levels that are comparable to, and even higher than, those observed in South Africa or Brazil.

Extreme inequality in the Middle East is driven by enormous and persistent between-country inequality

The 1990–2016 period has been a period of rapid population growth in the Middle East: total population rose by about 70%, from less than 240 million in 1990 to almost 410 million in 2016. The rise in average income has been much more modest, however. Using purchasing power parity estimates (expressed in 2016 euros), per-adult national income rose from about €20 000 in 1990 to €23 000 in 2016, that is, by about 15%. Using market exchange rates, per-adult national income rose from less than €9 000 in 1990 to about €10 000 in 2016 (see **Figure 2.10.3**). In Western Europe—a relatively low growth region by world standards—per-adult growth was 22%.

Should Middle East inequality be measured at purchasing power parity (PPP) or at market exchange rates (MER)? Both the PPP and the MER viewpoints express valuable and complementary aspects of international inequality patterns. The PPP viewpoint should of course be preferred if we are interested in the living standards of the inhabitants living, working and spending their incomes in the various countries (which is the case of most inhabitants). However the MER viewpoint is more relevant and meaningful if we are interested in external economic relations: e.g. the ability of tourists and visitors from Europe or from Gulf countries to purchase

Table 2.10.1

Population and income in the Middle-East, 2016

	Population (million)	Adult Population (million)	Adult population (% of ME total)	National Income (Billion 2016 € PPP)	% ME Total Income (PPP)	National Income (Billion 2016 € MER)	% ME Total Income (MER)
Turkey	80	53	21%	1 073	19%	548	22%
Iran	80	56	22%	896	16%	330	13%
Egypt	93	54	22%	800	14%	234	9%
Iraq-Syria-Other (non-Gulf)	102	52	21%	570	10%	243	10%
Gulf Countries	54	37	15%	2 394	42%	1 179	47%
Total Middle East	409	252	100%	5 733	100%	2 534	100%

Source: Alvaredo, Assouad and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2016, Gulf countries earned €2.4 billion in Purchasing Power Parity. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3, and into 2016 Market Exchange Rate (MER) euros at a rate of €1 = $1.1. PPP accounts for differences in the cost of living between countries. Values are net of inflation. Numbers may not add up due to rounding.

goods and services when they travel to other countries; or the ability of migrants or prospective migrants from Egypt or Syria to send part of their euro wages back home. Here market exchange rates matter a lot, and may also have an important impact on perceptions of inequality. This is why MER are used as benchmark measures of inequality in the Middle East.

It is critical to stress that enormous and persistent between-country inequality exists behind the Middle East average. In order analyze to summarize the changing population and income structure of the Middle East, it is useful to decompose the region into five blocs: Turkey; Iran; Egypt; Iraq-Syria (including other Arab, non–Gulf countries: Jordan, Lebanon, Palestine, Yemen); and Gulf countries (including Saudi Arabia, Oman, Barhain, UAE, Qatar and Kuwait) (see **Table 2.10.1**).

The first four blocs all represent approximately 20–25% of total population of the Middle East, whereas Gulf countries represent 15% of the population. In contrast, Gulf countries represent almost half of the total income of the region in market exchange rates. This reveals the large gap in per-adult national income between Gulf countries and other countries in the region. These marked difference help us understand why albeit novel, regional Middle East inequality estimates are not entirely unexpected.

The evolution of income inequality in the Middle East has been driven by the dynamics of between-country inequality. In 1990, Gulf countries' share in Middle East population was 10%, and their income share was between 44% (PPP) and 48% (MER). The narrowing of per-adult income inequality between Gulf countries and the other four country blocs identified above reduced regional inequality over the 1990–2016 period. However, the income gap between these two groupings remains enormous.

The fall in the income gap between Gulf countries and the rest of the Middle East reflects a number of complex and contradictory forces. It was partly due to the evolution of oil prices and output levels in Gulf countries, as well as to the relative fast output growth in non–Gulf countries including Turkey, but the very large rise of migrant workers also played a significant role, leading to an artificial reduction of national income per adult in Gulf countries. The massive inflow of foreign workers, especially in the construction sector and domestic services sector, quite simply led to a stronger increase in the population denominator than in the income numerator of Gulf countries. This massive rise of migrant workers saw the shares of foreigners in Gulf countries increase from less than 50% in 1990 to almost 60% in 2016.

From this viewpoint, it is also useful to distinguish between two groups of Gulf countries. The first of these groups is made up of Saudi Arabia, Oman and Bahrain, where nationals still make a small majority of the population, with the foreign population share remaining relatively stable at around 40–45% of total adult population between 1990 and 2016. The second group is that of the United Arab Emirates (UAE), Kuwait and Qatar, where the nationals have made up a smaller and smaller minority of the resident population, given that the foreign share rose from 80% to 90% of the total population. This second group made about one quarter of total population of Gulf countries in 1990, but this rose to about one third by 2016.

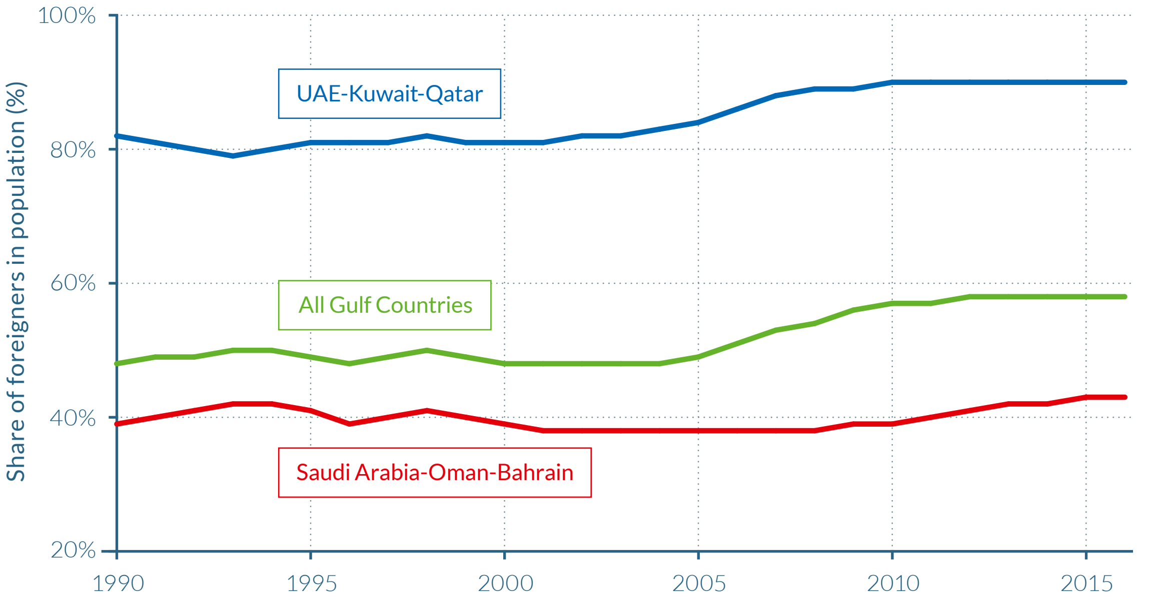
Within-country inequality is likely to be high in Middle East countries

Income tax data is unfortunately extremely limited in the Middle East and therefore prevents a detailed and precise analysis of within-country inequality. It is unfortunate that the only country for which data is currently available is Lebanon, as household surveys in the Middle East appear to underestimate top incomes at least as much as in the rest of the world (and possibly more). The Lebanese data confirms the general finding that top income levels reported in tax data are much higher than in household surveys: top 1% incomes are typically two to three times higher, with large variations across income levels and over years.

The lack of good data is particularly acute in the case of the Gulf countries, where the low official Gini coefficient might indeed hide important aspects of their political economy, namely the growing share of the non-national population, a large majority of which is composed of low-paid workers, living in difficult conditions. The substantial growth of migrant workers in Gulf countries give incentives to nationals within Gulf countries to defend their numerous privileges, beginning by restraining naturalization given that national citizens typically do not pay income tax, benefit from significant social spending, including free healthcare and education, receive subsidies for electricity and fuel, and often receive other benefits such as land grants. Furthermore, some citizens also have expectations that the state provides them with a job and housing, an idea enshrined in some Gulf country constitutions.[46] (**Figure 2.10.4**)

But perhaps the most striking manifestation of the difference between the local and foreign populations is the restrictions imposed on the migrant population through the "sponsorship system," or the "kafala system" as it is known in Arabic.[47] This system requires all unskilled laborers to have an in-country sponsor, usually their employer, who is responsible for their visa and legal status.[48] As a report by the Chatham House think tank describes, this system can lead to the creation of an extremely polarized social structure with two groups which are not legally, socially and economically equals.[49] As far as is known, little research has been conducted to study the two populations to measure income inequality within Gulf societies given the aforementioned data limitations, and therefore our quantitative understanding of these issues is still somewhat limited. Alvaredo, Assouad and Piketty are

Figure 2.10.4
Share of foreigners in Gulf countries, 1990–2015



Source: Alvaredo, Assouad and Piketty (2017). See wir2018.wid.world for data series and notes.
In 2015, the share of foreigners in the total population of the United Arab Emirates, Kuwait and Qatar was 90%.

the first researchers to distinguish systematically between the two populations (and lead to a large upward revisions of inequality estimate in the survey distribution). Unfortunately, there are still important limitations to the empirical understanding of these issues.

Better data on income inequality is crucially needed in the Middle East

Accessing better quality and larger volumes of country-level inequality data for the whole of the 1990–2016 period in Middle East countries might lead to different conclusions than those presented in this paper. In particular, a rise of within-country inequality could possibly counterbalance the reduction of between-country inequality between Gulf countries. Rising within-country inequality trends are found in a large number of very different countries across the world, e.g. in the United States, Europe, India, China, South Africa, Russia, with varying magnitudes as described in other chapters of this report. It is also possible that Middle East countries—along with Brazil—belong to a different category, that is, countries where inequality has always been very large historically and thus has not risen in recent decades. However, given the data sources currently available, it is not possible to draw precise conclusions on this phenomenon with a satisfactory degree of precision.

All in all, it is very difficult to have an informed public debate about inequality trends—and also about a large number of substantial policy issues such as taxation and public spending—without proper access to such data. While the lack of transparency on income and wealth is an important issue in many, if not most, areas of the world, it appears to be particularly extreme in the Middle East, and arguably raises a problem of democratic accountability in itself, independent from the levels of inequality observed.

2.11

INCOME INEQUALITY IN BRAZIL

Information in this chapter is based on “Extreme and Persistent Inequality: New Evidence for Brazil Combining National Accounts, Survey and Fiscal Data,” by Marc Morgan, 2017. WID.world Working Paper Series (No. 2017/12).

- ▷ Novel and more precise inequality data show that the level of inequality is much higher in Brazil than previously estimated.
- ▷ Previous inequality estimates suggested that policies targeting inequality over the past decades had been successful in significantly reducing it, but recent evidence suggests that national income inequality has remained relatively persistent at high levels over the past 15 years. At the time, the fall in labor income inequality, even if more moderate than previously thought, is confirmed by the new estimates.
- ▷ The distribution of income in Brazil has remained stable and extremely unequal over the last 15 years, with the top 10% receiving over 55% of total income in 2015, while the share of the bottom 50% was just above 12% and the middle 40%, approximately 32%. While inequality within the bottom 90% fell, driven by compression of labor incomes, concentration at the top of the distribution grew over the period, reflecting the increasing concentration of capital income.
- ▷ Since the global financial crisis in 2008, the share of total growth in income captured by the top 10% of earners has been the same than in the years of strong growth leading up to the crisis.
- ▷ The bottom 50% captured a very limited share of total growth between 2001–2015. So far, cash transfers had only a limited impact on the reduction of national income inequality.

Brazil's inequality is higher than previously estimated and relatively stable over the past two decades

Brazil has consistently been ranked among the most unequal countries in the world since data became widely available in the 1980s. However, from the mid-1990s, household surveys began to show that inequality was falling, due to a combination of strong labor market performance, declines in the skill wage premium due to educational expansion, systematic increases in the minimum wage (indexed to social benefits), and the growing coverage of social assistance programs.[50] This household data provided evidence that government policies had been effective in reducing inequality. Indeed, this apparent decline in Brazilian income inequality drew significant attention worldwide, as examples of large economies that could reduce inequality while growing solidly are relatively rare.[51]

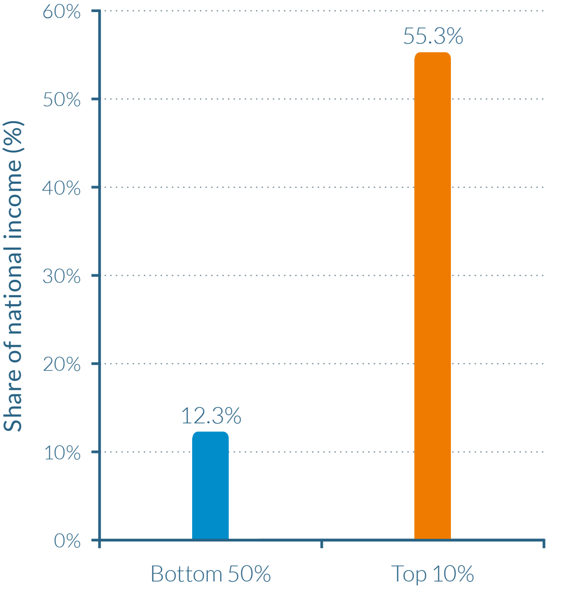
However, as described earlier in this report, household surveys only tell part of the story. Recent releases of income tax data by the Federal tax office have painted a different picture, showing that inequality in Brazil was higher than previously thought.[52] Marc Morgan has generated a series of distributional national accounts for Brazil, which combine annual and household survey data with detailed information on income tax declarations and national accounts. By ensuring the consistency of the surveys and tax declarations with macroeconomic totals, he is able to provide the most representative income inequality statistics to date that show a sharp upward revision of the official estimates of inequality in Brazil. The novel data also suggests that, if contrary to other emerging countries such as Russia, India or China, pre-tax inequality has remained relatively stable in Brazil since the turn of the new century, it has not declined as much as many commentators have argued.

Total income inequality has remained at very high levels in Brazil despite the fall in labor income inequality

The findings highlight the large extent of income concentration in Brazil. The richest 10% of Brazilian adults—around 14 million people—received over half (55%) of all national income in 2015, while the bottom half of the population, a group five times larger, earned between four and five times less, at just 12%. The middle 40% of the distribution receives just less than one third of total income (32%), a figure which is low by international standards. This clearly reveals that inequality in Brazil is principally affected by the extreme concentration at the top of the distribution. This concentration becomes less extreme when we look at the labour income distribution. The top 10% highest earners received 44% of all national labour income in 2015, with the middle 40% taking home almost 40% and the bottom 50% in this distribution receiving about 15%. (**Figure 2.11.1**)

Since 2000, total income inequality has remained relatively stable. Small gains were made by the bottom 50%, who increased

Figure 2.11.1
Bottom 50% and Top 10% income shares in Brazil, 2015



Source: Morgan (2017). See wir2018.wid.world for data series and notes.
In 2015, the Top 10% received 55% of national income.

Table 2.11.1
The distribution of national income in Brazil, 2015

Income group	Number of adults	Income threshold (€)	Average income (€)	Income share
Full Population	142 521 000	–	13 900	100%
Bottom 50%	71 260 000	–	3 400	12.3%
Middle 40%	57 008 000	6 600	11 300	32.4%
Top 10%	14 252 000	22 500	76 900	55.3%
Top 1%	1 425 000	111 400	387 000	27.8%
Top 0.1%	142 500	572 500	2 003 500	14.4%
Top 0.01%	14 300	2 970 000	10 397 600	7.5%
Top 0.001%	1 430	15 400 000	53 986 200	3.9%

Source: Morgan (2017). See wir2018.wid.world for data series and notes.

In 2015, the average income of the Top 10% was €76 900. All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = R$2.7. PPP accounts for differences in the cost of living between countries. Values are net of inflation. Numbers may not add up due to rounding.

their share of national income from 11% to 12% from 2001 to 2015, while the top 10% income share evolved from 54% to just over 55% over the period. Both of these gains were at the expense of a continuous squeeze on the middle 40%, whose share of national income fell from 34% to just above 32%. The stability in the total income inequality should not mask the registered decline in the inequality of labour incomes. The bottom 50% of earners made greater gains in this distribution, increasing their share from 12% to 15% from 2001 to 2015, while the top 10% labor income share fell from 47% to 44%. The middle 40% share increased from 37% to almost 40%, which confirms the overall compression in the labour income distribution and conveys the importance of capital income in the total income distribution. This is even more apparent the higher up in the hierarchy the comparison is made. For instance, while the top 1% of labour earners received 14% of national labour income in 2015, the same group in the national total income distribution received double this share (28%).

These extreme levels of inequality manifested themselves in large differences between the average incomes of the aforementioned groups, as represented by **Table 2.11.1**. In 2015, the average income of an adult living in Brazil was around €13 900 (R$37 100), but for those amongst the bottom 50% of earners, the average income was less than €3 400 (R$9 200, around a quarter of the national average). Moving up the income distribution, the average annual income of adults in the middle 40% was approximately €11 300 (R$30 500), meaning that a significant percentage of 90% of Brazil's adult population earned less than the national average, which highlights the extent of income skewness in Brazil and the lack of a broad "middle class." Consequently, the average income of the top 10% was over five times greater than the national average at €76 900 (R$207 600). The magnitudes increase substantially as one moves towards the upper echelons of the income distribution, with the average income of the richest 1% being around €387 000 (R$1 044 900).

Table 2.11.2 presents refined shares at the top of the income distribution for 2015, to show more precisely how national income is shared across the adult population and also compares how inequality estimates differ between the DINA series and survey data.

Using only the survey data, the top 1% (about 1.4 million adults) received 12% of national income in 2015. However, when income from fiscal data and undistributed income from national accounts are included, the share of this top 1% increases dramatically, to 28%. The large share of national income captured by the top 1% therefore seems to be gradually reducing the share of the middle 40% over time.

Higher up the distribution, the trend is similar, with the elites capturing a disproportionate share of Brazilian income. **Figure 2.11.2** compares the income share of the bottom 50% (70 million adults), with that of the top 0.1% (140 000 adults) over the fifteen-year time period. Having started at similar levels of national income in 2001—around 11% each—the two groups quickly experienced diverging fortunes, with the top 0.1% share growing to just under 15% of national income by 2004 and the share of the bottom 50% remaining virtually unchanged. By 2015 the gap between the groups' respective shares had grown to 4 percentage points, such that the collective incomes of the top 0.1% were significantly larger than those of the bottom 50% despite the top 0.1% being 500 times smaller in population size.

Table 2.11.2
Survey income and national income series in Brazil, 2015: Comparing income shares

Income group	Survey income series *(survey data)*	WID.world series *(survey + tax + national accounts data)*
Bottom 50%	16.0%	12.3%
Middle 40%	43.6%	32.4%
Top 10%	40.4%	55.3%
Top 1%	10.7%	27.8%
Top 0.1%	2.2%	14.4%
Top 0.01%	0.4%	7.5%
Top 0.001%	0.1%	3.9%
Total (% national income)	57.1%	100%

Source: Morgan (2017). See wir2018.wid.world for data series and notes.
In 2015, the share of survey income attributable to the Top 10% was 40%, while the share of national income attributable to the Top 10% was 55%.

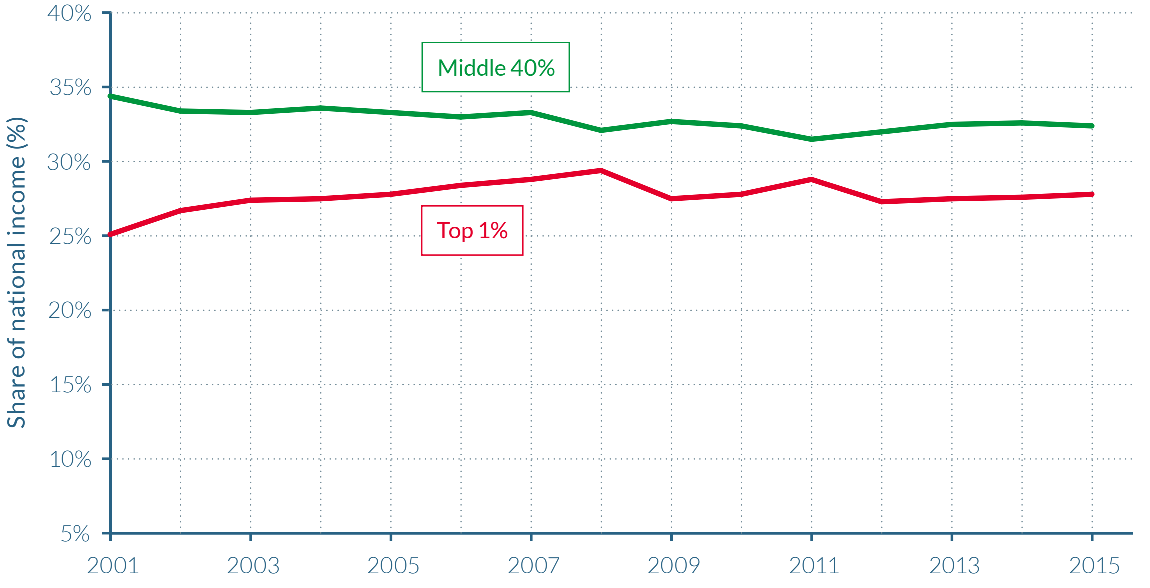
Morgan in the same work also compares the raw estimates from the surveys with his benchmark national income series (combining national accounts, surveys and fiscal data). There are clear, large discrepancies in the level and change in inequality that grow increasing larger the higher up the distribution one looks. These discrepancies thus highlight why relying exclusively on surveys and ignoring undistributed income in national accounts flowing to corporations can distort understanding of how income inequality has developed in Brazil. For example, household surveys indicate that income inequality fell between 2001 and 2015, with the top 10% share of national income falling from 47% to just above 40% and the bottom 50% share rising from just over 12% to 16%. These are in stark contrast with the trends and levels presented above, with a top 10% share oscillating around 55% (**Figure 2.11.3**). The general trend is therefore one of an increase in the concentration of national income shares at the top of the income distribution, small increases at the bottom and an ever-smaller share for the middle.

Brazilian income inequality rises as the richest experience higher growth in incomes

Distributional National Accounts also enable us to examine how growth at the macroeconomic level in Brazil has affected the income shares of the country's population. Between 2001 and 2015, cumulative real growth of national income per adult in Brazil totaled 18%. (See **Table 2.11.3**.) The question that arises from this evolution is how the income growth of different groups of the income distribution compares to these numbers. The real growth of average incomes in the bottom 50% was strong, increasing approximately by 29% over the fifteen-year period.

Figure 2.11.2a

Income shares of the Middle 40% and Top 1% in Brazil, 2001–2015



Source: Morgan (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 1% received 28% of national income.

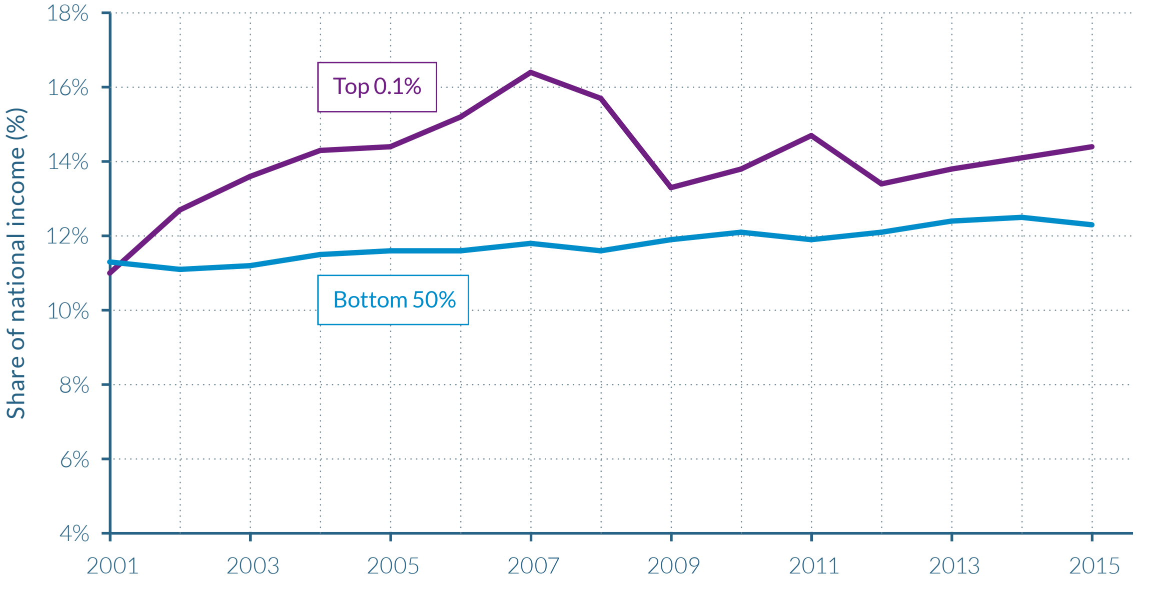
This was comparatively higher than the growth in incomes of the middle 40% (12%) and the top 10% (21%). However, growth was strongest among the top percentiles. The income of the top 1% grew by almost double the national average, at 31%, while the incomes of the top 0.1% grew at almost 55%, 3 times the national average. Growth was strongest at the very summit of the distribution, with the incomes of the top 0.01% and the 0.001% growing by 85% and 122%, respectively.

Despite the growth of incomes in the bottom half of the income distribution, the top of the distribution captured a disproportionately large part of the total income growth between 2001 and 2015. For example, the top 10% captured 61% of total growth, while the top 1% captured 43%. Even with the strongest growth performance over the period of three major income groupings, the low average incomes of the bottom 50% meant that the fraction of total growth they were able to capture was relatively small, at 18%. Subsequently, the change in the bottom 50% share of total national income was also small. The figures relating to the middle 40% help to reinforce the importance of the size of incomes in analyzing how group shares in national income have changed: despite their total cumulative growth rate being smaller than the bottom 50%, the fraction of total growth captured by the middle 40% was higher than that of the poorest half of the population, at 22%.

Table 2.11.3 also subdivides the incidence of growth by two roughly equal time periods, relating to that before the global financial crisis, and that during and after it. During the first period (2001–2007), all groups experienced strong increases in their average incomes as the economy grew solidly, with only the middle 40% growing at a slower pace than the national average. Nevertheless, the overwhelming gains went to the top decile, with the top 1% capturing over 65% of total growth. Growth in the years between 2007 and 2015 was slightly weaker, with average

Figure 2.11.2b

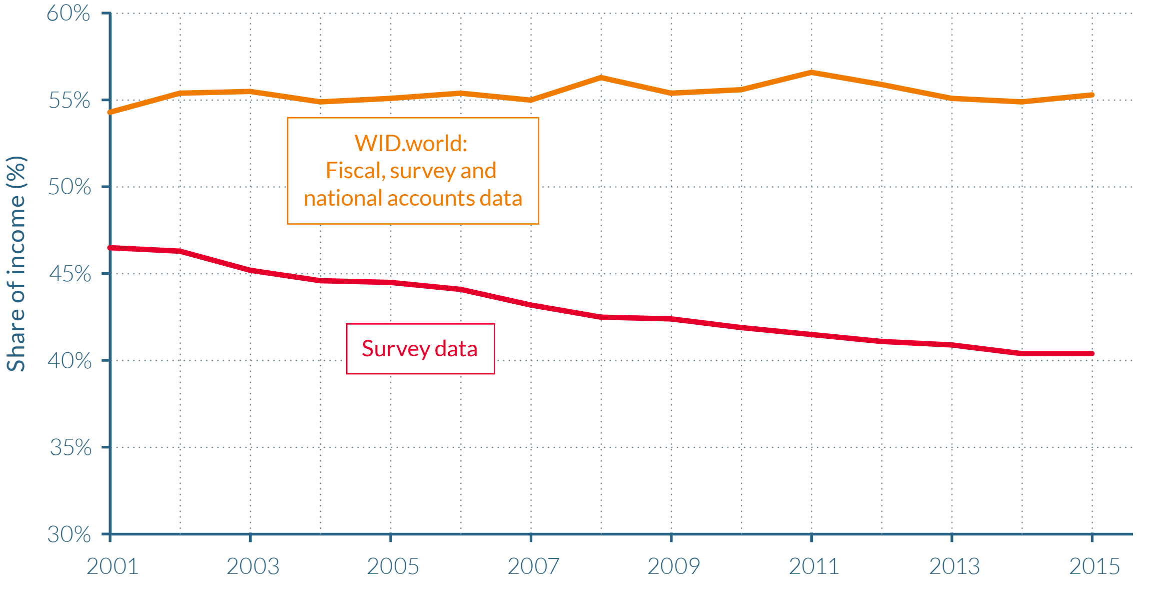
Income shares of the Bottom 50% and Top 0.1% in Brazil, 2001–2015



Source: Morgan (2017). See wir2018.wid.world for data series and notes.

Figure 2.11.3

Top 10% income share in Brazil, 2001–2015: National income series vs. survey income series



Source: Morgan (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 10% earners captured around 40% of national income according to household surveys. However, corrected estimates using fiscal, survey and national accounts show that their share is 55%.

incomes expanding by 7% as compared to 10% in the previous period, but growth was equally concentrated in the top decile after the financial crisis. The impact of the crisis was notably felt by the highest groups, as the average incomes of groups above the top 0.1% had not yet recovered to their 2007 levels by 2015.

Table 2.11.3

Income growth and inequality in Brazil, 2001–2015

	2001–2015		2001–2007		2007–2015	
Income group	**Total cumulated growth**	**Fraction of total growth captured**	**Total cumulated growth**	**Fraction of total growth captured**	**Total cumulated growth**	**Fraction of total growth captured**
Full Population	56%	100%	27%	100%	23%	100%
Bottom 50%	70%	14%	32%	14%	28%	14%
Middle 40%	47%	29%	23%	29%	20%	29%
Top 10%	59%	57%	28%	57%	24%	57%
Top 1%	73%	33%	46%	43%	19%	24%
Top 0.1%	104%	20%	89%	36%	8%	6%
Top 0.01%	144%	12%	153%	27%	-3%	-1%
Top 0.001%	193%	7%	241%	19%	-14%	-3%

Source: Morgan (2017). See wir2018.wid.world for data series and notes.

Between 2001 and 2015, the Top 10% captured 57% of total growth.

2.12

INCOME INEQUALITY IN SOUTH AFRICA

Information in this chapter is based on "Colonial rule, apartheid and natural resources: Top incomes in South Africa, 1903–2007," by Facundo Alvaredo and Anthony B. Atkinson (Centre for Economic Policy Research Discussion Paper, 2010, No. 8155), as well as on WID.world updates.

- South Africa stands out as one of the most unequal countries in the world. In 2014, the top 10% received 2/3 of national income, while the top 1% received 20% of national income.

- During the twentieth century, the top 1% income share was halved between 1914 and 1993, falling from 20% to 10%. Even if these numbers must be qualified, as they are surrounded by a number of uncertainties, the trajectory is similar to that of other former dominions of the British Empire, and is partly explained by the country's economic and political instability during the 1970s and 1980s.

- During the early 1970s the previously constant racial shares of income started to change in favor of the blacks, at the expense of the whites, in a context of declining per capita incomes. But while interracial inequality fell throughout the eighties and nineties, inequality within race groups increased.

- Rising black per capita incomes over the past three decades have narrowed the interracial income gap, although increasing inequality within the black and Asian/Indian population seems to have prevented any decline in total inequality.

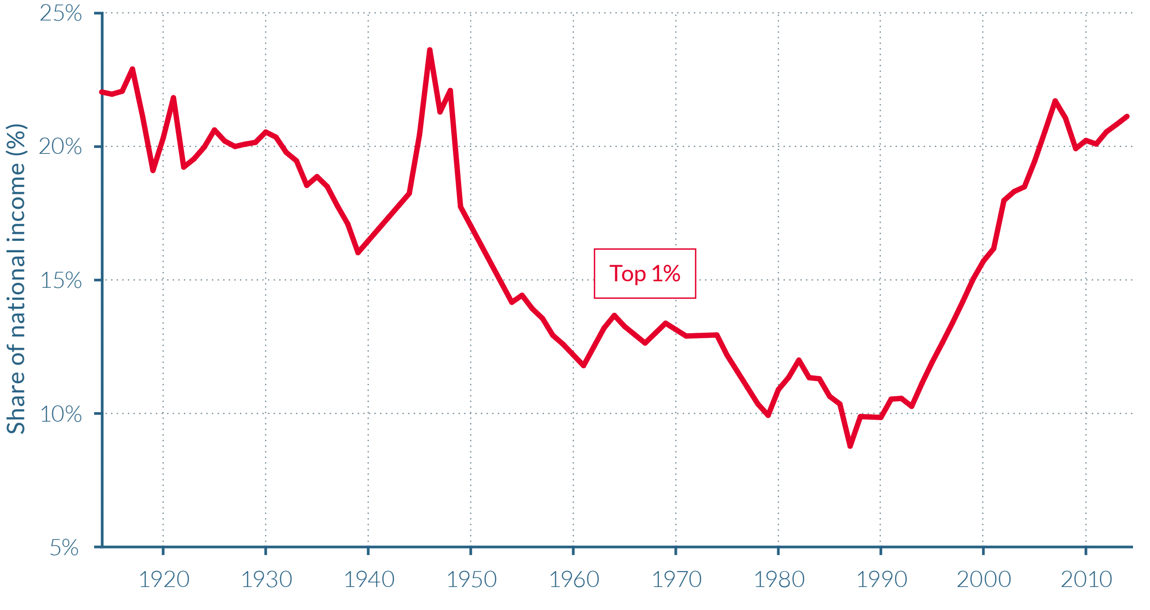
- Since the end of the Apartheid in 1994, top-income shares have increased considerably. In spite of several reforms targeting the poorest and fighting the segregationist heritage, race is still a key determinant of differences in income levels, educational attainment, job opportunities and wealth.

South Africa's dual economy is among the most unequal in the world

South Africa is one of the most unequal countries in the world. In 2014, the top 10% of earners captured two thirds of total income. This contrasts with other high-income inequality countries such as Brazil, the United States and India where the top 10% is closer to 50–55% of national income. However, unlike other highly unequal countries, the divide between the top 1% and the following 9% in South Africa is much less pronounced than the gap between the top 10% and the bottom 90%. Otherwise said, in terms of top income shares, South Africa ranks with the most unequal Anglo-Saxon countries, but, at the same time, there is less concentration within the upper income groups, mostly composed by the white population. The average income among the top 1% was about four times greater than that of the following 9% in 2014 (for comparative purposes, the top 1% in the United States earn seven times more than the following 9%), while average income among the top 10% was more than seventeen times greater than the average income of the bottom 90% (it is eight times more in the United States). It is then only logical that the income share of the top 1% is high, capturing 20% of national income, though this is not the largest share in the world.

The South African "dual economy" can be further illustrated by comparing South African income levels to that of European countries. In 2014, the average national income per adult among the richest 10% was €94 600, at purchasing power parity, that is, comparable to the average for the same group in France, Spain or Italy. But average national income of the bottom 90% in South Africa is close to the average national income of the bottom 16% in France. In light of these statistics, the recently debated emergence of a so-called middle class is still very elusive. Rather, two societies seem to coexist in South Africa, one enjoying living standards close to the rich or upper middle class in advanced economies, the other left behind. (**Figure 2.12.1**)

Figure 2.12.1
Top 1% income share in South Africa, 1914–2014



Source: Alvaredo & Atkinson (2010). See wir2018.wid.world for data series and notes.
In 2014, the Top 1% share of national income was 21%.

Inequality has decreased from the unification of South Africa to the end of apartheid

South Africa is an exception in terms of data availability in comparison with other African countries. The period for which fiscal data are available starts in 1903 for the Cape Colony, seven years before the Union of South Africa was established as a dominion of the British Empire, and ends in 2014, with some years sporadically missing, and noticeably an eight-year interruption following the end of apartheid in 1994. As is often the case with historical tax data series, only a very small share of the total adult population was eligible to pay tax in the first half of the twentieth century. Therefore, the fiscal data from which we can estimate top-income shares allows us to track the top 1% income share since 1913, but only cover the top 10% of the population from 1963 (with a long interruption between 1971 and 2008).

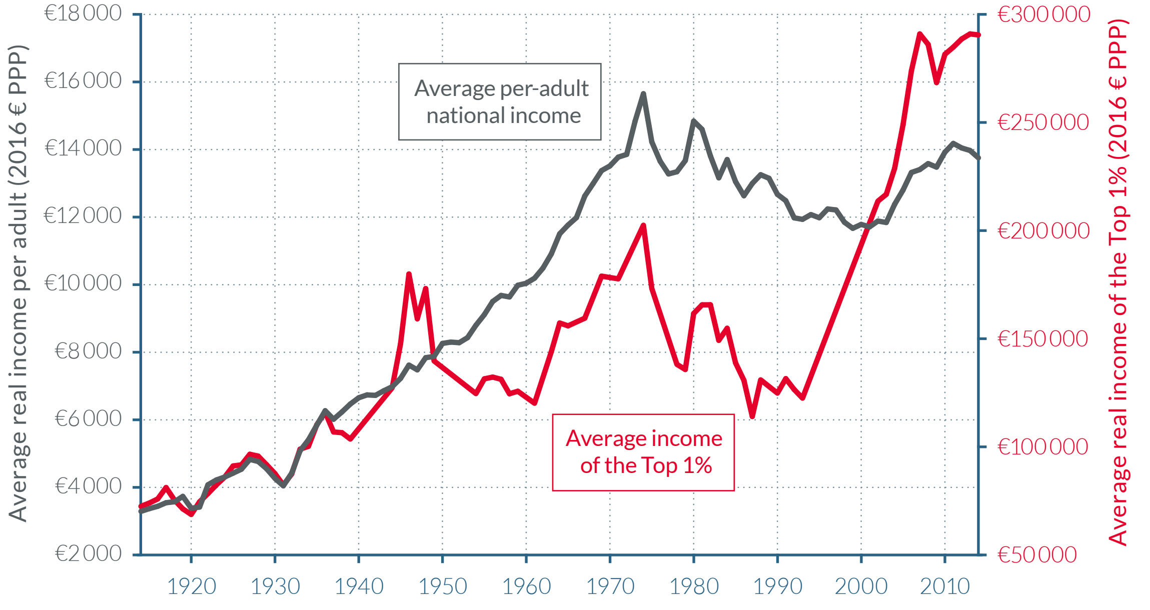
With important short run variations, the evolution of income concentration over the 1913–1993 period seems to follow a very clear long-term trend. The income share of the richest 1% was more than halved between 1913 and 1993, falling from 22% to approximately 10%. Not only did the income share attributable to the top 1% decrease, but inequality within this upper group was also reduced. Indeed, the share of the top 0.5% fell more quickly than the share of the next 0.5% (from percentile 99 to percentile 99.5). Consequently, while the top 0.5% represented about 75% of the top 1% in 1914, by the end of the 1980s, their representative proportion fell to 60%.

Despite the extreme social implications of the first segregationist measures that were implemented in the early 1910s, these policies did not lead to large increases in income concentration among the top 1%. This was also a time in which South Africa progressively developed its industrial and manufacturing sector, enjoying notable accelerations in the 1930s that were to the benefit of the large majority of the population. Aside from a brief fall during the Great Depression, average real income per adult then increased steadily. Following a trend similar to other former Dominions of the British Empire (Australia, Canada and New Zealand) inequality decreased significantly in South Africa from 1914 to the beginning of the the Second World War, despite some short-run variations in the late 1910s: the income share of the top 1% fell from 22% to 16%.

During the Second World War, national average continued to follow its previous trend, but the average real income of the richest 1% took off. As a consequence of the demand shock during the war, the agricultural export prices boomed, the manufacturing sector more than doubled its output between 1939 and 1945, and profits for the foundry and engineering industries increased by more than 400%.[53] However, the wage differential between skilled/white and unskilled/black workers remained extremely large. As C.H. Feinstein described, "black workers [were] denied any share of the growing income in the new economy they were creating."[54] The fact that the peak in the income share of the top 1%—as high as 23% in 1946—was concomitant with the war effort thus seems essentially due to a brief enrichment of the upper class.

In contrast, income growth in the 1950s was more inclusive, as average real income per adult increased by 29% between 1949 and 1961, while the average real income of the top 1% slightly decreased. By 1961 the income share of the top 1% had fallen to around 14%. In the 1960s, both averages grew approximately at the same rate such that inequality remained relatively constant. Following 60 years of successive increases, national average income was almost four times greater by the early 1970s than in 1913. Inequality resumed its downward sloping trend from 1973, but this also marked a period of overall income growth stagnation in South Africa until 1990 that culminated in a three-year recession.

Figure 2.12.2
Average income per adult and average income of the Top 1% in South Africa, 1914–2014



Source: Alvaredo & Atkinson (2010). See wir2018.wid.world for data series and notes.

In 2014, the average income per adult in South Africa was €13 750 (R107 300), while the average income of the Top 1% was €290 500 (R2 266 000). All values have been converted into 2016 Purchasing Power Parity (PPP) euros at a rate of €1 = $1.3 = R7.8. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

For the first time in the previous 90 years, gold output started falling. Richer seams were exhausted and extraction costs increased rapidly. The industry that was once the engine of the economy started to weaken. Increases in oil prices and other commodities accelerated inflation dramatically, averaging about 14% per year between 1975 and 1992. In the 1980s, international sanctions and boycotts were placed on South African trade as a response to the apartheid regime, adding further pressure to that created by domestic protests and revolts, and contributed to the destabilization of the regime in place. White dominance was challenged on both economic and political grounds, to which the ruling government progressively made concessions, recognizing trade unions and the right to bargain for wages and conditions; this could partly explain why the average real income per adult of the top 1% decreased faster than the national average. (**Figure 2.12.2**)

The progressive policies implemented after the apartheid were not sufficient to counter a profoundly unequal socio-economic structure

There are no fiscal data to estimate top-income shares for the eight years that followed 1993. However, joining up the data points to the next available figure in 2002 suggests that income inequality has increased sharply between the end of apartheid and the present, even if the magnitude of the increase must be taken with caution, as the estimates in these two periods may not be totally comparable. The income share of the top 1% increased by 11 percentage points from 1993 to 2014. Part of the increase from 1993 to 2002 should come from changes in the tax code. In particular, before 2002, capital gains were totally excluded, which is very likely to downward bias the share of top-income groups. Also, the tax collection capabilities seem to have increased substantially in the last years. That being said, using household survey data for the years 1993, 2000 and 2008 research has demonstrated that inequality increased significantly during the period for which we have no fiscal data.[55]

At first, it might seem puzzling that the abolishment of a segregationist regime was followed by an aggravation of economic inequality. The establishment of a multi-racial democracy, with a new constitution and a president of the same ethnic origin as the majority of the population, did not automatically transform the inherited socio-economic structure of a profoundly unequal country. Interracial inequality did fall throughout the eighties and nineties, but inequality within race groups increased: rising black per capita incomes over the past three decades have narrowed the black-white income gap, although increasing inequality within the black and Asian/Indian population seems to have prevented any decline in aggregate inequality. In explaining these changes scholars agree in that the labor market played a dominant role, where a rise in the number of blacks employed in skilled jobs (including civil service and other high-paying government positions) coupled with increasing mean wages for this group of workers.

Since 1994, several redistributive social policies have been implemented and/or extended, among which important unconditional cash transfers targeting the most exposed groups (children, disabled and the elderly). At the same time, top marginal tax rates on personal income were kept relatively high and recently increased to 45%. However, in spite of these redistributive policy efforts, surveys consistently show that top-income groups are still overwhelmingly white. Other studies further demonstrate that such dualism is itself salient along other key dimensions such as unemployment and education. Furthermore wealth, and in particular land, is still very unequally distributed. In 1913, the South African parliament passed the Natives Land Act which restricted land ownership for Africans to specified area, amounting to only 8% of the country's total land area, and by the early 1990s, less than 70 000 white farmers owned about 85% of agriculture land.[56] Some land reforms have been implemented, but with seemingly poor results,[57] and it is likely that the situation has not improved much since, although precise data about the recent distribution of land still needs to be collected.

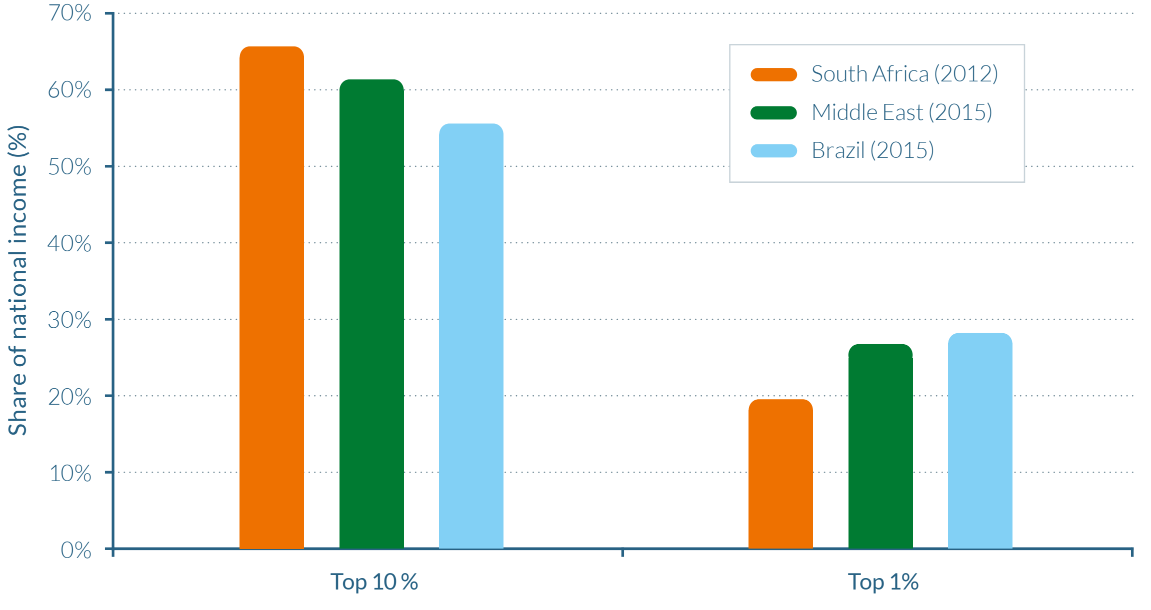
Given this socio-economic structure, the interruption of the international boycotts in 1993 might have more directly favored a minority of high skilled and/or richer individuals who were able to benefit from the international markets, which therefore contributed to increase inequality. This hypothesis would also explain the fact that income inequality in South Africa did not increase in the 1980s, while boycotts were put in place, contrary to other former Dominions (New Zealand, Canada and Australia) despite the country having so far followed a similar trend. Furthermore, the implementation of the Growth, Employment and Redistribution (GEAR) program in 1996, which consisted of removing trade barriers, liberalizing capital flows and reducing fiscal deficit might also have contributed, at least in the short run, to enrich the most well off while exposing the most vulnerable, in part by increasing returns to capital over labor and to skilled workers over unskilled workers.

The rapid growth experienced from the early 2000s until the mid-2010s was essentially driven by the rise in commodity prices and was not accompanied with significant job creation as the government hoped it would. The income share of the top 1% grew from just less than 18% in 2002 to over 21% in 2007, then decreased by about 1.5 percentage points and increased again in 2012–2013 as prices reached a second peak. The fact that these variations closely mirror the fluctuation in commodity prices suggest that a minority benefiting from resource rents could have granted themselves a more than proportional share of growth.

Lastly, it should be stressed that the top 1% only represents a small part of the broader top 10% elite which is mostly white. While the share of income held by the top 1% is relatively low as compared to other high inequality regions such as Brazil or the Middle East, the income share of the top 10% group is extreme in South Africa (**Figure 2.12.3**). The historical trajectory of the top 10% group may be different to that of the top 1%—potentially with less ups and downs throughout the 20th century. Unfortunately at this stage, historical data on the top 10% group does not go as far back in time as for the top 1% group."

Figure 2.12.3

South Africa: the world's highest top 10% income share, but not the highest top 1% share



Source: Alvaredo & Atkinson (2010), WID.world (2017). See wir2018.wid.world for data series and notes.

In 2012, the Top 10% share of national income was 65% in South Africa, while it was 55% in Brazil in 2014. Income shares correspond to the latest year available (2012 for South Africa, 2015 for the Middle East, 2015 for Brazil).

NOTES

1 See, for instance, C. Lakner and B. Milanovic, "Global Income Distribution: From the Fall of the Berlin Wall to the Great Recession," *World Bank Economic Review* 30, no. 2 (2016): 203–232; as well as P. Liberati, "The World Distribution of Income and Its Inequality, 1970–2009," *Review of Income and Wealth* 61, no. 2 (2015): 248–273;; and I. Ortiz and M. Cummins, "Global Inequality: Beyond the Bottom Billion: A Rapid Review of Income Distribution in 141 Countries," UNICEF Social and Economic Policy Working Paper, UNICEF, April 2011, https://www.unicef.org/socialpolicy/files/Global_Inequality.pdf. For existing global wealth reports, see the "Global Wealth Report 2016," Credit Suisse Research Institute, Credit Suisse AG, Zurich, November 2016, http://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=AD783798-ED07-E8C2-4405996B5B02A32E.

2 Lakner and Milanovic, "Global Income Distribution: From the Fall of the Berlin Wall to the Great Recession."

3 J. E. Stiglitz, A. Sen, and J. P. Fitoussi, "Report by the Commission on the Measurement of Economic Performance and Social Progress," Paris, http://ec.europa.eu/eurostat/documents/118025/118123/Fitoussi+Commission+report.

4 Measured at market exchange rate. At purchasing power parity, the corresponding value is $790.

5 G. Zucman, "The Missing Wealth of Nations: Are Europe and the U.S. Net Debtors or Net Creditors?" *Quarterly Journal of Economics* 128, no. 3 (2013): 1321–1364.

6 Our figures for the European Union include all countries on the European continent, apart from Russia and Ukraine.

7 T. Piketty, *Capital in the Twenty-First Century* (Cambridge MA: Belknap Press of Harvard University Press, 2014).

8 Not represented on the graph for the sake of clarity. Readers should refer to WID.world/world to view all graphs.

9 L. Czajka, "Income Inequality in Côte d'Ivoire: 1985–2014," WID.world Working Paper no. 2017/8, July 2017, http://wid.world/document/income-inequality-cote-divoire-1985–2014-wid-world-working-paper-201708/.

10 Very top incomes, however, grew more in post-tax terms than in pre-tax terms between 1946 and 1980 (194%), because the tax system was more progressive at the very top in 1946.

11 The growth in Medicare and Medicaid transfers reflects an increase in the generosity of the benefits, but also the rise in the price of health services provided by Medicare and Medicaid—possibly above what people would be willing to pay on a private market. See, for example, A. Finkelstein, N. Hendren, and E. F. P. Luttmer, "The Value of Medicaid: Interpreting Results from the Oregon Health Care Experiment," NBER Working Paper no. 21308, National Bureau of Economic Research, June 2015, http://www.nber.org/papers/w21308.pdf—and perhaps an increase in the economic surplus of health providers in the medical and pharmaceutical sector.

12 In turn, most of the growth of the post-tax income of the elderly Americans in the *bottom 50%* has been due to the rise of health benefits. Without Medicare and Medicaid (which cover nursing home costs for poor elderly Americans) average post-tax income for the bottom 50% seniors would have stagnated at $21 000 since the early 2000s, and would have increased only modestly since the early 1980s when it was around $15 500.

13 Piketty, *Capital in the Twenty-First Century.*

14 See E. Saez, "Taxing the Rich More: Preliminary Evidence from the 2013 Tax Increase," *Tax Policy and the Economy* 31, no. 1 (2017): 71–120.

15 The US Congressional Budget Office also finds an increase by about 4–5 points in the federal tax rate of the top 1% from 2011 to 2013. US Congressional Budget Office, "The Distribution of Household Income and Federal Taxes, 2013," US CBO Report, June 2016, Congress of the United States, Washington DC, https://www.cbo.gov/sites/default/files/114th-congress-2015–2016/reports/51361-householdincomefedtaxes.pdf.

16 In keeping with the national accounts conventions, the nonrefundable portion of tax credits and tax deductions are treated as negative taxes, while the refundable portion of tax credits are seen as transfers. Subsequently, nobody can have negative income taxes.

17 This general periodization is relatively well known and has been studied elsewhere (see in particular. See T. Piketty, "Income Inequality in France, 1901–1998," *Journal of Political Economy* 111, no. 5 (2003): 1004–1042; and Piketty, *Capital in the Twenty-First Century.*

18 See Piketty, "Income Inequality in France, 1901–1998," and Piketty, *Capital in the Twenty-First Century.*

19 See Piketty, *Capital in the Twenty-First Century*, ch. 9 in particular.

20 T. Piketty, E. Saez, and S. Stantcheva, "Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities," *American Economic Journal: Economic Policy* 6, no. 1 (2014): 230–271.

21 A. Bozio, R. Dauvergne, B. Fabre, J. Goupille, and O. Meslin. "Fiscalité et redistribution en France, 1997–2012", Rapport IPP, 2012. See in particular p.28 for tax rates on primary incomes (before pensions and unemployment insurance) and p.30 for tax rates on secondary incomes (including pensions and unemployment insurance). In the former case, tax rates at the top are lower than for any other income group. In the latter case, tax rates are lower for the bottom 50% than for the richest, but the middle class has a higher total tax rate than the top 0.1%.

22 T. Ferguson and H.-J. Voth, "Betting on Hitler: The Value of Political Connections in Nazi Germany," *Quarterly Journal of Economics* 123, no. 1 (2008): 101–137.

23 T. Piketty, L. Yang, and G. Zucman, "Capital Accumulation, Private Property and Rising Inequality in China, 1978–2015," NBER Working Paper no. 23368, National Bureau of Economic Research, June 2017, http://www.nber.org/papers/w23368.pdf.

24 Comparing the paper's inequality series to the official survey-based estimates highlights that although the trends are similar in both calculation methods, the data used in Piketty, Yang, and Zucman, "Capital Accumulation," shows both a much larger level and rise in inequality over the period. Most of the difference between these estimates comes from the use of high-income tax data.

25 In particular, the lack of national data on high-income taxpayers since 2011 forces the authors to apply the 2006–2010 average correction factors to years 2011–2015 (in effect making it impossible to detect a possible rebound of inequality since 2011).

26 See R. Kanbur, Y. Wang, and X. Zhang, "The Great Chinese Inequality Turnaround," ECINEQ WP 2017-433, Society for the Study of Economic Inequality (ECINEQ), April 2017, http://www.ecineq.org/milano/WP/ECINEQ2017-433.pdf; and R. Garnaut, L. Song, C. Fang, and L. Johnston, "Domestic Transformation in the Global Context," in *China's Domestic Transformation in a Global Context*, ed. L. Song, R. Garnaut, C. Fang, and L. Johnston, 1–16 (Acton, Australia: Australian National University Press, 2015).

27 As a result, the middle 40% income share is now similar in China to urban China: the top 10% income share is higher in China than in urban China, while the bottom 50% income share is lower, leaving the share of the middle 40% at about 43%–44% in both cases in recent years.

28 The Western European average referred to is the simple arithmetic average of per-adult income in Germany, France, and Britain. Note that using the Western European average income as a reference point is clearly an oversimplification and does not do justice to the complexity of country-specific trajectories. For example, Germany, France, and Britain have quasi-identical average incomes in 2016, but Britain lagged behind Germany and France in 1980 (only slightly above Russian level), and was well ahead in 1870–1914.

29 The best indicator of the mediocre Soviet economic and social performance in the postwar decades is perhaps the stagnation of life expectancy. See, for example, E. Todd, *The Final Fall: An Essay on the Decomposition of the Soviet Sphere*, trans. J. Waggoner (New York: Karz, 1979).

30 See, for example, B. Milanovic, *Income, Inequality, and Poverty during the Transition from Planned to Market Economy* (Washington, DC: World Bank, 1998).

31 See J. Nellis, "Time to Rethink Privatization in Transition Economies?" *Finance and Development* 36, no. 2 (1999): 16–19.

32 In 1995, the government of Boris Yeltsin adopted a "loans-for-shares" scheme, whereby some of the largest state industrial assets were leased through auctions for money lent by commercial banks to the government. The auctions were thought by many to have been rigged and lacked competition, being largely controlled by favored insiders with political connections or used for the benefit of the commercial banks themselves. Since neither the loans nor the leased enterprises were returned in time, this effectively became a form of selling, or privatizing, state assets at very low prices. See I. W. Lieberman and D. J. Kopf, eds., *Privatization in Transition Economies: The Ongoing Story* (Amsterdam: Elsevier JAI, 2008).

33 See J. Flemming and J. Micklewright, "Income Distribution, Economic Systems and Transition," in *Handbook of Income Distribution*, ed. A. B. Atkinson and F. Bourguignon,843–918 (Amsterdam: Elsevier, 2000).

34 See also B. Milanovic and L. Ersado, "Reform and Inequality during the Transition: An Analysis using Panel Household Survey Data, 1990–2005," UNU-WIDER Working Paper no. 2010/62, United Nations University World Institute for Development Economics Research, Helsinki, May 2010, https://www.wider.unu.edu/sites/default/files/wp2010-62.pdf.

35 All figures are presented in 2016 Euros using purchasing power parity (PPP) conversions. In 2016, €1 = ₽ 74.5 (rubles) at the market exchange rate or ₽ 28.3 using PPP conversions.

36 European Bank for Reconstruction and Development (EBRD), *Transition for All: Equal Opportunities in an Unequal World*, Transition Report 2016–2017, October 2016, available for download at http://www.ebrd.com/transition-report.

37 The corrected inequality series combines survey data with income tax data and wealth data, while the EBRD growth incidence curve relies solely on self-reported survey data. For a more detailed discussion, see F. Novokmet, T. Piketty, and G. Zucman, "From Soviets to Oligarchs: Inequality and Property in Russia 1905–2016," WID.world Working Paper no. 2017/09, July 2017, http://wid.world/wp-content/uploads/2017/08/NPZ2017WIDworld.pdf.

38 See Part I.

39 S. L. Richman, "War Communism to NEP: The Road to Serfdom," *Journal of Libertarian Studies* 5, no. 1 (1981): 89–97.

40 This figure from 1905 relies not on actual income tax data, since the tax was never implemented in tsarist Russia, but on income tax projections that were made by the imperial tax administration at the time the regime was considering implementing such a tax. Similar estimates were made during the same period in France, but their implementation revealed that the tax administration was significantly underestimating top income levels. See T. Piketty, *Les hauts revenus en France au XXème siècle* (Paris: Bernard Grasset, 2001).

41 See A. Banerjee and T. Piketty, "Top Indian Incomes, 1922–2000," *World Bank Economic Review* 19, no. 1 (2005): 1–20.

42 Economic policies also sought to rationalize the public sector; its branches now had to pursue the objectives of profitability and efficiency. Trade was opened, an exchange rate floating regime was implemented and banking as well as capital market were also liberalized.

43 I. Anand and A. Thampi, "Recent Trends in Wealth Inequality in India," *Economic and Political Weekly* 51, no. 50 (December 2016).

44 United Nations Development Programme (UNDP), "Towards the Developmental State in the Arab Region," Arab Development Challenges Report 2011, UNDP Regional Centre for Arab States, Cairo, 2011, available for download at http://www.undp.org/content/undp/en/home/librarypage/hdr/arab-development-challenges-report-2011.html

45 E. Ianchovina, L. Mottaghi, and S. Devarajan,"Inequality, Uprisings, and Conflict in the Arab World," World Bank Middle East and North Africa (MENA) Region Economic Monitor, World Bank, Washington, DC, October 2015, http://documents.worldbank.org/curated/en/303441467992017147/pdf/99989-REVISED-Box393220B-OUO-9-MEM-Fall-2015-FINAL-Oct-13-2015.pdf.

46 J. Kinninmont, "Future Trends in the Gulf," Chatham House Report, The Royal Institute for International Affairs, London, February 2015, https://www.chathamhouse.org/sites/files/chathamhouse/field/field_document/20150218FutureTrendsGCC Kinninmont.pdf.

47 Human Rights Watch, "South Asia: Protect Migrant Workers to Gulf Countries,"Human Rights Watch news, December 18, 2013

48 Ibid.; and A. Kapiszewski,"Arab versus Asian Migrant Workers in the GCC Countries," United Nations Expert Group Meeting on International Migration and Development in the Arab Region, United Nations Secretariat, Beirut, May 15–17, 2006, http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.403.7975&rep=rep1&type=pdf

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51 See B. Keeley, *Income Inequality: The Gap between Rich and Poor*, OECD Insights (Paris: OECD Publishing, 2015).

52 M. Medeiros, P. H. G. F. Souza, and F. A. de Castro, "The Stability of Income Inequality in Brazil, 2006–2012: An Estimate Using Income Tax Data and Household Surveys," *Ciência y Saúde Coletiva* 20, no. 4 (2015): 971–986.

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54 C. H. Feinstein, *An Economic History of South Africa: Conquest, Discrimination, and Development* (Cambridge: Cambridge University Press, 2005).

55 M. Leibbrandt, I. Woolard, A. Finn, and J. Argen, "Trends in South African Income Distribution and Poverty since the Fall of Apartheid," OECD Social, Employment and Migration Working Papers, no. 101, OECD Publishing, Paris, May 28, 2010

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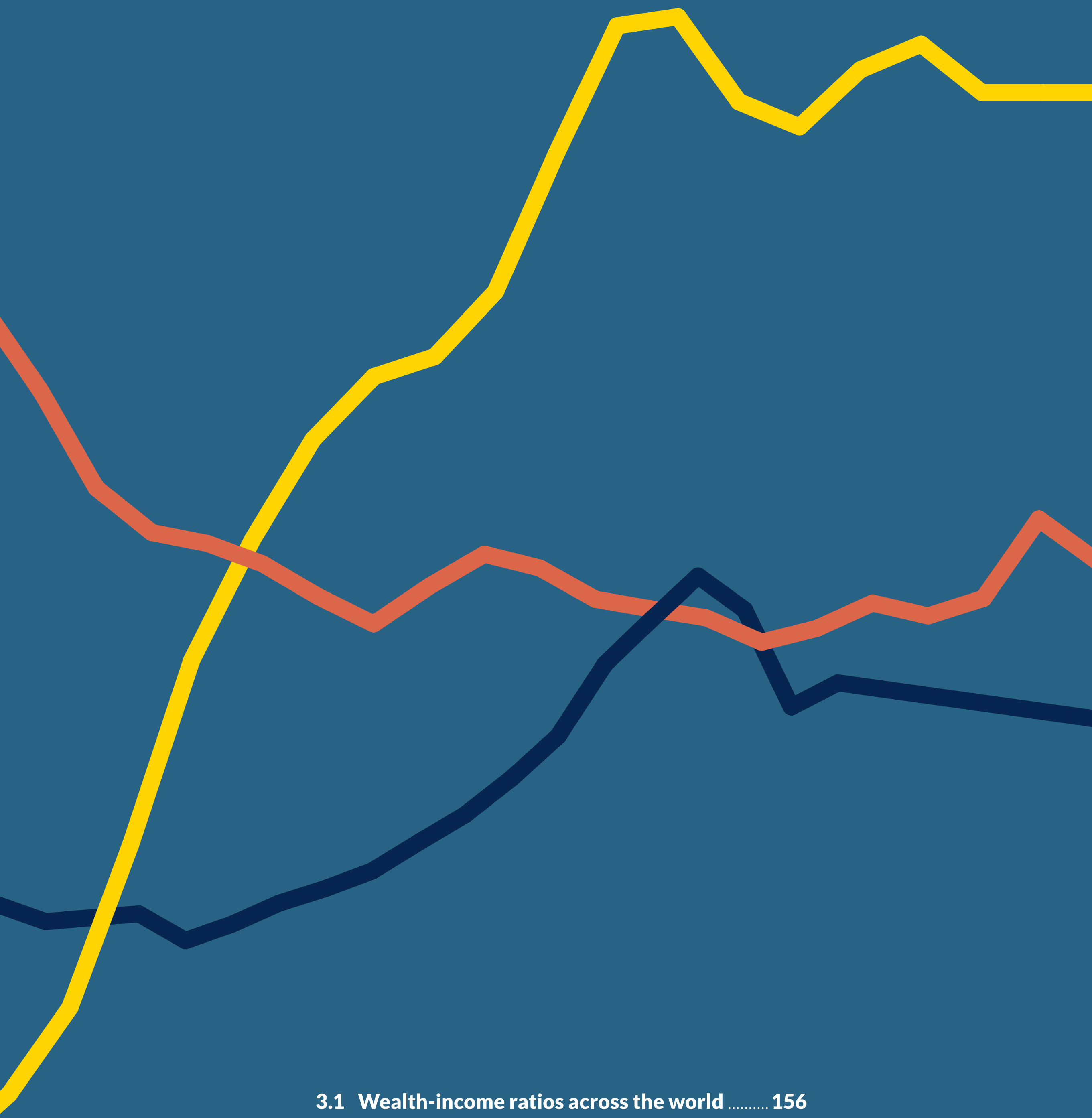
PART III

PUBLIC VERSUS PRIVATE CAPITAL DYNAMICS



3.1

WEALTH-INCOME RATIOS ACROSS THE WORLD

- Analyzing the composition of an economy's national wealth, between assets that are privately and publicly owned, is a prelude to understanding the dynamics of wealth inequality among individuals. New data have allowed us to better comprehend the evolution of countries' wealth-income ratios and can help answer crucial policy questions.
- A general rise in the ratio between net private wealth and national income has been observed in nearly all countries in recent decades. It is striking to see that this long-run finding has largely been unaffected by the 2008 financial crisis, or by asset price bubbles in countries such as Japan and Spain.
- There have been unusually large increases in the ratios for China and Russia, which have quadrupled and tripled, respectively, following their transition from a communist- to a capitalist-oriented economy. Private wealth-income ratios in these countries are approaching levels observed in France, the UK, and the United States.
- Public wealth has declined in most countries since the 1980s. Net public wealth (public assets minus public debts) has even become negative in recent years in the United States and the UK, and is only slightly positive in Japan, Germany, and France. This arguably limits government ability to regulate the economy, redistribute income and mitigate rising inequality.
- In China, public property largely declined but remains at a high level today: net public wealth has stabilized at about 30% of national wealth since 2008 (as compared to 15%–25% in the West during the mixed-economy 1950–1980 period).
- The only exceptions to the general decline in public property seen in the data are oil-rich countries with large public sovereign funds, such as Norway.
- The structural rise of private wealth-income ratios in recent decades is due to a combination of factors including high saving rates and growth slowdowns (volume factors), the increase of real estate and stock prices (relative asset price factors), and the transfer of public wealth to private wealth (institutional factors), described in the next chapters.

New data have allowed us to better understand the relationship between wealth and inequality

Understanding how the level and structure of national wealth have evolved in the long run is one of the most fundamental economic questions. National income is a "flow" concept: it is defined as the sum of all income flows produced and distributed in a given country during a given year; it can also be broken down between the remuneration of labor and capital. National wealth, on the other hand, is a "stock" concept: it is defined as the sum of all assets—in particular housing, business, and financial assets, net of debt—that were accumulated in the past. The relationship between national wealth and national income can inform us about a number of key economic, social, and political evolutions, including the relative importance of capital in an economy and the structure of ownership.

Before we look at distribution of private wealth (that is, what share of private wealth is owned by the bottom 50% of the population, the top 10%, and so on), it is critical to better understand the evolution of total private wealth, and how it compares to public wealth and to total national wealth—which by definition is equal to the sum of private and public wealth. It is also important to keep in mind that the very notions of private property and public property can have very different meanings depending on the country or the period considered. For instance, private property in land or housing can take very different forms, depending on the extent of tenant rights, the length of their tenures, the ability of landlords to change their rents or expel them unilaterally, and so forth. In a similar way, corporate property may not have the same meaning when workers' representatives hold substantial voting rights in corporate boards (such as in Nordic countries or Germany) as in countries where shareholders control all voting rights.

Also, public property in China today is a different reality from public property in this country forty years earlier, or in the context of Norway's public sovereign fund today, and so on. Understanding the details of the legal, political, and governance system is important to understanding the interplay between property structure and power relations between social groups. The study of private and public wealth cannot be limited to the analysis of trends and levels; it must be grounded in a deeper understanding of the countries' institutions and how these affect political and social inequality, as well.

Studying the evolution of national wealth-national income ratios can also help improve our knowledge on the structure of wealth, savings, and investment and thus can be used to study fundamental macroeconomic questions. These questions include: What are the long-run dynamics and prospects regarding the evolution of public debt? And what are the patterns of net foreign asset positions? In order to properly analyze these issues, it is critical to look at the entire national balance sheet—that is, the overall structure of who owns what. Public debt or foreign assets are not owned by the planet Mars; by definition, they belong to private or public property owners. Monitoring the evolution of capital accumulation and the composition of private assets, for example, can also help identify potential signs of instability in an economy. Indeed, in the cases of Japan and Spain, wealth-income ratios reached historical highs in 1990 and 2008, respectively, as both countries experienced asset market bubbles.

Until recently it was difficult to fully get to grips with such dynamics because of a lack of data. Thomas Piketty and Gabriel Zucman have recently presented harmonized annual series of wealth-income ratios for the eight largest rich economies in the world from 1700 onwards.[1] These series have also been discussed in *Capital in the Twenty-First Century* and in the ensuing debates on the return to a patrimonial society.[2]

Their work has been extended by other researchers. The WID.world database now contains data on more than twenty countries, which we discuss in this report. In particular, we currently have series on the structure of private and public wealth in a number of emerging and ex-communist economies, which are able to provide new insights on crucial public policy issues.

We should stress, however, that this is an area where we still need to make a lot of progress. In particular, we still know far too little about the structure of public, private, and foreign ownerships in many areas of the developing and emerging world, particularly in Africa, Latin America, and Asia.

Private wealth-income ratios have risen remarkably since the 1970s

In 1970, private wealth-national income ratios ranged from around 200%–350% in most developed countries (see **Figure 3.1.1** and **Figure 3.1.2**). The past four decades saw a sharp rise in these ratios in all countries. By 2007, the year in which the global financial crisis began, private wealth-national income ratios in the countries observed averaged 550%, peaking at 800% in the extreme case of Spain. Despite the fall in these ratios in some of the countries following the financial crisis and the decline in housing prices, the multi-decade trend seems to have been largely unaltered. By 2016, the market value aggregate private wealth—measured in years of national income—is typically twice as large in 2016 as in 1970.

There have, however, been interesting cross-country variations in magnitudes and levels. Within Europe, country trajectories have been roughly similar as net private wealth rose from 250–400% of net national income in 1970 to 450–750% by 2016. Italy showed the most spectacular rise in its private wealth-to-income ratio, which approximately tripled from 250% in 1970 to over 700% in 2015, followed by the UK where the private wealth-national income ratio more than doubled, from approximately 300% to 650%, over the same forty-five years. France (from approximately 300% to more than 550%) followed a similar trajectory, though at a slightly lower order of magnitude, while this trend was also followed by Germany (from approximately 250% to 450%) and Spain (from about 400% to 650%) over the same period.

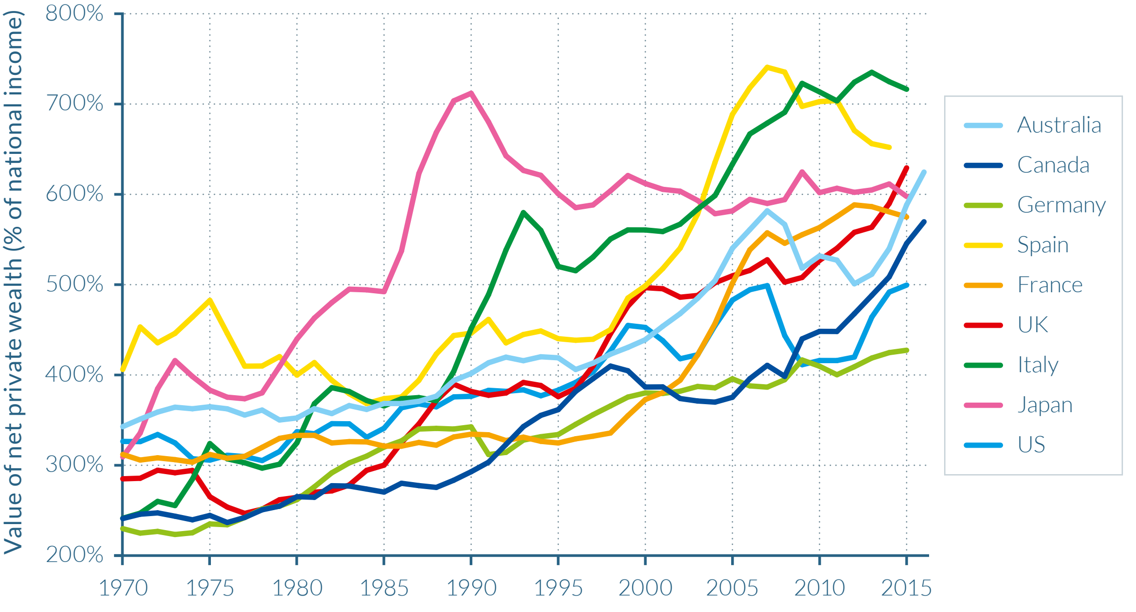
Outside of Europe, Australia and Canada demonstrated comparable evolutions in their private wealth-national income ratios to France, Italy, and the UK. Canada's private wealth more than doubled between 1970 and 2016, from around 250% of net national income to more than 550%, while Australia's rise was still significant but less striking, increasing from slightly less than 350% of national income to over 550%. In the United States, private wealth—relative to national income—rose by a half over the same time period, from less than 350% of national income to around 500%.

In Japan, the private wealth-income ratio also almost doubled over the time period (300% to almost 600%) and, like Spain, experienced enormous fluctuations as a result of its asset price bubble in the years leading up to 1990. In Japan, real estate and stock market prices rose dramatically from around 1986 as overly optimistic expectations regarding future economic fundamentals increased the value of the country's capital assets and sent its private wealth-national income ratio soaring to as much as 700% by 1990. But soon after the Nikkei stock market index had plummeted and the price of assets followed suit, leading to what was dubbed the "lost decade" and a 150-percentage-point fall in the wealth-income ratio by 2000. However, despite further falls, the wealth-income ratio remained one of the highest among the rich countries. As explained in detail in chapter 4.6, Spain has followed a similar trend since the bursting of the country's asset price bubble, with its wealth-to-income ratio falling by around 150 percentage points from its peak in 2007 to approximately 650% in 2014.

Thanks to recent research that has been completed on some of the world's largest emerging economies, it is now also possible

Figure 3.1.1

Net private wealth to net national income ratio in rich countries, 1970–2016

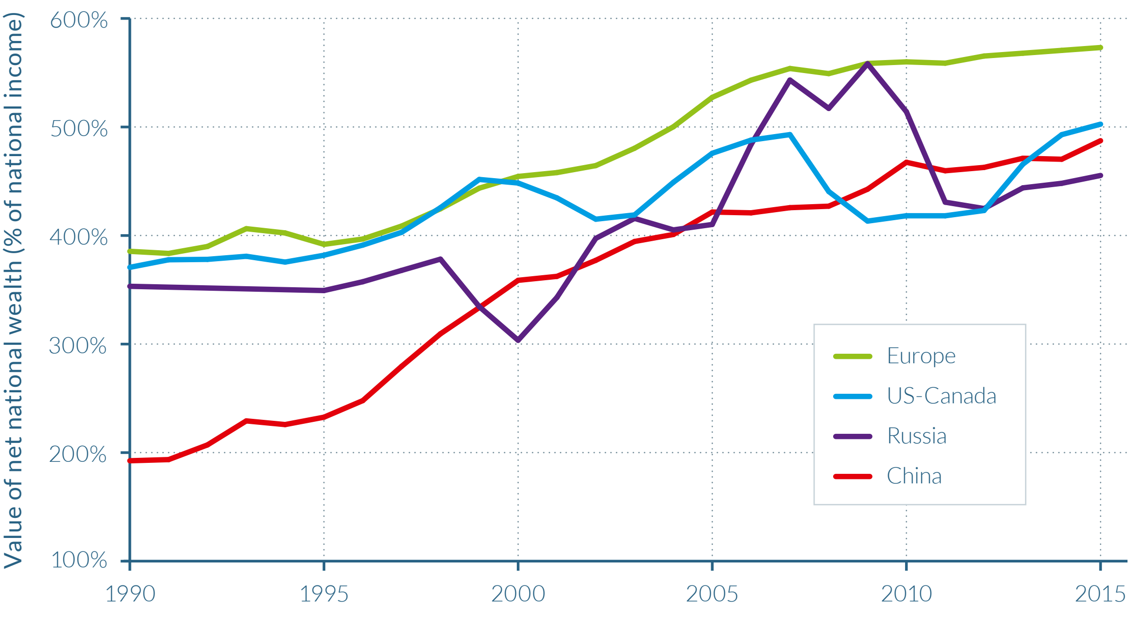


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net private wealth in the UK was 629% of net national income, i.e. it was worth 6.3 years of national income. Net private wealth is equal to private assets minus private debt. Net national wealth is equal to net private wealth plus net public wealth.

Figure 3.1.2

Net national wealth to net national income ratio in emerging and rich countries, 1990–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net national wealth in China was 487% of net national income, i.e. it was worth 4.9 years of national income. Net national wealth is equal to net private wealth plus net public wealth. Net private wealth is equal to new private assets minus net private debt.

to compare how these countries' wealth-income ratios have evolved. This is particularly interesting given the changes in political and economic regimes experienced in the emerging world over the period considered. As depicted in **Figure 3.1.2**, China and Russia both experienced large rises in their private wealth-income ratios after their transitions away from communism. While to some extent these increases are to be expected (as a large proportion of public wealth is transferred to the private sector), the scale of change experienced is particularly striking in China. The comparison with the trajectories observed in developed countries is also of particular interest (about which more will be said below).

At the time of the "opening-up" policy reforms in 1978, private wealth in China amounted to just over 110% of national income, but by 2015, this figure had reached 490%, following almost unrelenting rises. Russia's transition began twelve years later in 1990, but the change since has been no less spectacular. Over this shorter period of time, Russia's private wealth-income ratio more than tripled from around 120% to 370%. It is interesting to compare these changes with those in Europe and North America, described above, as China's ratio is only just below that of the United States, and Russia is not a long way behind, either. Furthermore, the speed and scale of the change in these emerging economies far surpasses that seen in rich countries. By way of comparison, the only time the UK or the United States experienced a similar magnitude of change in wealth-income ratios followed their huge falls at the beginning of the twentieth century.

Rising national wealth-to-income ratios in recent decades come exclusively from the rise of private wealth

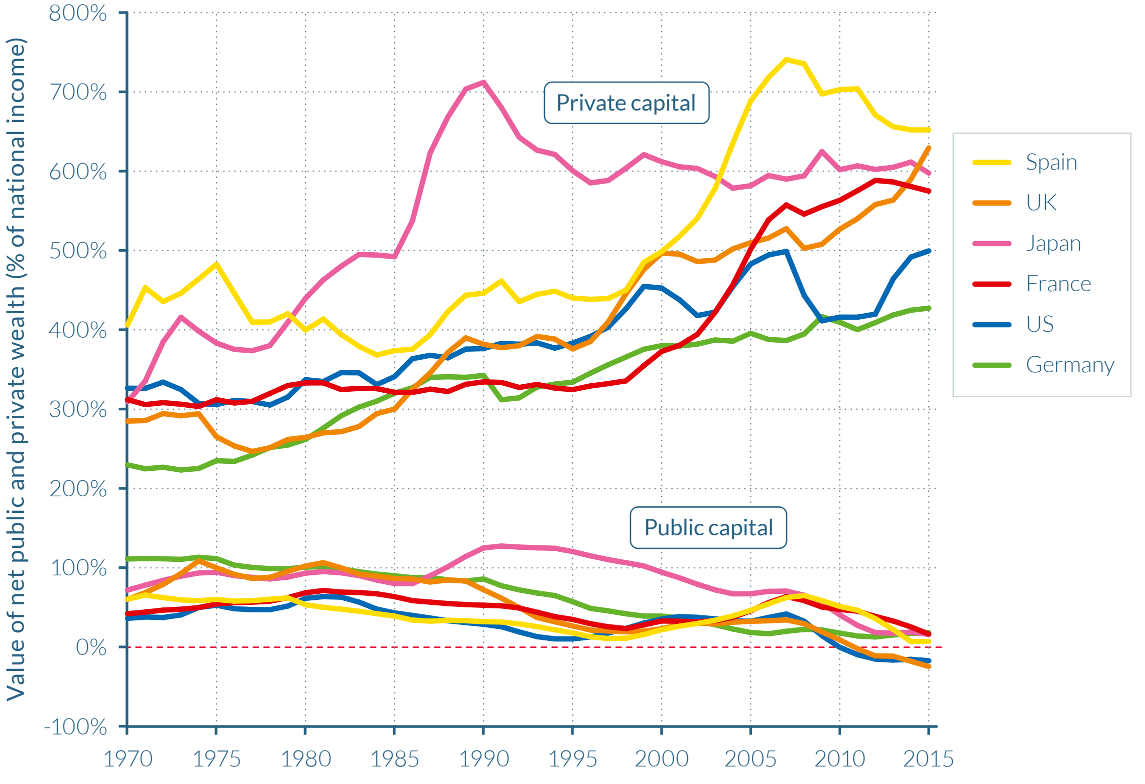
From **Figure 3.1.3** it quickly becomes clear that the recent upward trend in national wealth-to-income ratios has exclusively been the result of private wealth accumulation. Indeed, in the UK and the United States, national wealth consists entirely of private wealth, as net public wealth has become negative (that is, public assets are now below public debt). France, Japan, and Germany have also experienced a significant decline in public wealth, which is now worth just about 10–20% of national income according to official estimates—that is, a very tiny fraction of total national wealth. The domination of private wealth in national wealth represents a marked change from the situation which prevailed in the 1970s, when net public wealth was typically between 50% and 100% of national income in most developed countries (and over 100% in Germany). Today, with either small or negative net public wealth, the governments of developed countries are arguably limited in their ability to intervene in the economy, redistribute income, and mitigate rising inequality. (More on this will be said below.)

In practice, the decline in net public wealth in recent decades is mostly due to the rise of public debt, while the ratios of public assets to national income have remained relatively stable in most countries (see **Figures 3.1.4a** and **3.1.4b**). The relative stability of public assets—relative to national income—can be viewed as the consequence of two conflicting effects: on the one hand, a significant fraction of public assets were privatized (particularly shares in public or semi-public companies, which used to be relatively important in a number of developed countries between the 1950s and the 1970s); on the other hand, the market value of the remaining public assets—typically public buildings hosting administrations, schools, universities, hospitals, and other public services—has increased over this time period.

China and Russia provide two contrasting examples of how private-wealth-to-national-income ratios have evolved, relative to the aforementioned countries, for which the privatization strategies chosen by the two countries play an integral role. (This is further analyzed in chapters 3.2 through 3.4.) The gradual process of privatization of public

Figure 3.1.3

Net private wealth and net public wealth to national income ratios in rich countries, 1970–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

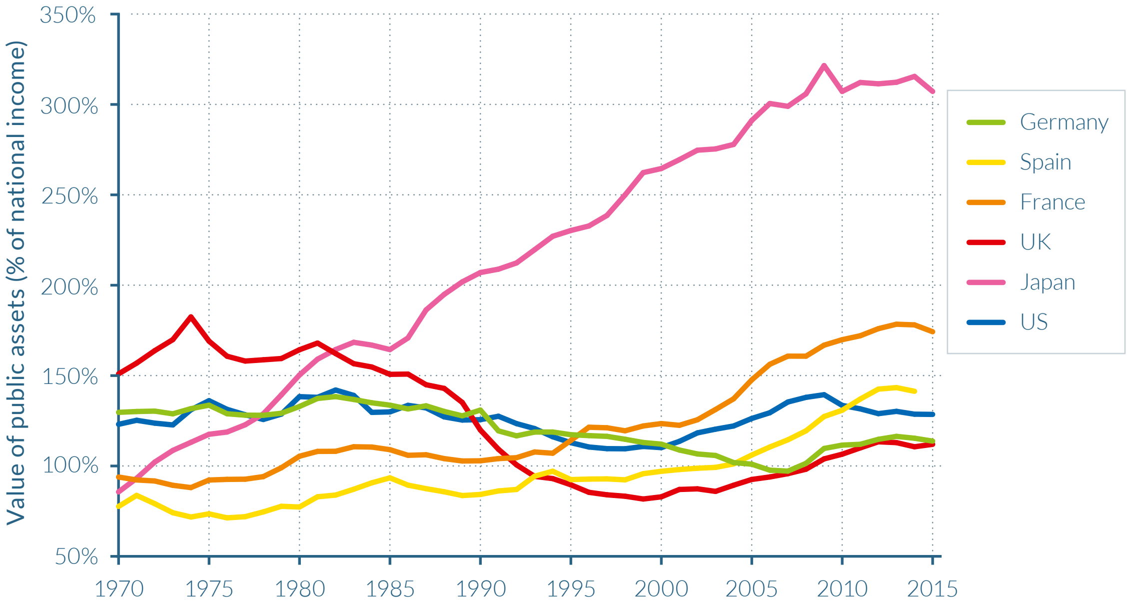
In 2015, the value of net public wealth (or public capital) in the US was negative (-17% of net national income) while the value of net private wealth (or private capital) was 500% of national income. In 1970, net public wealth amounted to 36% of national income while the figure was 326% for net private wealth. Net private wealth is equal to new private assets minus net private debt. Net public wealth is equal to public assets minus public debt.

wealth in China led to a slight over-fall in the value of public wealth as a proportion of national income, from just over 250% of national income in 1978 to approximately 230% in 2015, in a context of rapidly rising asset prices. In Russia, the voucher privatization strategy chosen aimed to transfer public assets into the private sector as quickly as possible, and subsequently had the effect of reducing the net public wealth to national income ratio enormously, from over 230% of national income in 1990 to around 90% in 2015.

The dominance of private wealth over public wealth within countries is further highlighted by their relative shares in national wealth. As depicted by **Figure 3.1.5**, all observed countries (with the exception of Norway) have seen a decline in the value of public property relative to private property. In the late 1970s, the share of net public wealth in net national wealth was positive and substantial in all developed countries: it was as large as 25% in countries including Germany and Britain, and 15% in Japan, France, and the United States. By 2016, the share of public wealth has become negative in Britain and the United States, and is only marginally positive in Japan, Germany and France. In China, the share of public wealth was as large as 70% in 1978, and seems to have stabilized around 30% since 2008—a level that is somewhat larger (but not incomparable) to that observed in Western countries during the mixed-economy period of the 1950s–1970s.

Figure 3.1.4a

Public assets to net national income ratio in rich countries, 1970–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

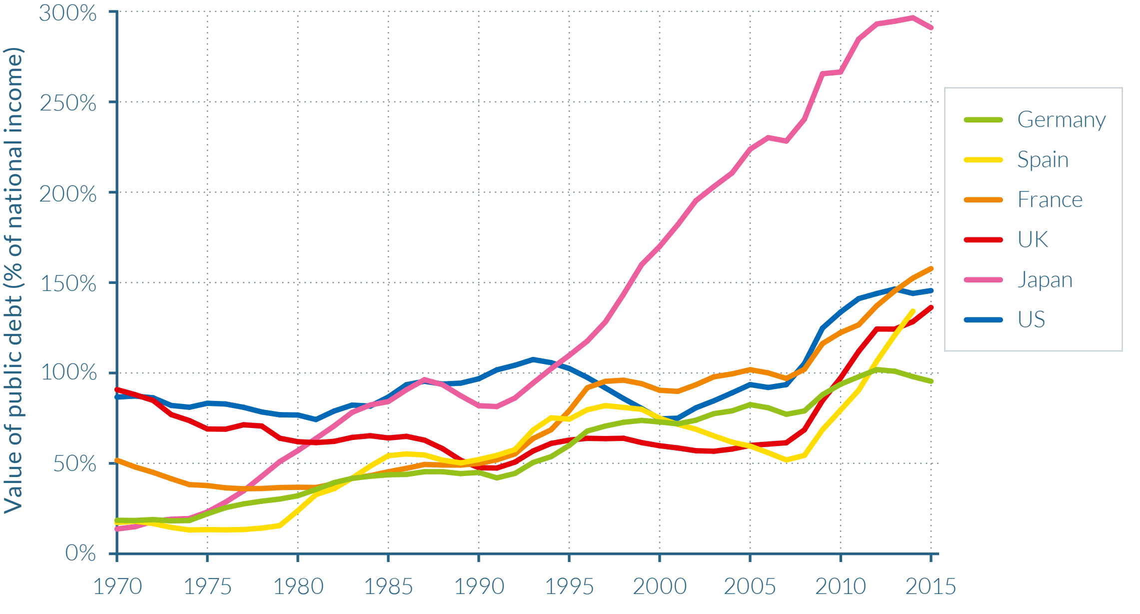
In 2015, the value of public assets in Germany was 114% of net national income, i.e. it was worth 1.1 years of national income.

Norway, along with some other resource-rich countries, is unique in this sense, using its large sovereign investment fund to invest in projects that can increase the wealth of the state. Following oil and gas discoveries in 1969, the Norwegian government established a Global Pension Fund in the 1990s to invest a proportion of the revenue earned from these nonrenewable energy sources and ensure that the benefits from North Sea oil production accrued not just to the current generation, but also to future generations. This is seen as an important instrument of economic policy in Norway to support government saving, finance public expenditure, and wealth accumulation. As a result, the share of public wealth within total national wealth rose from around 30% in 1978 to almost 60% by 2015 as the value of public wealth rose to roughly 300% of national income (considerably greater than in China's in relative terms).

There are two interesting comparisons to be made here that illustrate the importance of political institutions and ideologies in determining national wealth-to-income ratios. To summarize, it's not only a question of oil—it depends on what the government decides to do with public wealth and with the economy. The first comparison is with Russia. Despite accumulating similar trade surpluses in relative terms to Norway—equal to around 200% of national income—according to official statistics, Russia has been unable to accumulate large foreign assets, and instead a significant proportion of these surpluses are estimated to be held in offshore assets and thus cannot be taxed or used for government expenditure (unlike in Norway). The second comparison is with the UK, given that it also was able to benefit from North Sea oil. In his book *Inequality, What Can Be Done?*, Anthony Atkinson poses a thoughtful question.[3] "It is an interesting piece of conjectural history," he writes, "to ask what would have happened if the UK had created such a fund in 1968 and had spent only the real return" in a similar way to Norway.[4] Atkinson goes on to show that

Figure 3.1.4b

Public debt to net national income ratio in rich countries, 1970–2015

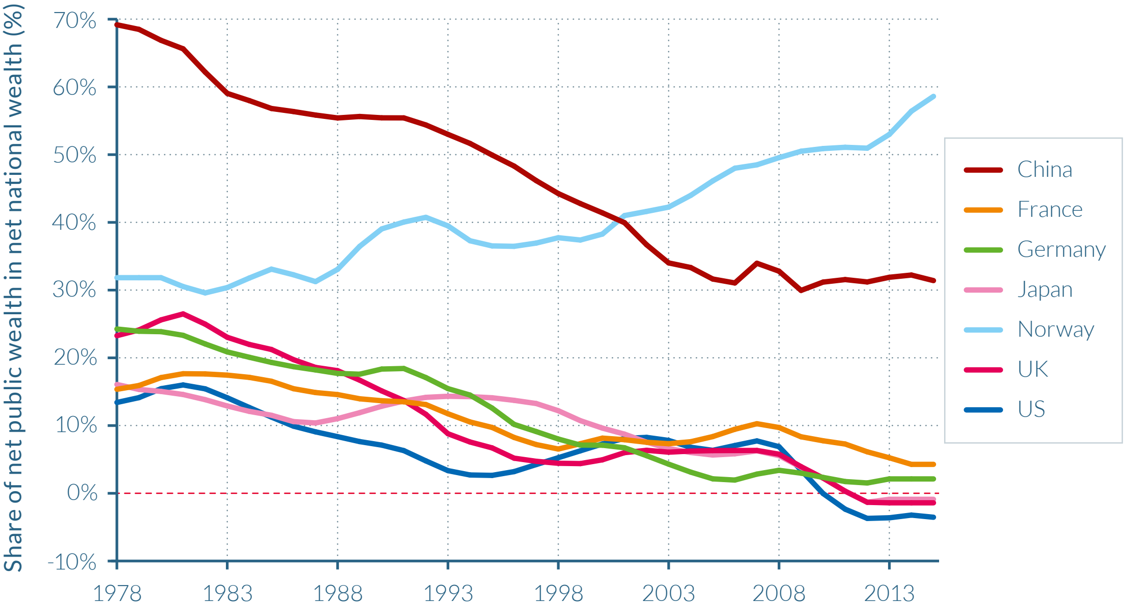


Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of public debt in the US was 146% of net national income, i.e. it was worth 1.5 years of national income.

Figure 3.1.5

The share of public wealth in national wealth in rich countries, 1978–2015



Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the share of public wealth in national wealth in France was 3% against 17% in 1980. Net public wealth is equal to public assets minus net public debt. Net national wealth is equal to net private wealth plus net public wealth.

the accumulated fund for the UK would have been very considerable (some £350 billion), or about 60% of the Norwegian fund. As the UK is a larger country, the fund would have represented a smaller percentage of national income, but nevertheless, the fiscal cushion would have enabled the UK's net worth to be positive in rather than negative today.

Recent evolutions in wealth-income ratios are likely the result of economic policy decisions and country-specific contexts

The following chapters provide a more detailed analysis of why wealth-income ratios developed as described above in developed countries since the 1970s (chapter 3.2), and in China and Russia since their respective transitions away from communist-dominated economic and political models (chapter 3.3).

In summary, the structural rise of private wealth-income ratios in recent decades has been due to a combination of factors. High saving rates and growth slowdowns (volume factors) were responsible for approximately 60% of the increase in national wealth-income ratios in the rich countries observed, while rises in real estate and stock prices (relative asset price factors) represented the remaining 40%. The transfer of public wealth to private wealth (institutional factors) is critical to understanding the evolution of private wealth-income ratios in China and Russia, but also in developed countries that underwent large privatization exercises (generally in the mid-1980s), though on a much smaller scale.

Since the financial crisis, trends in wealth-income ratios have varied between countries, underlining the importance of institutional and country-specific contexts. Wealth-income ratios dipped in all of the observed countries following the crisis, suggesting short-term capital losses were experienced as a result of falling asset prices, as evidenced by lower house prices and stock market indices across countries from 2008. The size, speed, and timing of the fall and subsequent recovery in ratios—which occurred to some extent in all but two countries for which data are available (Japan and Spain)—vary significantly, again highlighting how individual country circumstances can substantially affect the wealth-income ratio. For example, the fall in ratios in Spain (down 150%), and the United States (down 140%) are likely to have been larger than in other countries due to overinflated prices for stocks and property assets that helped to create the emergence of these bubbles in the first place (see chapter 4.5 in particular).

3.2

THE EVOLUTION OF AGGREGATE WEALTH-INCOME RATIOS IN DEVELOPED COUNTRIES

- National savings and economic growth and asset prices are key to understanding how national wealth has evolved in the long run. National savings and growth account for about 60% of the rise in national wealth in rich countries, while asset prices account for the remaining 40%.
- The rise in housing largely drove domestic capital accumulation since the late 1970s, with significant variations across countries.
- External wealth has played an important role in the general evolution of wealth-income ratios.
- Today's private wealth-national income ratios in rich countries appear to be returning to the high values observed in the late 19th century, which were as high as 600%–700%

National savings, economic growth, and asset prices are key to understanding how national wealth-income ratios have evolved in the long run

In order to properly analyze the evolution of national wealth-national income ratios and the structure of property, we need to combine a large number of complex explanatory factors and processes.

First, for a given level of national wealth, the division between private and public wealth is largely a consequence of government policies. If the government in Russia or China decides to privatize public assets—typically below market prices—then the share of private wealth will mechanically increase. More generally, if a government decides to run fiscal surpluses in order to accumulate public assets (and/or nationalize private assets, sometimes below or sometimes above market prices, depending on the historical and ideological context), then other things being equal, the share of public wealth will rise. If a government runs fiscal deficits and finances its deficits by issuing public debt or privatizing public assets, then the share of public wealth will decline.

In the case of developed countries, the combination of public policies (fiscal deficits, privatization of public assets, and expansion of public debt) followed since the 1970s led to a reduction of the share of public wealth from around 20% of national wealth in the 1970s (between 15% and 25%, depending on the specific country) to about 0% (or slightly negative levels) by 2016 (see **Figure 3.1.5**). If different fiscal and regulation policies had been followed, and if the public share in national wealth had remained at the same level as in the 1970s, then by definition the level of private wealth would be about 20% lower in 2016 than what it actually was (other things equal, that is, for a given level of national wealth). In that sense, the decline in public wealth explains a very large fraction of the overall rise in private wealth–national income ratios.

The other issue is to understand the evolution of national wealth–national income ratios. Here one needs to consider the interplay between the level of national savings (the sum of public and private saving), the level of economic growth (itself determined by population and productivity growth), and the evolution of relative asset prices. More precisely, following the work by Piketty and Zucman (2014), one can decompose the evolution of national wealth-national income ratios into two components: volume effects and price effects.

Volume effects are largely determined by the evolution of national savings: the higher the level of national savings, the larger the accumulation of national assets and hence national wealth. They also depend on the level of growth: for given savings, a lower population and/or productivity growth will tend to raise the ratio of national wealth to national income (simply because national income is lower). In sum, countries with high savings and low growth (for example, because of demographic stagnation, as in Japan and large parts of Europe) naturally tend to accumulate high national wealth–national income ratios.[5]

Price effects are determined by the evolution of asset prices—in particular, housing and equity prices—relative to consumer prices. This in turn depends on a number of institutional and policy factors—for example, the gradual lift of rent control contributed to the large increase in housing prices over the period—as well as on the patterns of saving and investment strategies. For example, if the aging households in Japan or Europe choose to invest a large proportion of their savings in domestic assets including real estate (and do not, or cannot, diversify their portfolio internationally as much as would have been possible) then it is perhaps not too surprising that high upward pressure is generated on housing prices.

By combining systematic data series on the patterns of saving, investment, and economic growth in developed countries since 1970, one can show that both volume and price effects have played a significant role. For example, looking at the eight largest developed economies, one finds that about 60% of national wealth accumulation between 1970 and 2010 can be attributed on average to volume effects, versus about 40% to price effects. It is worth noting, however, that there are very large cross-country variations. For instance, volume effects explain 72% of the accumulation of national wealth in the United States between 1970 and 2010, while residual capital gains explain 28%. Similar to the United States, new savings also appear to explain around 70–80% of national wealth accumulation in Japan, France, and Canada between 1970 and 2010, while residual capital gains accounted for the remaining 20–30%. Capital gains were larger, however, in Australia, Italy, and the UK, where they accounted for more than 40%–60% of the increase in wealth. In the UK, more than half of the country's growth in wealth (58%) over the period was attributable to improvements in asset prices. On the contrary, asset prices were reduced over the period in Germany so savings accounted for all the rise in in national wealth—while capital gains actually moderated this rise.[6]

Our new extended series confirm these general findings. In particular, following the 2008 financial crisis, we observe very different patterns of asset price adjustments. For example, housing prices fell substantially in the United States and Spain (more on this below), and much more moderately in the UK and France. The general conclusion, however, is that the decline in asset prices observed in some countries in recent years is relatively small as compared to the long-run rise in relative asset prices observed since 1970.

What explains these important long-run capital gains in most countries identified in the data? To some extent, the capital gains made in the housing and stock markets since the 1970s–1980s can be understood as the outcome of a long-run asset price recovery. Asset prices fell substantially during the 1910–1950 period mainly due to low savings rates and negative valuation effects (including losses on foreign portfolios) and have been rising regularly ever since 1950. There might, however, have been some overshooting in the recovery process, particularly in housing prices. This could be explained by the kind of home portfolio bias described above.

Germany was the one interesting exception to the general pattern of positive capital gains. Given the country's relatively large saving flows, one would expect to observe a higher national wealth-income ratio than the 430% recorded in 2015. According to estimates that include research and development expenditure in saving flows, "missing wealth" in Germany is of the order of 50%–100% of national income, suggesting that German statisticians may have either overestimated saving and investment flows, or underestimated the current stock of private wealth, or both. However, another possibility is that Germany had not experienced a long-run asset price recovery of the same magnitude as other countries because of the importance the German legal system places on the rights to control private assets by stakeholders other than private property owners. Rent controls, for example, may have prevented the market value of real estate from increasing as much as in other countries. Similarly, voting rights granted to employee representatives on corporate boards may reduce the market value of corporations. Germans may also not have the same preferences for expensive capital goods, especially housing, than the British, French, and Italians, perhaps the result of historical and cultural reasons that mean they favor living in a more polycentric country rather than one with a large centralized capital city.

Lastly, it is worth noting that when an average of wealth accumulation is computed for European countries as whole, capital gains and losses become less important as a factor in understanding gains in wealth-income ratios.[7] Europe overall experienced lower residual capital gains than in France, Italy, and the UK due to the impact of Germany. Had regional balance sheets for the United States been available, it is possible that decomposing wealth accumulations would reveal that regional asset price variations within the United States would not be too different from those found in Europe. Therefore, it is possible that substantial relative asset price movements can become permanent within relatively small national or regional economic units, but these effects tend to correct themselves at a larger scale.[8]

The rise in housing wealth largely drove domestic capital accumulation

The accumulation of housing wealth has played a large role in the total accumulation of domestic capital, but with significant variations between countries. In France, Italy, and the UK, the rise in domestic capital-national income ratios is almost entirely due to the rise of housing (**Table 3.2.1**). In Japan, housing represents less than half of the total rise of domestic capital—and an even smaller proportion of the total rise of national wealth, given the large accumulation of net foreign assets.

In most countries, other domestic capital goods have also contributed to the rise of national wealth, in particular because their market value has tended to increase. In particular, we can look at Tobin's Q ratios—a definition of the gap between the market and the book value of corporations.[9] These were much below 1 in the 1970s, meaning that the market value of wealth assets (that is, their price on the stock market) was considerably below their book value (that is, the value of assets based on the company's balance sheet account; their assets minus liabilities) and were closer to 1 (and at times above 1) in the 1990s–2000s. But there are again interesting cross-country variations. Tobin's Q was very low in Germany, remaining well below 1 (and typically around 0.5), contrary to values in the UK and the United States. One interpretation is the "stakeholder effect" described briefly above. Shareholders of German companies do not have full control of company assets—they share their voting rights with workers' representatives and sometimes regional governments—which might push a company's stock market value below its book value.[10] However, another possibility is that some of the variations in Tobin's Q reflect data limitations. Quite puzzlingly, indeed, in most countries Tobin's Q appears to be structurally below 1, although intangible capital is imperfectly accounted for, which in principle should push values above 1. Part of the explanation may be that the book value of corporations tend to be overestimated in national accounts.

External wealth has played an important role in the general evolution of wealth-income ratios

The above analysis of how wealth has been accumulated in rich countries does not differentiate whether wealth was accumulated domestically or abroad. National wealth can be viewed as the sum of domestic wealth and net foreign wealth—that is, foreign assets (assets owned by domestic residents in other countries) minus its gross foreign liabilities (domestic assets owned by residents from other countries). Reviewing the data on national and net foreign wealth for the 1970–2016 period indicates that net foreign wealth—whether positive or negative—has been a relatively small part of national wealth in rich countries throughout the 1970–2016 period (see **Figure 3.2.1**).

Despite net foreign assets representing a relatively small fraction of national wealth, external wealth has played an important role in the general evolution of wealth-income ratios. First, Japan and Germany accumulated sizable positive net foreign positions in the 1990s and 2000s, as these export-orientated economies generated large trade surpluses, and by 2015, the countries owned the equivalent of about 50% and 70% of national income in net foreign assets, respectively. Although Japan's and Germany's net foreign positions are still substantially smaller than the positions reached by France and the UK

Table 3.2.1

Domestic capital accumulation in rich countries, 1970–2015: Housing vs. other domestic capital

	1970 domestic capital / national income ratio		2015 domestic capital / national income ratio		1970–2015 rise in domestic capital / national income ratio	
	incl. Housing	incl. Other domestic capital	incl. Housing	incl. Other domestic capital	incl. Housing	incl. Other domestic capital
US	**357%**		**518%**		**161%**	
	132%	225%	179%	339%	48%	113%
Japan	**378%**		**532%**		**154%**	
	150%	228%	214%	318%	64%	90%
Germany	**326%**		**393%**		**67%**	
	160%	166%	268%	125%	108%	-41%
France	**343%**		**576%**		**233%**	
	122%	221%	412%	164%	290%	-57%
UK	**339%**		**624%**		**376%**	
	99%	240%	334%	290%	290%	50%
Italy	**238%**		**612%**		**374%**	
	108%	130%	439%	173%	331%	43%
Canada	**304%**		**520%**		**237%**	
	126%	178%	302%	218%	190%	47%
Australia	**429%**		**715%**		**286%**	
	184%	245%	410%	305%	227%	59%

Source: Piketty & Zucman (2014) and Estevez-Bauluz (2017). See wir2018.wid.world for data series and notes.

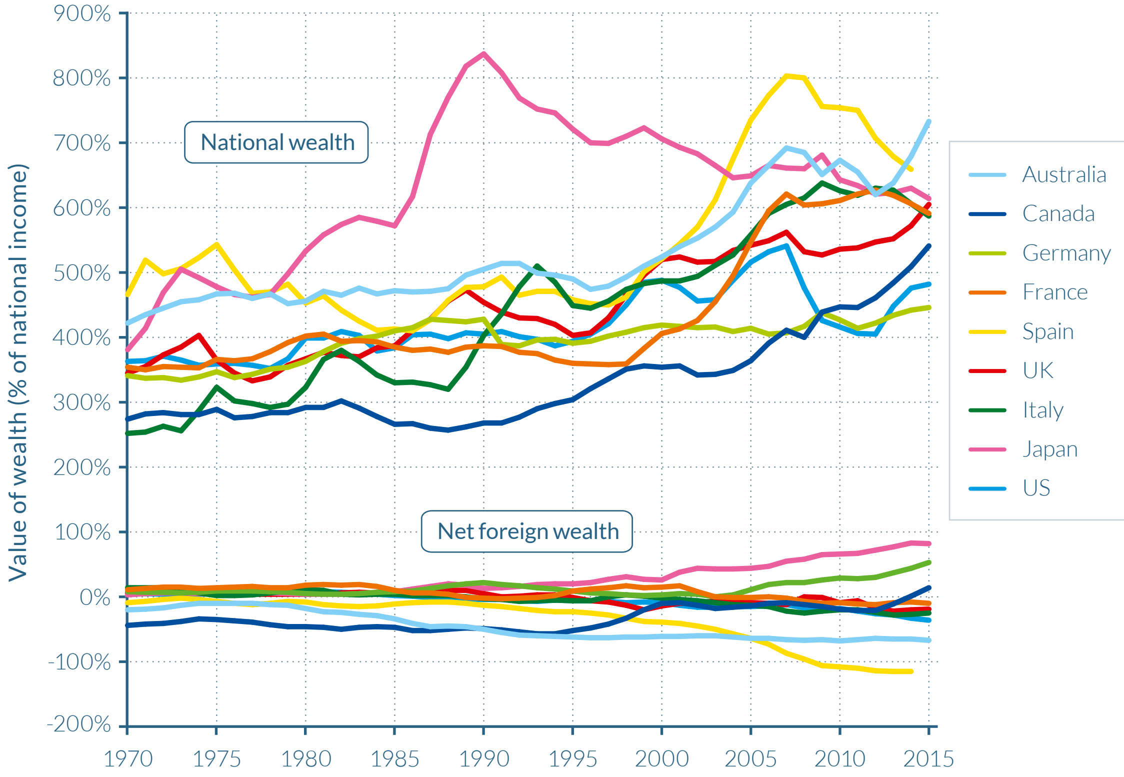
In 2015, the value of domestic capital in Italy was 612% of net national income, i.e. it was worth 6.1 years of national income. Domestic capital is the market-value of national wealth minus net foreign assets.

before the First World War, they have nonetheless grown to be substantial. As a result, the rise in net foreign assets represents more than a quarter of the total rise of the national wealth-national income ratios in the two countries. By contrast, most of the other rich nations exhibit net foreign positions which are negative—typically between -10% and -30% of national income—and which have generally declined over the period. One caveat to these official net foreign asset positions is that they do not include the sizable assets held by a number of developed country residents in tax havens. In all likelihood, including these assets would turn the rich world's total net foreign asset position from negative to positive, and this improvement would probably be particularly large for Continental Europe where 15% of the region's GDP is estimated to be held in offshore tax havens.[11] Chapter 3.4 and chapter 4.5 also provide estimations of offshore wealth in Russia and Spain, respectively.

Second, there has been a huge rise in the total amount of foreign assets owned by

Figure 3.2.1

Net national and net foreign wealth in rich countries, 1970–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net national wealth in France was 591% of net national income (i.e. it was worth 5.9 years of national income), while the value of net foreign wealth was -10% of net national income. Net national wealth is equal to net private wealth plus net public wealth. Net foreign wealth is equal to all foreign assets held by national citizens minus all national assets held by foreign citizens.

countries since the 1970s, such that a significant share of each rich country's domestic capital is now owned by other countries. The rise in cross-border positions is significant everywhere, being spectacularly large in Europe, and a bit less so in the larger economies of Japan and the United States. One implication is that capital gains and losses on foreign portfolios can be large and volatile over time and across countries, and indeed foreign portfolios have generated large capital gains in the United States (but also in Australia and the UK) and significant capital losses in some other countries (Japan, Germany, France). Strikingly, in Germany, virtually all capital losses at the national level can be attributed to foreign assets. In the United States, net capital gains on cross-border portfolios represent one-third of total capital gains at the national level, and the equivalent of the total rise in the US national wealth-national income ratio since 1970.

Returning to the gilded age?

It is almost impossible to properly understand the rise of wealth-income ratios in developed countries in recent decades without putting the recent period into a longer historical perspective. As outlined above, a significant part of the rise of wealth-income ratio since 1970 is due to capital gains: about 40% on average, with large differences between countries. But the key question is: Were these capital gains due to a structural, long-run rise in the relative price of assets (caused, for example, by uneven technical progress), or was this a recovery effect that could have compensated for capital losses observed during earlier parts of the twentieth century?

Analyzing the evolution of wealth-income ratios over a further one hundred years reveals that capital gains experienced since 1970 were due to recovery effects. Because of historical data limitations, this long-term analysis is restricted to four countries—namely, France, Germany, the UK, and the United States. However, these countries indicate two clear patterns. For the three European countries, similar U-shaped patterns are evident, such that today's private wealth-national income ratios appear to be returning to the high values observed over the period 1870–1910, which were as high as 600%–700%.

In addition, European public wealth-national income ratios have followed an inverted U-curve over the past century. However, the magnitude of the pattern of public wealth accumulation is very limited compared to the U-shaped evolution of private wealth, meaning that European national wealth-income ratios are strongly U-shaped, too (see **Figure 3.2.2**). It can also be observed that at around the start of the twentieth century, European countries held a very large positive net foreign asset position, averaging around 100% of national income. Interestingly, the net foreign position of Europe has again turned (slightly) positive in 2000–2010, when the national wealth-income ratio again exceeded that of the United States.

Starting from this set of descriptive facts, and using the best historical estimates of saving and growth rates, it is also possible to estimate the relative contribution of savings and capital gains since 1870. This exercise shows that total accumulation of national wealth over this 140-year-long period appears to be well accounted for by saving flows. But in order to fully reconcile differences in private wealth-income ratios, small residual capital gains are required for France, the UK, and the United States, and a small residual capital loss for Germany. In all cases, however, saving flows account for the bulk of wealth accumulation: capital gains seem to wash out in the long run.

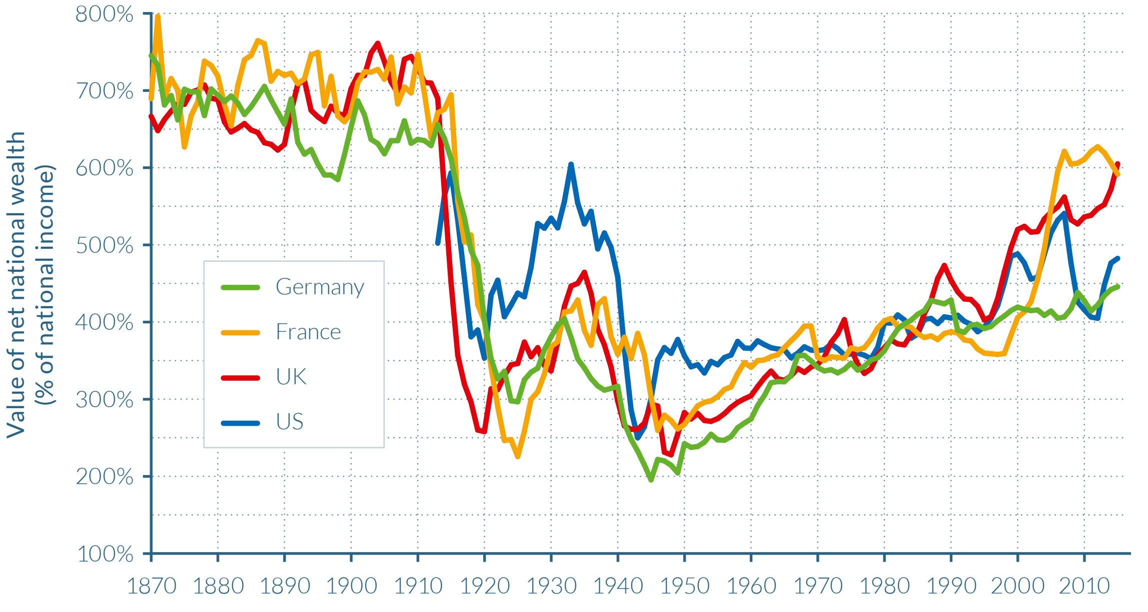
Dividing the analysis by sub-periods, it becomes clear that in every European country a strong U-shaped relative capital price effect was experienced. In the UK, for example, negative rates of real capital losses near -2% per year were experienced between 1910 and 1950, followed by real gains of approximately +1% per year between 1950 and 1980 and around 2.5% between 1980 and 2010.[12] France also exhibits similar patterns, and collectively the data for these two countries seem to illustrate a slight overshooting in the recovery process so that the total relative asset price effect over the 1910–2010 period appears to be somewhat positive. In Germany, by contrast, the recovery seems like it is yet to emerge, as the total relative asset price effect averaged close to -1% between 1910 and 2010.

This sub-period analysis allows for the huge decline in wealth-income ratios that occurred in Europe between 1910 and 1950 to be decomposed.[13] In the UK, war destructions played a negligible role, accounting for an estimated 4% of the total decline in the wealth-income ratio. Instead, low national savings during this period accounted for 46% of the fall in the wealth-income ratio and negative valuation effects (including losses on foreign portfolios) for the remaining 50%. These negative valuation effects were in part due to the numerous anti-capital policies were then put into place after the First World War—before which, capital markets largely ran unfettered. These policies were gradually lifted from the 1980s on, contributing to an asset price recovery.

In France and Germany, cumulated physical war destructions account for about one-quarter of the fall in wealth-income ratios. Low national saving and real capital losses each explain about half of the remaining three-quarters. Interestingly, the private

Figure 3.2.2

Long-run trends in the national wealth of rich countries, 1870–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 1870, the value of net national wealth in Germany was 745% of net national income, i.e. it was worth 7.5 years of national income. Net national wealth is equal to net private wealth plus net public wealth.

wealth-national income ratio declined less in the UK than in France and Germany between 1910 and 1950, but the reverse holds for the national wealth-income ratio, due to the large quantity of public debt held by the UK around 1950. The US case is again fairly different from that of Europe, however, as the fall in the country's wealth-income ratio during the 1910–1950 period was more modest, and so was the recovery since 1950. Regarding capital gains, every sub-period in the United States shows small but positive relative price effects. The capital gain effect grew larger in the recent decades and largely derived from United States' growing foreign portfolio, as it seems too large to be accounted for by under-estimated saving and investment flows.

These results show that over a few years and even a few decades, valuation effects and war destructions are of paramount importance in determining wealth-to-income ratios. But in the main rich economies, today's wealth levels are reasonably well explained by saving and income growth rates across the period since 1870.

These findings have a number of implications for the future and for policy making. First, the low wealth-income ratios of the mid-twentieth century were due to very special circumstances. The world wars and anti-capital policies destroyed a large fraction of the world capital stock and reduced the market value of private wealth, which is unlikely to happen again with free markets. By contrast, the determinants of the wealth-income ratio—saving and growth rates—will in all likelihood matter a great deal in the foreseeable future. As long as countries keep saving sizable amounts (due to a mixture of bequest, life-cycle, and precautionary reasons), countries with low growth rates are bound to have high wealth-income ratios. For the time being, this effect is stronger in Europe and Japan, but to the extent that growth will ultimately slow everywhere, wealth-income ratios may well ultimately rise across the whole world.

The return of high wealth-income ratios is certainly not bad in itself, but it raises new issues about capital taxation and regulation. Because wealth is always very concentrated (due in particular to the cumulative and multiplicative processes governing wealth inequality dynamics—see Part IV for more detail on this), high wealth-income ratios imply that the inequality of wealth, and potentially the inequality of inherited wealth, is likely to play a bigger role for the overall structure of inequality in the twenty-first century than it did in the postwar period. This evolution might reinforce the need for progressive capital and inheritance taxation.[14] If international tax competition prevents this policy change from happening, one cannot exclude the development of a new wave of anti-globalization and anti-capital policies.

Furthermore, because saving and growth rates are largely determined by different forces, wealth-income ratios can vary a great deal between countries. This fact has important implications for financial regulation. With perfect capital markets, large variations in wealth-income ratios potentially imply large net foreign asset positions, which can create political tensions between countries. With imperfect capital markets and home portfolios bias, structurally high wealth-income ratios can contribute to domestic asset price bubbles such as those seen in Japan and Spain. Housing and financial bubbles are potentially more devastating when the total stock of wealth amounts to six to eight years of national income rather than only two to three years. The fact that the Japanese and Spanish bubbles are easily identifiable in the dataset also suggests that monitoring wealth-income ratios may help designing appropriate financial and monetary policy. In Japan and Spain, most observers had noticed that asset price indexes were rising fast, but in the absence of well-defined reference points, it is always difficult for policy makers to determine when such evolutions have gone too far and whether they should act. Wealth-income ratios and wealth accumulation decompositions can provide useful, if imperfect, reference points here.

3.3

COMPARING THE EXPERIENCES OF FORMER COMMUNIST STATES

Information in this chapter is based on two sources. The first is "From Soviets to Oligarchs: Inequality and Property in Russia 1905–2016," by Filip Novokmet, Thomas Piketty, and Gabriel Zucman, 2017. WID.world Working Paper Series (No. 2017/9). The second is "Capital Accumulation, Private Property and Rising Inequality in China, 1978–2015," by Thomas Piketty, Li Yang, and Gabriel Zucman, 2017. WID.world Working Paper Series (No. 2017/6).

- The evolution of public and private wealth in China and Russia since their transitions away from communism can be viewed as extreme cases of the general rise of private wealth relative to national income in rich countries since the 1970s–1980s.
- Their experiences are largely explained by institutional differences, particularly their respective privatization strategies for public assets. Privatization occurred at a much faster rate, in a more chaotic manner and at a larger extent in Russia than in China due to its "shock therapy" liberalization policies and voucher privatization schemes for state owned enterprises.
- Despite being at roughly equal levels in 1980, private wealth reached approximately 500% of national income in China by 2015—roughly equal to levels seen in the US and just below those of France and the UK (550–600%), while this figure was notably smaller for Russia, on the order of 350–400%.
- Public wealth remained at around 200–250% in China between 1980 and 2015, but decreased tremendously from 300% to less than 100% in Russia, again reflecting differences in the countries' privatization strategies.
- Differences in savings and investment incentives saw a significant proportion of Russian wealth leave the country to be held in offshore assets, while the overwhelming majority of Chinese wealth stayed within the country's boundaries to be invested in domestic assets.

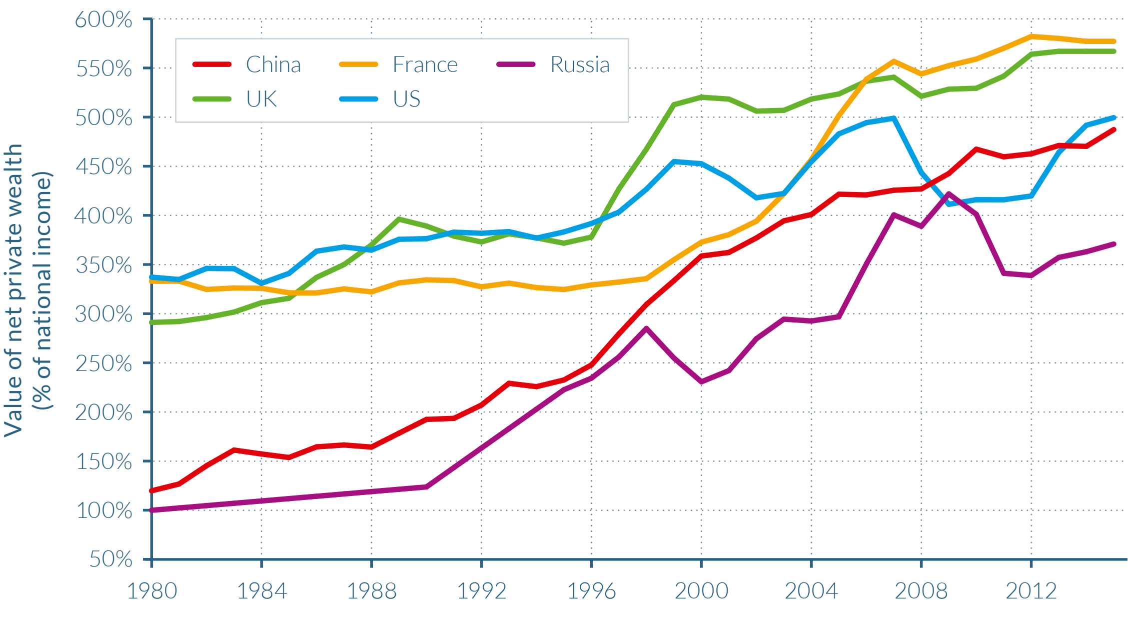
Privatization strategies were key in determining wealth accumulation differences between China and Russia

The transition away from communism in both China and Russia had profound effects on aggregate wealth in both countries. However, there were also considerable differences between the two countries, which are first evident in the evolution of their respective private wealth–national income ratios. As examined in detail in chapter 3.2, the general rise of private wealth relative to national income in rich countries since the 1970s–1980s can be attributed to a combination of factors including the combination of growth slowdowns and relatively high saving rates and general rises in asset prices. The case of Russia together with that of China and other ex-communist countries can be viewed as an extreme case of this general evolution, but the liberalization and public asset privatization strategies chosen by the two countries also had crucial impacts on the development of these countries' wealth to national income ratios.

In Russia as in China, private wealth was very limited back in 1980, at slightly more than 100% of national income in both countries. But by 2015, private wealth reached approximately 500% of national income in China, roughly equal to levels seen in the US, and rapidly approaching the levels observed in countries such as France and the UK (550–600%). Private wealth in Russia has also increased enormously relative to national income, but the ratio was comparatively only of the order of 350–400% in 2015—that is, at a markedly lower level than in China and in Western countries as illustrated by **Figure 3.3.1**. This gap would have been larger if estimates of offshore wealth were not included in Russia's private wealth (more to come on this in chapter 3.5). This is an important source of wealth to include in estimates for Russia as it represents approx-

Figure 3.3.1

Net private wealth to net national income ratios in China, Russia and rich countries, 1980–2015: The rise of private wealth



Source: Novokmet, Piketty & Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of private wealth in the US was 500% of national income, i.e. it was worth 5 years of national income. Net private wealth is equal to net private assets minus net private debt.

imately 70% of national income, while the global average offshore wealth is estimated to be in the region of 10% of national income.[15]

The rise of national wealth in Russia has been almost exclusively driven by increases in private wealth, which have themselves come at the expense of public wealth. National wealth increased only weakly relative to national income during the last quarter of a century, rising from 400% in 1990 to 450% by 2015, with public wealth falling from around 300% of national income to below 90%. In contrast, China's public wealth remained relatively constant from 1978 to 2015, staying above 230% of national income. Given the large rise in private wealth described above, national wealth has thus doubled from around 350% to 700% of national income over the period (see **Figure 3.3.2**). Interestingly, national wealth fell notably following the end of communism in Russia, dropping from around 425% of national income in 1990 to 300% in 2000. This was largely due to the speed at which the so-called shock therapy and voucher privatization strategy was implemented to transfer public wealth to the private sector (particularly that of state-owned enterprises). However, while public wealth-income ratios in China fluctuated during the first decade that followed the "reform and opening up" policies of 1978, they have risen almost constantly since. The speed of privatization of both state-owned enterprises and housing stock was much slower in China than in Russia, allowing for a more gradual and consistent transfer of wealth from the public to the private sector. The larger variations seen in Russian wealth as compared to Chinese wealth that occurred between 1998 and 2002, and between 2006 and 2010, can in large part be explained by the stock market fluctuations experienced in Russia during these periods of time.

Understanding the differences in wealth accumulation between China and Russia

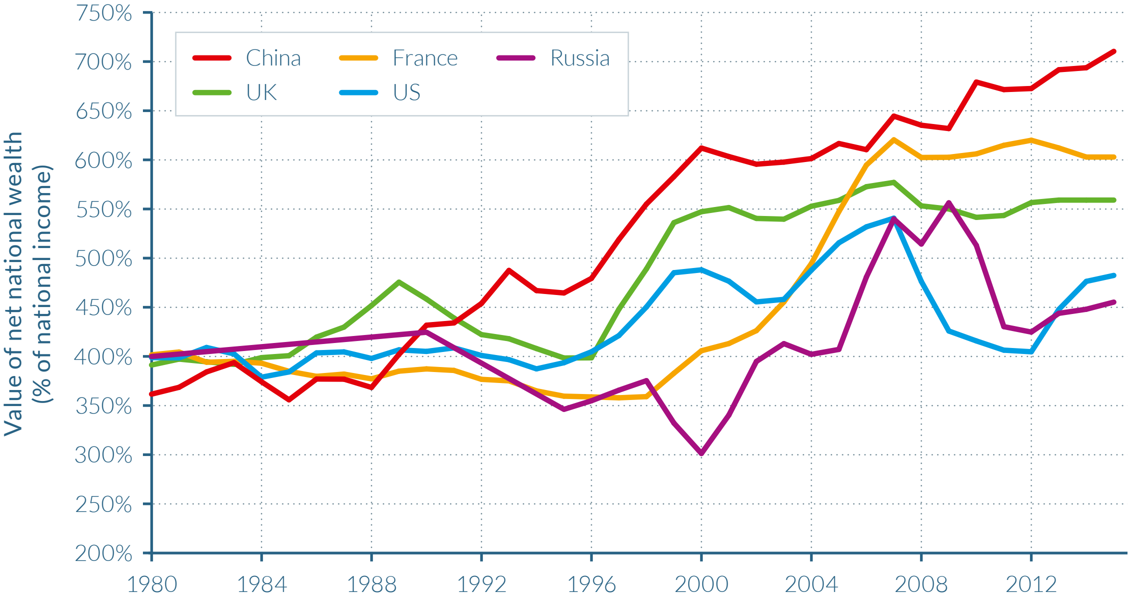
The widely divergent patterns of national wealth accumulation observed in Russia and China can be accounted for by a number of factors. First, saving rates (net of depreciation) have been markedly higher in China, typically as large as 30–35%, as compared to 15–20% at most in Russia. If a country saves more, it is natural that it will accumulate more wealth. Second, these Chinese savings were used for the most part to finance domestic investment and hence domestic capital accumulation in China. In contrast, a very large fraction—typically about half—of Russia's national savings were used to finance foreign investment, via very large trade surpluses and current account surpluses, rather than domestic investment. This is not necessarily disadvantageous in itself, but these large flows of foreign savings resulted in little wealth accumulation as a result of the general mismanagement of the surpluses, including bad portfolio investment, capital flight, and offshore leakages.

Again, the gap between Russia and China would be even larger if offshore wealth were not included in Russian national wealth calculations. Its inclusion is undoubtedly illuminating in helping readers to understand the evolution of wealth trends in Russia, but given that offshore wealth is largely out of the reach of the national government, its presence in Russian wealth calculations could also be argued to overestimate its tangible value for the country. In contrast, if the full value of cumulated trade surpluses in Russia's national wealth were considered in estimations, then Russia's national wealth-income ratio would have been at the same level as China's by 2015, at around 700% of national income. The magnitude of change when including and excluding these factors illustrates the macroeconomic significance of this issue.

Finally, China's national wealth-income ratios are higher than in Russia because relative asset prices have increased more in the former than the latter. In particular, Tobin's Q ratios are much closer to one in China than in Russia.[16] This means that the market value of wealth assets in China (that is, their price on the stock market) is much closer to their book value (that is, the value of assets based on the company's balance sheet account; their assets minus liabilities) than in Russia, where these values were

Figure 3.3.2

Net national wealth to net national income ratios in China, Russia and rich countries, 1980–2015: National wealth accumulation



Source: Novokmet, Piketty & Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of national wealth in China was 710% of national income, i.e. it was worth 7.1 years of national income. Net national wealth is equal to net private wealth plus net public wealth.

consistently very low. The interpretation of this finding may reflect a number different factors.

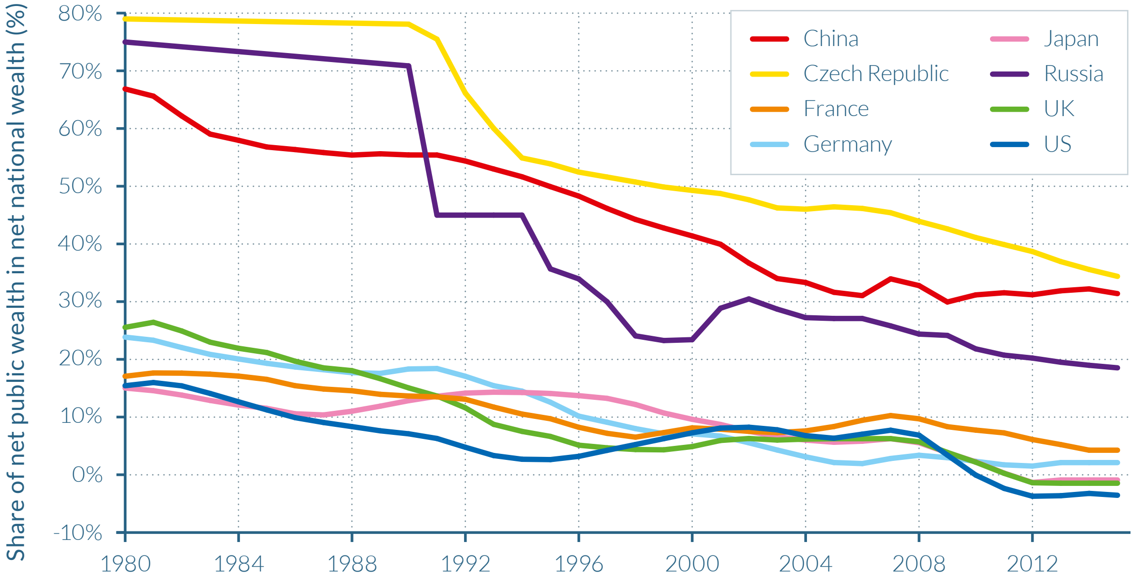
On the Chinese side, the key factor influencing Tobin's Q ratio nearing one is the country's restricted capital markets which limit the number of Chinese companies listed on the stock exchange.[17] On the Russian side, there are a larger number of factors. One interpretation is that company stakeholder models have various actors other than shareholders—including worker representatives and sometimes regional government, share corporate decision-making power— which may reduce the market value of equity shares, but not necessarily the social value of companies. A less optimistic interpretation of low Q ratios, which may better fit the Russian case, is that there were ill-defined property rights and low protection of shareholder stakes in companies, not because of the benefit of other well-defined and potentially efficiency-enhancing stakeholders, but simply because the legal system is not working well. In addition, it could also be that this low market valuation reflects the importance of offshore assets and legal outsourcing in the management and control of Russian corporations. That is, Russian corporations are embedded into a complex nexus of contracts and offshore legal entities, of which the system of official shares ruled by the Russian legal system and traded on Moscow stock market is only the visible part.[18]

Understanding the evolution of public wealth in China and Russia

The ex-communist countries of China and Russia have followed the same general patterns of a declining overall share of public property in total wealth as rich countries in recent years, though starting from a much higher level of public wealth. In the ex-communist countries of China and Russia, the share of net public wealth fell from around 70% in 1980 to 35% and 20%, respectively, in 2015—a veritable turnaround

Figure 3.3.3

The share of public wealth in national wealth in former communist and rich countries, 1980–2015: The decline of public property



Source: Novokmet, Piketty & Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the share of public wealth in national wealth in Russia was 19%. Net public wealth is equal to public assets minus net public debt. Net national wealth is equal to net private wealth plus net public wealth.

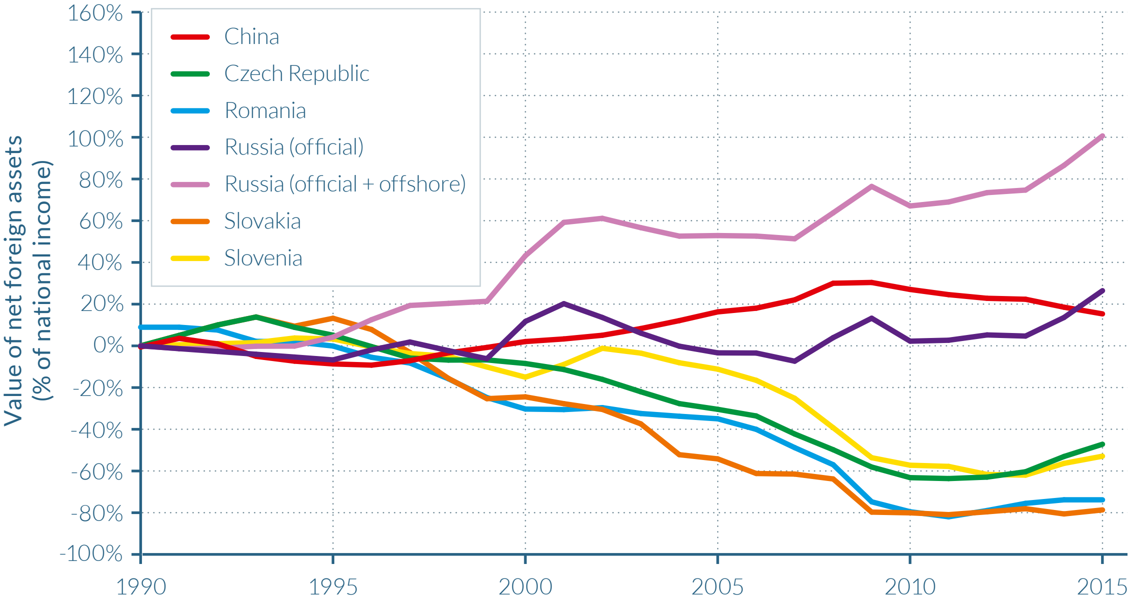
in their public-private wealth ratios. As depicted by **Figure 3.3.2**, the share of net public wealth in net national wealth reversed in both China, from around 70%–30% in 1978 to 30%–70% in 2015, and in Russia, from 70%–30% to 20%–80% between 1990 and 2015. These recent figures for the countries' public-private wealth ratios are not incomparable to those observed in the so-called "capitalist" countries during the mixed-economy period that followed the Second World War (1950–1980). But while these countries have ceased to be communist, in the sense that public ownership has ceased to be the dominant form of property, they still have much more significant public wealth than other capitalist countries. This is due both to low public debt and significant public assets—for instance, Russia's energy sector. (**Figure 3.3.3**)

However, there are also strong differences between China's and Russia's experiences. The larger magnitude of the reversal in public-private wealth ratio in Russia, and its occurrence over a shorter time period, serves to underline the greater speed and depth of privatization in Russia relative to China. Indeed, this process is still continuing in China, and the public-private divide could even be stabilized at the current level if the Chinese authorities choose to do so. In contrast, Russia's "shock therapy" approach to privatization was markedly different from that followed in China and other ex-communist countries. This contrast is evident in the period immediately after Russia's transition toward a market economy commenced, from 1990 to 1995, when the fall in the share of net public wealth in net national wealth in Russia (70% to 35%) was five times larger than that in China (55% to 50%). Its implications for income inequality and wealth inequality are discussed in more detail in Part II and Part IV, respectively.

In contrast, the importance of foreign assets within China and Russia has been fairly similar since their transitions away from communist models, but have occurred for vastly different reasons. As illustrated by **Figure 3.3.4**, both countries have positive net foreign assets,

Figure 3.3.4

Net foreign assets in former communist countries, 1990–2015



Source: Novokmet, Piketty & Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the share of net foreign assets as a fraction of national income in Russia (including offshore assets) was 101%. Net foreign assets are all assets held by national citizens in foreign countries minus all assets held by citizens from foreign countries in the national country.

meaning that the assets they own in the rest of the world are more valuable than those owned by foreigners in China and Russia, respectively. In Russia, this has largely been due to the country's economic and natural endowments, given its large, but not necessarily permanent, natural resources, and has allowed the country to accumulate trade surpluses and foreign reserves for the future, as can also be observed in most oil-rich countries in the Middle East and elsewhere.

The accumulation of net foreign assets in China that are similar in magnitude to those of Russia should be viewed as much more striking, however, and indicate significant differences between the two countries. Chinese net foreign assets were accumulated in the absence of any significant natural resource endowment, and with much smaller trade surpluses of less than 3% of national income on average over the 1990–2015 period. In comparison, Russia's trade surpluses averaged 10% of national income for the same period. This reflects more efficient management of trade surpluses and foreign reserves, which are viewed as critical for China's economic and financial sovereignty by its Communist Party, and also the political choice of limiting foreign investors' rights in China.

Differences in political institutions and ideologies seem to have played an even bigger role than purely economic factors in the evolution of wealth-national income ratios in China and Russia, and the share of the public and private sector within national wealth. As has already been stressed, the speed and depth of Russia's privatization strategy was vastly different from the much slower and more gradual transition plan implemented by China, particularly the fire sale of Russian state-owned enterprises through the country's voucher privatization scheme. Furthermore, differences in savings and investment incentives saw a significant proportion of Russian wealth leave the country to be held in offshore assets, while the overwhelming majority of Chinese wealth stayed within the country's boundaries.

3.4

CAPITAL ACCUMULATION, PRIVATE PROPERTY, AND RISING INEQUALITY IN CHINA

Information in this chapter is based on “Capital Accumulation, Private Property and Rising Inequality in China, 1978–2015,” by Thomas Piketty, Li Yang, and Gabriel Zucman, 2017. WID.world Working Paper Series (No. 2017/6).

- While Chinese national wealth doubled in recent decades, from 350% to 700% of national income, its composition also changed dramatically. The share of agricultural wealth fell from close to half of total capital in the late-1970s to less than a tenth by the mid-2010s. By contrast, the privatization of the housing sector and the liberalization of capital markets saw the shares of housing and domestic capital dominate the make-up of China’s national wealth.
- Perhaps the most spectacular evolution has been in the division of national wealth between public and private wealth. Private wealth rose from around 100% of national income in 1978 to over 450% of national income in 2014, largely due to the privatization of housing stock, reaching a level close to those seen in France, the United States, and the UK.
- The balance of public and private wealth changed from a 70–30 proportional split of public-private assets in 1978 to a 35–65 split by 2015, but public wealth remained important as a share of national income, at around 250%. This level is high when compared to rich countries.
- High Chinese savings rates were an important driver of the rise in wealth accumulation, but according to simulations, they accounted for only 50% to 60% of the rise. The rest can be accounted for by increases in relative asset prices.
- China’s wealth accumulation was primarily driven by domestic capital accumulation. Chinese net foreign position, despite substantial growth since 2000, remains relatively modest compared to Japan or Germany. On the other hand, China remains more suspicious regarding foreign ownership of companies than Europe and North America.

China's transition to a mixed economy led to a surge in national wealth and a radical change in its composition

The Chinese wealth-national income ratio has increased substantially in recent decades. In 1978, national wealth as a percentage of national income was approximately 350%, but by 1993 this figure had reached 500% and grew to over 700% by 2015, as the composition of national wealth changed dramatically. The share of agricultural land used to make up almost half of total capital in 1978, but dropped sharply to less than a tenth of the total in 2015, as illustrated by **Figure 3.4.1**. In contrast, housing and other domestic capital wealth (buildings, equipment, machinery, patents, assets used by corporations, public administrations and households) increased enormously, in volume and in their share of the total: housing wealth increased from around 50% of national income in 1978 to approximately 200% in 2015, while other domestic capital grew to be the largest wealth component, rising from around 100% to over 350% between 1978 and 2015. Net foreign assets have also become a notable addition to China's national wealth since the turn of the twenty-first century, amounting to approximately 25% of national income.

But perhaps the most spectacular evolution since the late 1970s has been the division of national wealth into private and public wealth (see **Figure 3.4.2**). Private wealth was relatively small in 1978, at around 100% of national income, but grew to represent over 450% of national income in 2014, while public wealth remained roughly stable, between 200% and 250% of national income over the period (first increasing slightly until 1993–1994 and then declining back to its initial level). As a result, the balance of public and private wealth in national wealth has altered enormously, with the 70–30 proportional split of public-private assets in 1978 reversed to a 35–65 split by 2015, as the country transitioned away from a communism-based economic model towards a mixed-form economy.

The extent of national wealth privatization in the Chinese economy differed, however, depending on the type of wealth asset, as can be seen in **Figure 3.4.3**. In the housing sector privatization was particularly comprehensive, with the private housing stock rising from roughly 50% to over 95% between 1978 and 2015, while for other forms of domestic capital the public share has declined but is still around 50%. Domestic equities (traded and non-traded), for example, were almost entirely owned by the state (95%) in 1978, but private ownership rose to around 30% by 2015, such that the government continues to own around a 60% share and foreign ownership accounts for the remaining 10%. Interestingly, the fraction of Chinese equities that are publicly owned dropped substantially until 2006, but seems to have stabilized—or even increased somewhat—since 2007.

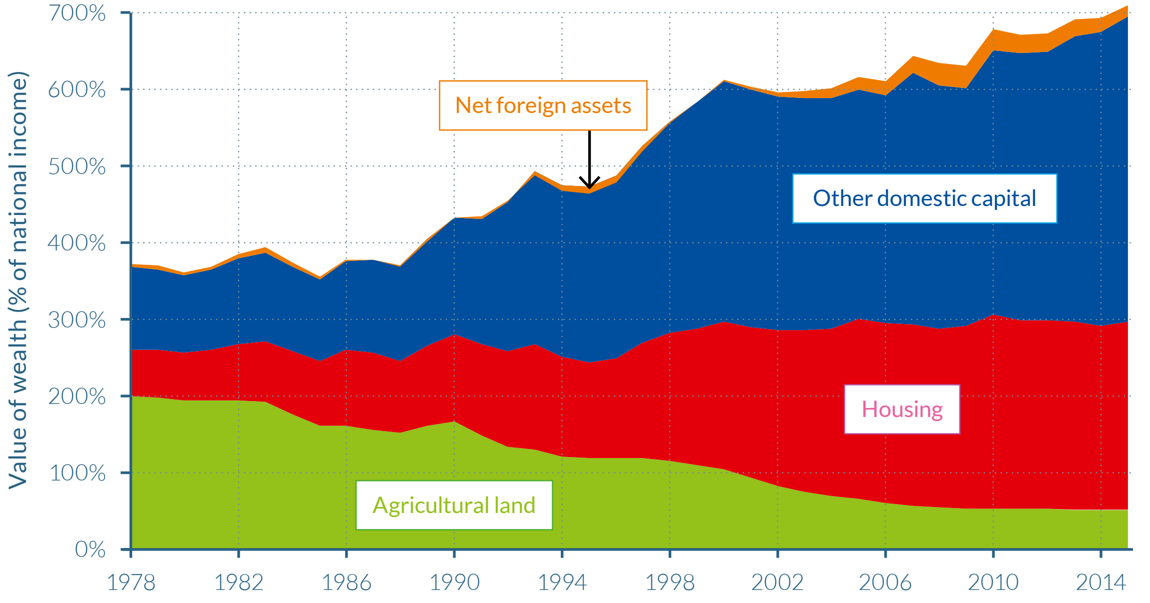
Public assets remain substantial in China, unlike in most Western countries

The private wealth-national income ratio in China is now in the range of 450–500%, much closer to levels seen in most OECD countries. In the United States and the UK, the ratio is closer to 500% and 550–600%, respectively, but in China, public assets remain substantial unlike in these western countries where public wealth has become very small, or even negative, with public debt exceeding public assets. Indeed, the share of public property in China today is somewhat larger than, but by no means incomparable to, what it was in the West from the 1950s to the 1980s, and has recently appeared to have strengthened further: since the 2008 financial and economic crisis the public share in China's mixed economy has seemingly increased and thus domestic capital accumulation has been one of the primary drivers of wealth growth in China.

The size and structure of China's publicly-held wealth assets has large implications for economic development. The size of public property has important consequences for the state's ability to conduct industrial and

Figure 3.4.1

The asset composition of national wealth in China, 1978–2015

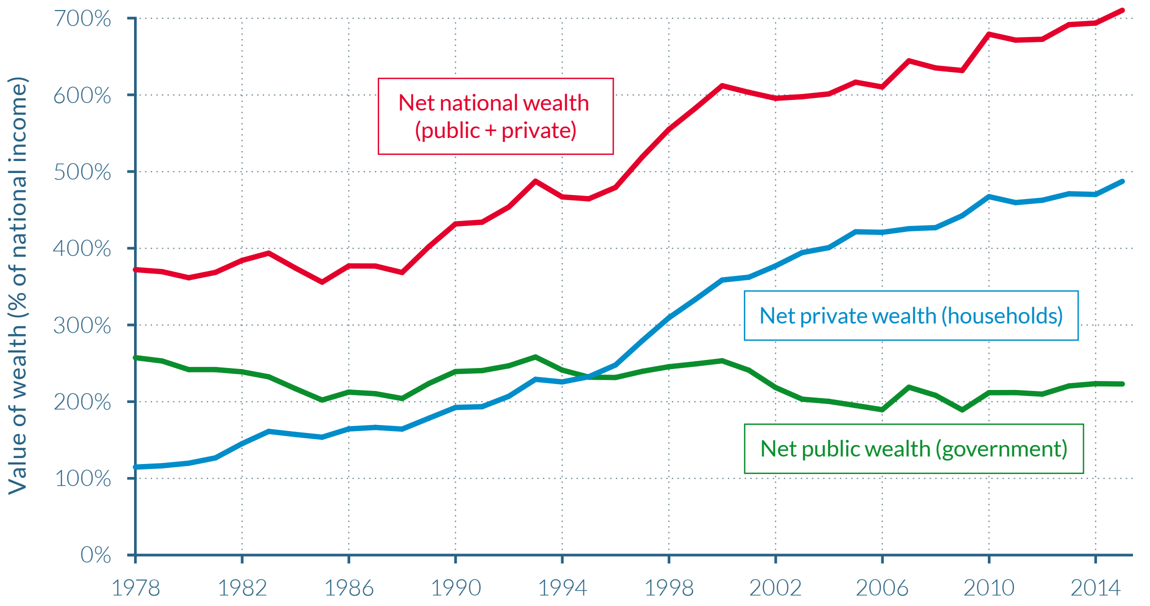


Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of national wealth was equivalent to 710% of national income, i.e. it was worth 7.1 years of national income. The value of total housing wealth was 246% of national income.

Figure 3.4.2

The structure of national wealth in China, 1978–2015

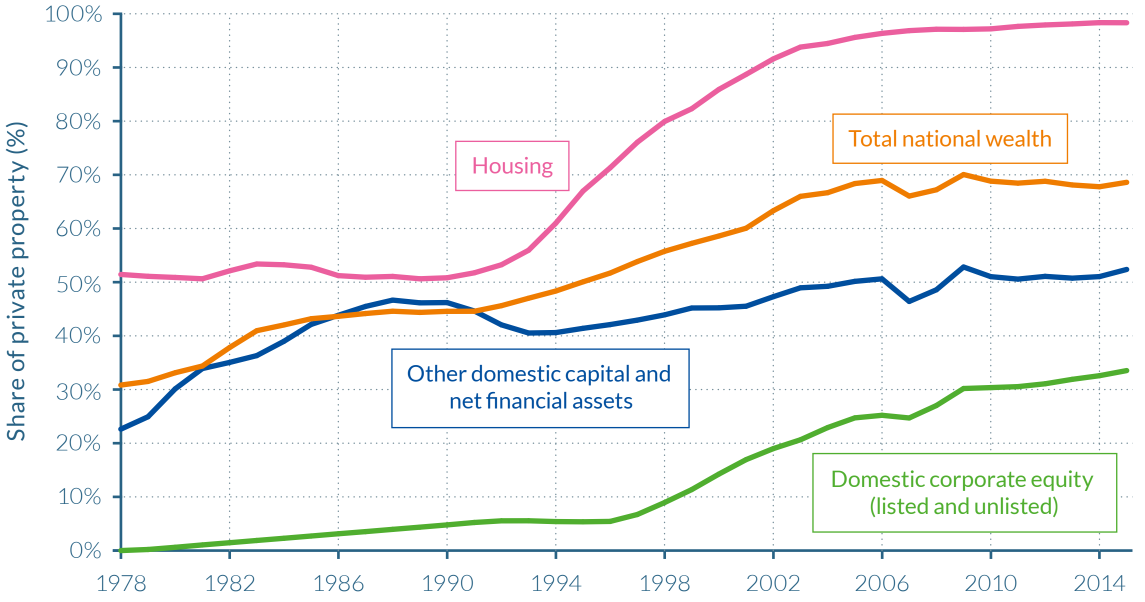


Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net private wealth was equivalent to 487% of net national income, i.e. it was worth 4.5 years of national income. Chinese public wealth was equal to 223% of national income. Net national wealth is equal to net private wealth plus net public wealth. Net private wealth is equal to private assets minus private debts. Net public wealth is equal to public assets minus public debts.

Figure 3.4.3

The share of private property by type of asset in China, 1978–2015: The rise of private property



Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the share of private property in total national wealth was 69%. The share of private property in housing was 98%.

regional development policies; sometimes more efficiently and sometimes less so. It also has potentially considerable fiscal consequences, as governments with negative net public wealth typically have to pay large interest payments before they can finance public spending and welfare transfers, while those with large positive net public wealth can benefit from substantial capital incomes, enabling them to finance more public spending than would be possible through tax collection.

It is interesting to compare the evolution of the public share in national wealth in China and a resource-rich country with a large sovereign wealth fund such as Norway. These two countries have essentially switched positions: the public share in Chinese national declined from 70% to 30% between 1978 and 2015, while it rose from 30% to 60% in Norway over the same period (see **Figure 3.4.4**). A key difference between public wealth in Norway and China is that most of Norway's public wealth is invested abroad. Norway's large positive net public wealth generates capital income that is mostly used to finance further foreign capital accumulation, which in the long-run can be used to reduce taxes and to finance more public spending. In that sense, it is a very different form of public property than in China. Norwegian public property has therefore largely been accumulated for fiscal and financial purposes, rather than for industrial development and retaining a measure of control over the economy as seen in China. Norway's sovereign fund has, however, also been used at times to promote certain policies, for example, regarding social and environmental objectives.

High savings rates and increases in relative asset prices drove wealth accumulation

High savings and investment rates over the period have been important drivers of Chinese wealth accumulation, but they are insufficient to account for the total increase in the country's wealth—as it has also been the case for several rich countries. The other important element in understanding Chinese wealth accumulation is the rise of relative asset prices, in particular housing and equity prices that grew considerably more than the rise in consumer prices. As per the estimates of Thomas Piketty, Li Yang and Gabriel Zucman, savings explain 50% to 60% of the rise in the wealth-income ratio since 1978, while the increase in relative asset prices accounts for the remaining 40% to 50%.

Just as in rich countries, the rise in relative asset prices has been the result of a series of factors. First in this series of factors is the high taste preferences and demand for housing assets by Chinese households, which itself may be partly due to limited access to alternative savings and investment vehicles—Chinese citizens could not invest overseas, for example, and capital markets took time to develop—and also to insufficient awareness of expansions in the public pension system. A second important explanation involves changes in the legal system that reinforced private property rights including the lifting of rent controls, increases in the relative power of landlords over tenants and changes in the relative power of shareholder and workers within enterprises.

Decomposing wealth accumulation by sectors (private and public) and assets (financial and nonfinancial) in China over the period 1996–2015 provides interesting insights. When analyzing private wealth, there are clear differences between the returns on assets: strong, positive capital gains have been made by nonfinancial assets (231%), which centered around residential housing assets (163%), while there were only negligible capital gains for net financial wealth (1%). Conversely, there were strong capital gains for public financial assets (68%) and smaller gains for public nonfinancial wealth (19%). The majority of these large capital gains on public financial assets came from government-owned equities, and can be linked to the reform of state-owned enterprises that began in 2003 and the unprecedented wave of initial public offerings of state-owned enterprises that started in 2006. China also made notable capital losses on its net foreign assets, in part due to the appreciation of the yuan after 2004, explaining why despite its large current account surpluses, its net foreign asset position has increased only moderately (from -9% of national income in 2000 to 15% in 2015).

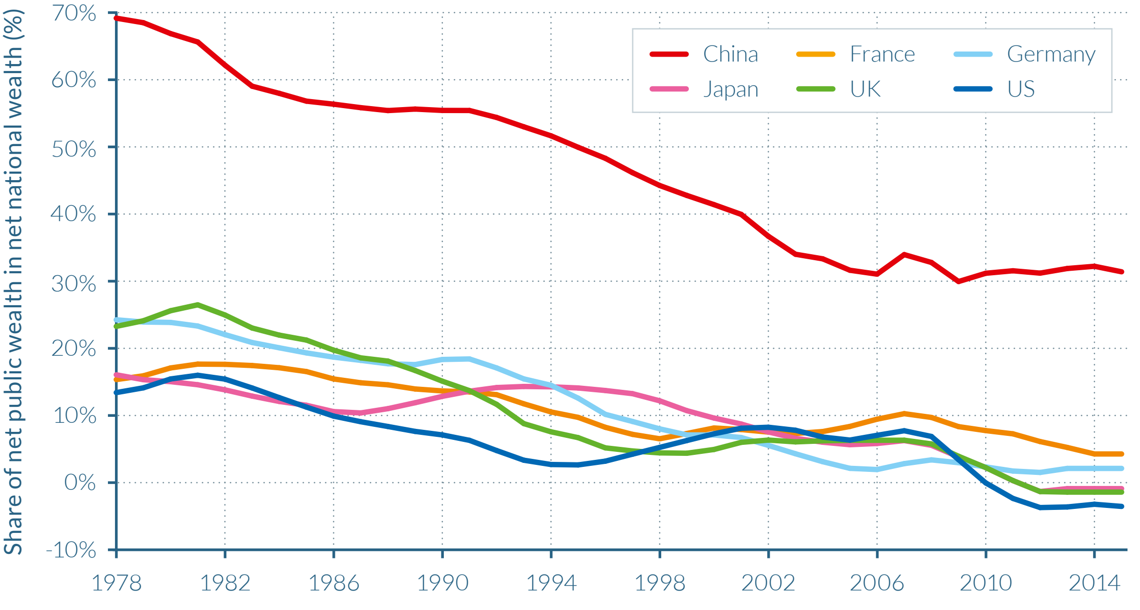
China, like Japan, seems more suspicious vis à vis foreign ownership than Europe or North America

Domestic financial intermediation has also played a key role in the development of wealth in China over the last four decades. The ratio between total domestic financial liabilities—that is, total debt and equity issued by households, the government, and the corporate sector combined—and total domestic capital has risen from 60% in 1978 to 140% in 2015. This is a substantial rise given the limited financial development seen in China in the late 1970s. However, despite this financial development, the level of financial intermediation remains much lower in China than in many Western countries, where financial intermediation ratio roses from between 100–140% in 1978 to 200–300% in 2015, as depicted by **Figure 3.4.5**.

Foreign ownership of Chinese companies has not played a strong role in the rise of wealth, however. The fraction of domestic financial liabilities owned by the rest of the world reached only 5% in China in 2015, and has not past 7% across the whole observed period, as seen in **Figure 3.4.6**. Japan has the next smallest percentage of foreign ownership at 10% of domestic financial liabilities, followed by 15% in the United States and 25–30% in Germany and France. These differences partly reflect size effects: European countries are smaller, and if ownership were to be consolidated at the European level, the rest of the world would own only about 15% of European wealth (as in the United States). Even so, there does appear to be a tendency that some Asian countries—Japan and even more so China—are less open to foreign ownership than European and North American countries.

Figure 3.4.4

The changing shares of public property in China and rich countries, 1978–2015

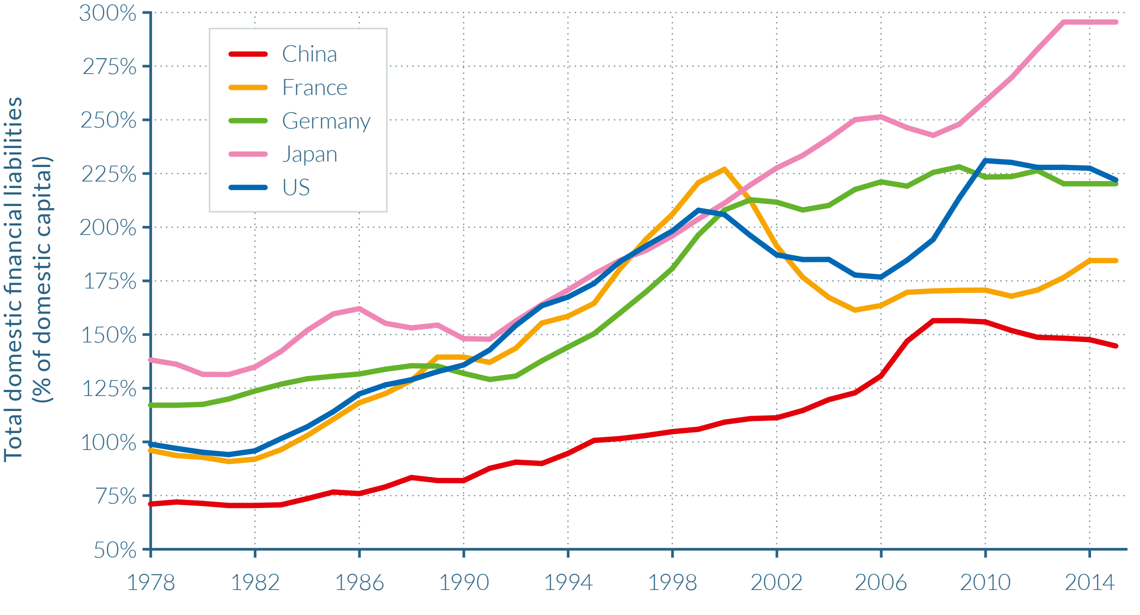


Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the share of public property within total national wealth in China was 31%, while in the US it was -4%. Net national wealth is equal to net private wealth plus net public wealth. Net public wealth is equal to public assets minus public debts.

Figure 3.4.5

Domestic financial liabilities in China and rich countries, 1978–2015: The rise of financial intermediation

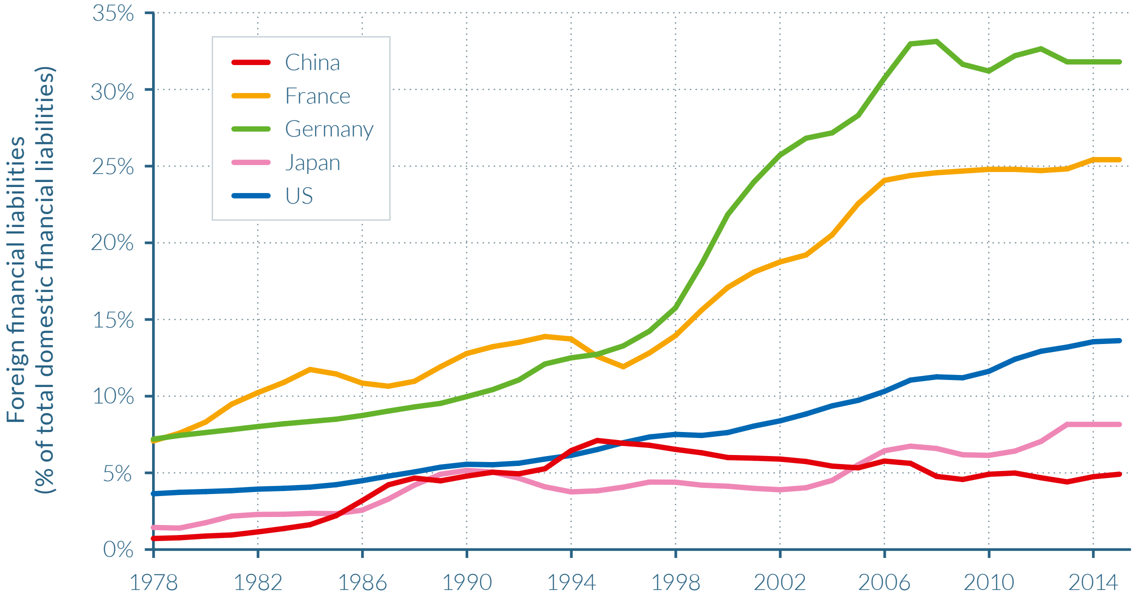


Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of domestic financial liabilities in China was equal to 145% of domestic capital, while in Germany it was 220%.

Figure 3.4.6

Foreign financial liabilities in China and rich countries, 1978–2015: The rise of foreign ownership



Source: Piketty, Yang and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of foreign financial liabilities in China equated to 5% of total domestic financial liabilities, while in France it was 25%. Foreign financial liabilities are comprised of portfolio equity held by foreigners, foreign direct investment, foreign debt and financial derivatives.

3.5

THE RISE OF PRIVATE PROPERTY IN RUSSIA

Information in this chapter is based on "From Soviets to Oligarchs: Inequality and Property in Russia 1905–2016," by Filip Novokmet, Thomas Piketty, and Gabriel Zucman, 2017. WID.world Working Paper Series (No. 2017/10).

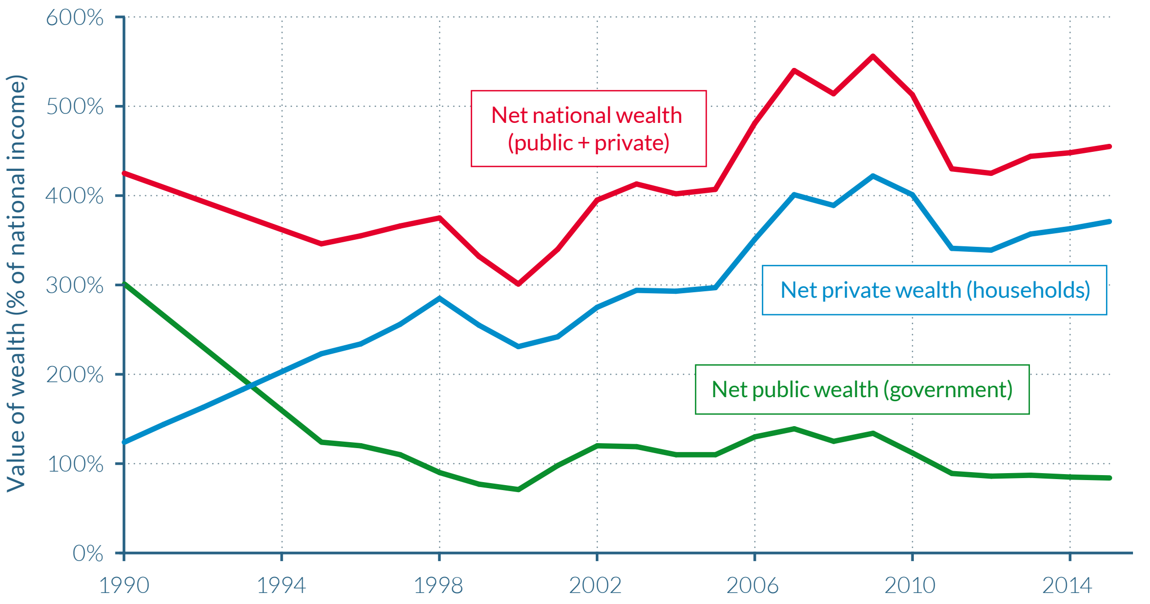
- ▷ Russia's net national wealth-income rose moderately since the country's transition from a communist to a capitalist economic model, increasing from around 400% in 1990 to 450% in 2015. At the same time, there have been significant fluctuations in the country's wealth breakdown, as the shock therapy and voucher privatization strategy transferred enormous wealth at a very fast rate from the public to the private sector. Public wealth amounted to 300% of national income in 1990, but was just 100% in 2015.
- ▷ Private housing wealth represented by far the largest component of Russian private wealth in 2015. The gradual rise of housing can be accounted for by real-estate price movements and a privatization of the housing sector that was more gradual than the voucher privatization method used for companies.
- ▷ The very low level of official financial assets owned by Russian households—around 70–80% of national income throughout the 1990–2015 period—is particularly striking. This suggests that the privatization of Russian companies did not lead to any significant long-run rise in the value of household financial assets.
- ▷ However, discrepancies in Russia's balance of payments allow researchers to estimate that a small number of Russian citizens had offshore wealth assets that amounted to 70% of national income in 2015, doubling the official value of financial assets. This is suspected to be the result of capital flight, made possible through weaknesses in Russia's legal and statistical system.

Russia's transition from public to private property

The evolution of aggregate private and public wealth in Russia has changed dramatically since the fall of the Soviet Union. As the country transitioned from a communist to capitalist model after 1990, public property was transferred to the private sector. Net national wealth amounted to slightly more than 400% of national income in 1990, roughly three-quarters of which was owned by the state and one-quarter by private individuals. But by 2015, these proportions reversed, as illustrated by **Figure 3.5.1**. Net private wealth amounted to 350% of national income, while net public wealth represented less than 100%; the overall national wealth to national income ratio had increased by just 12% over 25 years. Furthermore, this dramatic fall in Russia's net public wealth occurred over just a few years, between 1990 and 1995, as the country implemented its so-called shock therapy transition strategies, which included the privatization of state-owned enterprises through vouchers.[19] (More on this will be addressed in Part IV of the report.)

It is noteworthy that aggregate national wealth fell relative to national income in the initial stages of Russia's transition. As can be seen on Figure 3.5.1, net national wealth decreased between 1990 and 1999, from over 400% of national income to about 300%, such that aggregate national wealth fell even more than national income over this period, which almost halved itself. National wealth rose then considerably between 1999 and 2009, reaching about 550% of national income. This peak corresponded to a very large rise of Russian stock market prices and housing prices during this decade, but as asset prices then fell in the aftermath of the financial crisis, aggregate national wealth fell back to around 450% of national income in 2015, only just above its value 25 years previously. As a consequence, the major transformation

Figure 3.5.1
The structure of national wealth in Russia, 1990–2015

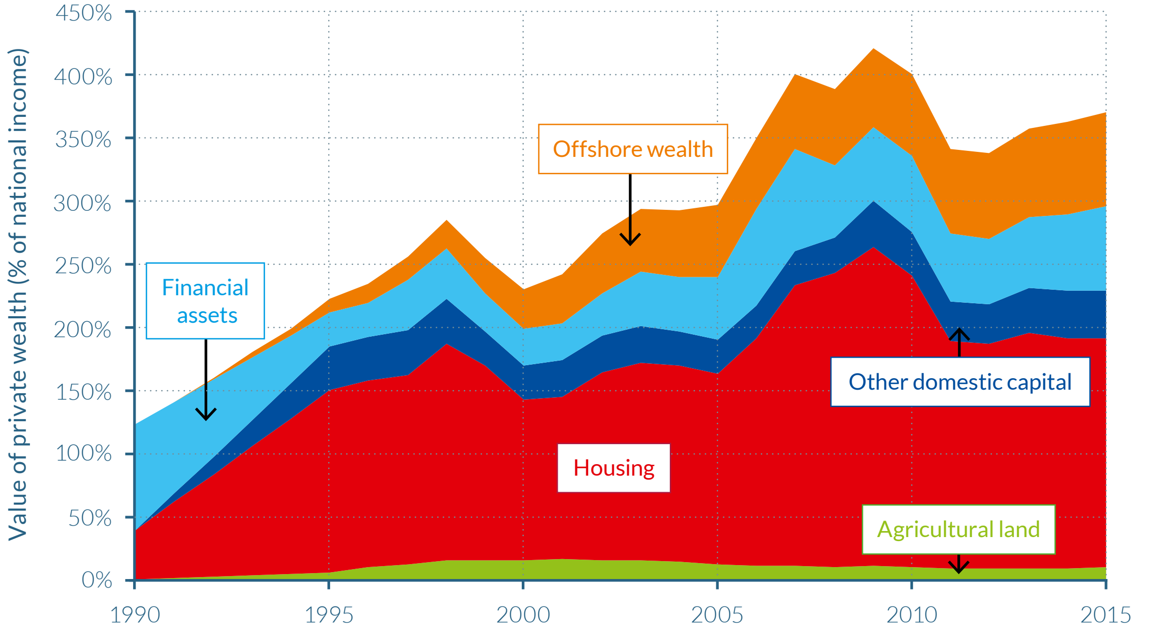


Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of net national wealth was equal to 455% of national income, i.e. it was worth 4.6 years of national income. Net public wealth was equal to 84% of national income. Net national wealth is equal to net private wealth plus net public wealth. Net private wealth is equal to private assets minus private debts. Net public wealth is equal to public assets minus public debts.

Figure 3.5.2

The asset composition of private wealth in Russia, 1990–2015



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, the value of housing assets was equal to 182% of national income, i.e. it was worth 1.8 years of national income. The value of financial assets was 67% of national income.

during the 1990–2015 period was the shift from public to private property, rather than any significant and sustained increase in the aggregate value of national wealth.

Private housing has risen to dominate private wealth in Russia

In order to better understand which factors influenced the evolution of national wealth-income ratios in Russia and the composition of the country's wealth, it is critical to look separately at the different asset categories. As seen in **Figure 3.5.2**, there was a significant rise in private wealth since 1990.[20] Housing played a critical role here as property prices more than doubled between the year 2000 and the peak of the housing bubble in 2008–2009, increasing the value of housing wealth from less than 50% of national income in 1990 to 250% at its peak, before easing to approximately 200% by 2015. Comparatively, other domestic capital (mostly consisting of unincorporated businesses owned directly by households) and agricultural land (which was also largely privatized during the 1990s) increased over time, but these assets played a relatively limited role as compared to the rise of private housing.

In addition to real estate price movements, the gradual rise of private housing wealth between 1990 and 2015 can be accounted for by the more continuous manner in which housing privatization occurred, relative to the voucher privatization method used for companies. Tenants were typically given the right to purchase their housing unit at a relatively low price, but they did not need to exercise this right immediately. Due to various economic, political and psychological factors, many Russian households waited until the late 1990s and even the 2000s to exercise this right. Indeed, some were concerned about the possible maintenance costs associated to private ownership as under public housing ownership maintenance work was taken care of by public authorities, while others were more concerned about a possible political downturn, particularly following the presidential election of 1996 when Boris Yeltsin won with a relatively small margin against communist party leader Gennady Zyuganov.

Official household financial assets are particularly low in Russia, due largely to the voucher method chosen to privatize former state-owned enterprises

What is also particularly striking is the very low level of official financial assets owned by Russian households attained in official Rosbank financial balance sheets and other official sources. Household financial assets have always been less than 70–80% of national income throughout the 1990–2015 period, and they have often been less than 50% of national income; in the late 1990s and early 2000s, they were as little as 20–30% of national income. Thus, it is as if the privatization of Russian companies did not lead to any significant long-run rise in the value of household financial assets, in spite of the fact that it had become possible for individuals to own financial shares in Russian firms. This appears particularly paradoxical.

The initial decline in financial assets was perhaps predictable. Back in 1990, household financial assets—which at the time mostly consisted of saving accounts—amounted to about 70–80% of national income. But as prices were liberalized in the early 1990s, these Soviet-era savings were all but eradicated by hyperinflation. The consumer price index was multiplied by nearly 5000 between 1990 and 1996, with annual inflation rates consistently above 150% and as high as 1 500% in 1992 and 900% in 1993. Following the introduction of the new ruble—worth 1 000 old rubles—in 1998, the inflation rate stabilized at around 20–30% per year on average up to 2006.

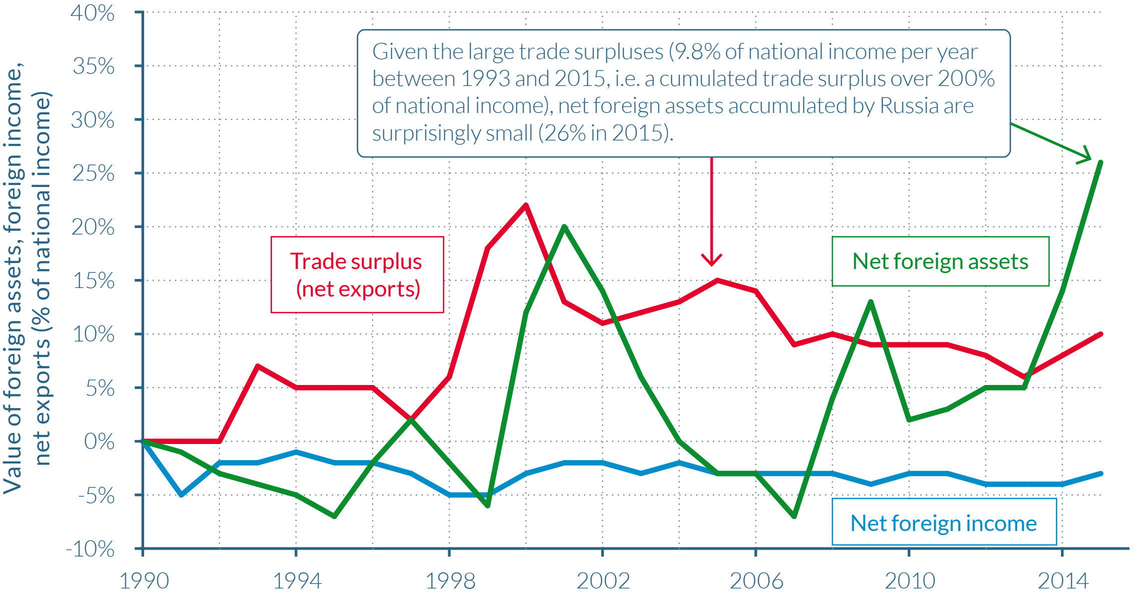
What is more surprising is why the new financial assets that were accumulated by Russian households during the 1990s—in particular through voucher privatization—did not compensate for this loss in savings. Of course, when vouchers were first introduced in 1992–1993, it was very difficult for Russian households to know what to do with these new financial instruments and how to put a price on them. More generally, it could be argued that in the chaotic monetary and political context of the 1990s it is not too surprising that the market value of household financial assets remained relatively low until the somewhat more stable mid- to late-1990s. What is more difficult to understand, however, is why such extremely low valuations persisted well after this period. In particular, in spite of the spectacular Russian stock market boom that occurred between 1998 and 2008, it is conspicuous that total financial assets officially owned by Russian households amounted to little more than 70% of national income in 2008—that is, less than the level observed in 1990.

Taking into account offshore wealth doubles Russia's total official financial assets

In the view of Filip Novokmet, Thomas Piketty, and Gabriel Zucman, the main explanation for this paradox is the existence of a small subset of Russian households that own very substantial offshore wealth—that is, nonofficial financial assets in offshore tax havens. According to their benchmark estimates, offshore wealth has gradually increased between 1990 and 2015, representing approximately 75% of national income at the end of the period. As depicted by **Figure 3.5.2**, offshore wealth was thus roughly as large as official financial assets owned by Russian households. By definition, offshore assets are difficult to estimate, and the benchmark estimates presented in this section are neither precise nor fully satisfactory, but these orders of magnitude seem to be reasonable, and if anything may be somewhat underestimated given the way in which they are constructed, as explained below.

In order to estimate the rise and magnitude of offshore wealth held by Russian house-

Figure 3.5.3
Trade surplus and missing foreign assets in Russia, 1990–2015



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.
In 2015, the value of Russia's trade surplus (exports - imports) was equal to 10% of national income.

holds, it is natural to start by looking at the evolution of Russia's trade balance and its balance of payments. Examining these two balances together, there is a clear contrast between the very large trade surpluses recorded in Russia and the country's relatively modest foreign assets, as illustrated by **Figure 3.5.3**.

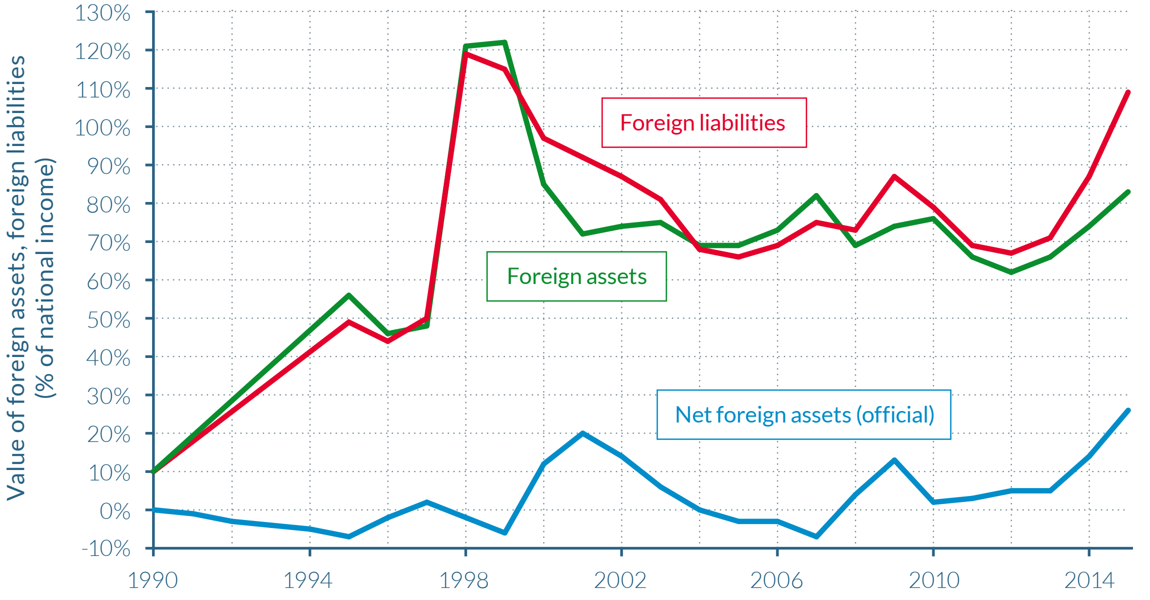
Russia has had strong trade surpluses each single year since the early 1990s. These trade surpluses—mostly driven by exports in oil and gas—averaged almost 10% of national income between 1993 and 2015, having been at around 5% between 1993 and 1998, and as much as 20% in 1999–2000. Thus, in each of the last 20 years, the Russian economy has exported the equivalent of around 10% of its annual income in excess of what the country has imported. Given that Russia's initial financial position when beginning its transition was close to zero, with very few foreign assets or foreign debt, these sustained surpluses should have led to a massive accumulation of foreign assets held by Russian citizens in the rest of the world. However, the paradox is that net foreign assets accumulated by Russia are surprisingly small at about 25% of national income in 2015.

Investigating Russia's balance sheet reveals further inconsistent information regarding the ownership of financial assets. Both foreign assets (that is, assets owned by Russian residents in the rest of the world) and foreign liabilities (that is, assets owned by rest-of-the-world residents in Russia) have increased significantly since the fall of the Soviet Union. Both were extremely small in 1990, at around 10% of national income, reflecting low levels of financial integration with the rest of the world and strong capital controls. But by 2015, foreign assets had reached almost 110% of national income, and foreign liabilities were close to 85% of national income, hence a net foreign asset position of about 25% of national income.

How can such a low level of net foreign wealth accumulation be accounted for? An obvious

Figure 3.5.4

Official foreign assets and liabilities in Russia, 1990–2015



Source: Novokmet, Piketty and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2015, official net foreign assets were 26% of national income. Net foreign assets are foreign assets minus foreign liabilities. Foreign assets are assets owned by Russian residents in the rest of the world. Foreign liabilities are assets owned by rest-of-the-world residents in Russia.

explanation is capital flight: some Russian individuals, and/or some Russian corporations acting on behalf of individuals, and/or some Russian government officials acting on behalf of individuals, were able to appropriate some of Russia's trade surpluses to accumulate offshore wealth—that is, foreign assets that are not properly recorded as such in Russia's official financial statistics. Given the weaknesses of Russia's legal and statistical system, and the widespread use of offshore entities to organize business and financial transactions in Russia over this period, it is maybe not too surprising that such leakages might have occurred.[21]

Discrepancies in Russia's balance of payments can aid estimations of the country's offshore wealth

How large these capital flight leakages are, and the associated accumulation of offshore wealth is, are challenging to measure. Simple calculations of trade surpluses (230%) minus official net foreign assets (30%) over the 1990–2015 period, would suggest that cumulated capital flight is on the order of 200% of national income. But this does not include the cumulated capital income flow on these foreign assets, which could have been significant if rates of return on these assets were high. Indeed, it appears that returns on foreign assets were lower than the returns on foreign liabilities over the 1990–2015 period, as illustrated by the small negative net foreign income flows in **Figure 3.5.3**. This net capital income outflow hence absorbed approximately a quarter to a third of Russia's annual trade surplus.

Furthermore, the capital gains and losses realized on the portfolio of foreign assets and liabilities needs to be accounted for. These portfolio effects can be substantial if there are large differences between annual surpluses and the observed evolution of net foreign assets. This is partly what happened in Russia as foreign investors bought Russian assets in the 1990s when stock market prices were extremely low and benefited from the country's booming stock market of the 2000s, providing part of the explanation as to why foreign liabilities rose as much as **Figure 3.5.4** shows. These portfolio effects therefore imply that a substantial part of Russia's trade surpluses was translated into assets held by citizens from elsewhere in the world. But the magnitude of the aforementioned differentials in rates of return and portfolio effects were not large enough to fully explain the missing wealth paradox.

Filip Novokmet, Thomas Piketty, and Gabriel Zucman therefore look to exploit inconsistencies in Russia's balance of payments to estimate the size of offshore wealth—that is, Russia's missing foreign assets. Their relatively conservative estimations indicate that offshore wealth reached approximately 75% of national income by 2015, suggesting that Russians own approximately as much offshore wealth as their official financial asset holdings (about 70–80% of national income in both cases). That is, they own about 50% of their total financial wealth offshore. These results are similar to estimates obtained by Gabriel Zucman's earlier research that used a different methodological approach.[22] Thus they can be viewed as somewhat reassuring. But while these magnitudes are believed to be broadly accurate, these estimations lack absolute precision given the general lack of international financial transparency—and the difficulties of identifying by whom these missing assets are owned and what form they take potentially pose even greater challenges.

Even more uncertain is the location of the assets held offshore by Russian citizens. Some of this offshore wealth might be invested back in Russian corporations, while it is also discussed that some Russians own significant property assets in cities such as London and in the countryside of nations such as French, and/or have large shares in companies and in sports teams in countries such as Germany, the UK, and the United States. Inspecting the list of Russian billionaires released by *Forbes* illustrates that these individuals collectively own more than $400 billion in assets—that is, the equivalent of about half of the estimated $800 billion in Russian offshore wealth. Comparing the corresponding wealth portfolios published by *Forbes* and other magazines, one could be tempted to conclude that most of the offshore wealth is held in Russian companies, in particular in the energy and financial sectors. On this basis, interpretations of the available data indicate that a large fraction of Russia's official foreign liabilities—over 80% of national income in 2015—is actually held by Russian residents via offshore accounts. But given that the *Forbes* list does not provide any information regarding the fraction of reported billionaire wealth held offshore—likely a very large proportion—it is difficult to provide more conclusive explanations.

NOTES

1 T. Piketty and G. Zucman, "Capital Is Back: Wealth-Income Ratios in Rich Countries 1700–2010," *Quarterly Journal of Economics* 129, no. 3 (2014): 1255–1310.

2 T. Piketty, *Capital in the Twenty-First Century* (Cambridge, MA: Belknap Press of Harvard University Press, 2014).

3 A. Atkinson, *Inequality: What Can Be Done?* (Cambridge, MA: Harvard University Press, 2015).

4 T. van den Bremer, F. van der Ploeg, and S. Wills, "The Elephant in the Ground: Managing Oil and Sovereign Wealth," *European Economic Review* 82 (2016): 113–-131.

5 See Piketty and Zucman, "Capital Is Back," for a complete analysis and decomposition of volume and price effects. See also Piketty, *Capital in the Twenty-First Century*, part 2. Here we summarize only the main conclusions and emphasize the more recent evolutions.

6 See Piketty and Zucman, "Capital Is Back."

7 See Piketty and Zucman, "Capital Is Back," in particular Figures VII and VIII.

8 See Piketty and Zucman, "Capital Is Back."

9 J. Tobin and W. C. Brainard, "Asset Markets and the Cost of Capital," in *Economic Progress, Private Values and Public Policy*, ed. B. Balassa and R. Nelson, 235–262 (Amsterdam: Elsevier North Holland, 1977).

10 In Germany, book-value national wealth was substantially above market-value national wealth (about 5 years of national income instead of 4 years) between 1970 and 2010. The opposite occurred in the UK over this period

11 Annette Alstadsæter, Niels Johannesen, and Gabriel Zucman find that the equivalent of 10% of world GDP is held in tax havens globally, but this average masks a great deal of heterogeneity—from a few percent of GDP in Scandinavia, to about 15% in Continental Europe, to about 60% in Gulf countries and some Latin American economies. See A. Alstadsæter, N. Johannesen, and G. Zucman, "Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality," NBER Working Paper no. 23805, National Bureau of Economic Research, September 2017, http://www.nber.org/papers/w23805.pdf..

12 See Piketty and Zucman, "Capital Is Back," Table VII.

13 See Piketty and Zucman, "Capital Is Back," Table VIII.

14 See T. Piketty, "On the Long-Run Evolution of Inheritance: France 1820–2050," *Quarterly Journal of Economics* 126, no. 3 (2011): 1071–1131; and T. Piketty and E. Saez, "A Theory of Optimal Inheritance Taxation," *Econometrica* 81, no. 5 (2013):1851–1886.

15 See G. Zucman, "Taxing across Borders: Tracking Personal Wealth and Corporate Profits," *Journal of Economic Perspectives* 28, no. 4 (2014): 121–148; and Alstadsæter, Johannesen, and Zucman, "Who Owns the Wealth in Tax Havens?"

16 See T. Piketty, L. Yang, and G. Zucman, "Capital Accumulation, Private Property and Rising Inequality in China, 1978–2015," NBER Working Paper no. 23368, National Bureau of Economic Research, June 2017, http://www.nber.org/papers/w23368.pdf, for a detailed volume-price decompositions of China's wealth accumulation.

17 Piketty, Yang and Zucman, in "Capital Accumulation," estimate Tobin's Q of these Chinese companies that are not listed on the stock exchange to be 1. Given that these not listed companies represent approximately 80% of all Chinese companies, this has a tendency to move the average Tobin's Q toward 1.

18 See D. Nougayrède, "Outsourcing Law in Post-Soviet Russia," *Journal of Eurasian Law* 6, no. 3 (2013): 383–448; D. Nougayrède, "Yukos, Investment Round-Tripping and the Evolving Public/Private Paradigms," *American Review of International Arbitration* 26, no. 3 (2015): 337–364; and D. Nougayrède, "The Use of Offshore Companies in Emerging Market Economies: A Case Study," *Columbia Journal of European Law* 23, no. 2 (2017): 401–440.

19 One key argument behind the shock therapy doctrine was that rapid privatization would prevent any possible return to public property and communism. See, for example, M. Bojko, A. Shleifer, and R. W. Vishny, *Privatizing Russia* (Cambridge, MA: MIT Press, 1995).

20 Note, however, a fall in aggregate national wealth right after the fall of communism, not presented here to simplify the interpretation over the 1990 to 2015 period.

21 See, for example, the work by legal experts, such as Nougayrède, "Outsourcing Law in Post-Soviet Russia"; Nougayrède, "Yukos, Investment Round-Tripping"; and Nougayrède, "The Use of Offshore Companies."

22 See G. Zucman, "The Missing Wealth of Nations: Are Europe and the US Net Debtors or Net Creditors?" *Quarterly Journal of Economics* 128, no. 3 (2013): 1321–1364; G. Zucman, "Taxing across Borders: Tracking Personal Wealth and Corporate Profits," *Journal of Economic Perspectives* 28, no. 4 (2014): 121–148;; and G. Zucman, *The Hidden Wealth of Nations: The Scourge of Tax Havens*, trans. T. L. Fagan (Chicago: University of Chicago Press, 2015).

PART IV

TRENDS IN GLOBAL WEALTH INEQUALITY

4.1

GLOBAL WEALTH INEQUALITY: TRENDS AND PROJECTIONS

- Data on global wealth inequality is sparser than data on income inequality, so estimates should be interpreted with care. It is not possible to construct at this stage a consistent global wealth distribution. However, available research on key regions—in particular, China, Europe, and the United States—provide valuable insights into global wealth dynamics.

- Evidence points towards a rise in global wealth inequality over the past decades. At the global level—represented by China, Europe, and the United States—the top 1% share of wealth increased from 28% in 1980 to 33% today, while the bottom 75% share hovered around 10%.

- Wealth is substantially more concentrated than income. The top 10% owns more than 70% of the total wealth in China, Europe, and the United States, the bottom 50% owns less than 2%, and the middle 40% ("the global wealth middle class") owns less than 30%.

- If established trends in wealth inequality were to continue, the top 0.1% alone will own more wealth than the global middle class by 2050.

Global wealth inequality estimates are scarcer than for global income inequality and subject to caution

The available data on wealth inequality is much sparser than for income inequality, especially at the global level. It is therefore more difficult to provide a complete picture of how global wealth inequality has evolved over the past few decades.

We want to be very clear about this: available data sources make it impossible at this stage to properly estimate the level and evolution of the global distribution of wealth. We can to some extent estimate the global distribution of income and its evolution, as we have tried to cautiously show in Part II of this report. The situation is different for wealth. As we have shown in Part III of this report, there are very large areas of the world—particularly in Africa, Latin America, and Asia—where we are not even able to properly measure the aggregate level of national wealth and its decomposition into private and public property, foreign wealth, and natural capital. We first need to make more progress on the measurement of total wealth and its changing structure before we can construct estimates of distribution of private wealth among individuals.

A number of magazines (most notably, *Forbes*) do publish global rankings of billionaires, and some financial institutions (for instance, Credit Suisse) have combined billionaire data with other data sources to estimate global distributions of wealth. Typically these studies find that top wealth holders have been rising at very high speed in recent decades—substantially faster than the size of the world economy—and below we will agree with this general conclusion. However the methodologies used by *Forbes* and by these institutions often lack transparency; in particular, they do not release their raw data sources and detailed computer codes. It is impossible therefore to reconstruct their statistical results. This is not merely a technical question; methodological choices can indeed have a large impact on the measured evolution of wealth inequality, and transparency of methods and sources is critical if we want to reach some agreement about inequality facts.

In the context of the WID.world project, we choose to proceed in a gradual manner and to release wealth inequality series solely for the countries for which raw sources allow us to do so in a satisfactory manner. Ideally, one needs to combine household wealth surveys together with wealth rankings and administrative fiscal data (coming from both the income tax, using the capitalization method, and the inheritance tax, using the estate multiplier method) to be able to properly estimate the distribution of wealth and to confront sources in a transparent way. At this stage, these conditions are satisfied only for a handful of countries—most notably, the United States, a number of countries in Europe (in particular, France, the UK, and Spain), and to a lesser extent China (where we have access to household wealth surveys and wealth rankings, but where access to fiscal data is extremely limited). We have also produced estimates of wealth inequality for Russia and the Middle East, but they are more fragile, and we do not use them to produce global wealth estimates in this report.

Our global wealth inequality estimates since 1980 therefore combine data from three large regions: the United States, China, and Europe. Europe itself is represented by three countries (France, Spain, and the United Kingdom), which on the basis of other countries for which we have wealth inequality data (in particular, Sweden and Germany) appear to be broadly representative. Starting from 1987, we can also compare our results with the *Forbes* billionaire rankings, which provide a better coverage of countries, though only for a tiny, extremely wealthy part of the population, and with little knowledge of how this information was collected.

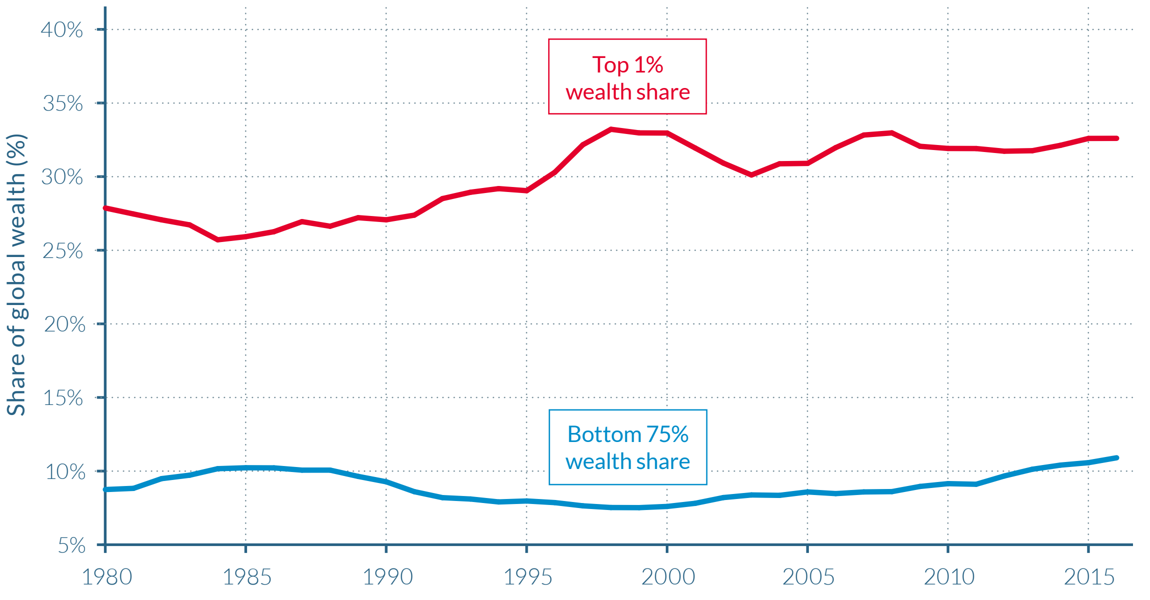
Available data show that global wealth inequality is extreme and on the rise

At the global level (represented by China, Europe, and the United States), wealth is substantially more concentrated than income: the top 10% owns more than 70% of the total wealth.[1] The top 1% wealthiest individuals alone own 33% of total wealth in 2017. This figure is up from 28% in 1980. The bottom 50% of the population, on the other hand, owns almost no wealth over the entire period (less than 2%). Focusing on a somewhat larger group, we see that the bottom 75% saw its share oscillate around 10%. Wealth concentration levels would probably be even higher if Latin America, Africa, and the rest of Asia were included in the analysis, as most people in these regions would be in the poorer parts of the distribution. We leave this to future editions of the *World Inequality Report*. (**Figure 4.1.1**)

We compare in **Table 4.1.1** the growth rates of the different wealth groups between 1980 and 2017 (all growth rates are expressed in real terms—that is, after deduction of inflation). A number of striking findings emerge. First, one can see that average wealth has grown faster since the 1980s than average income, reflecting the general tendency of wealth/income ratios to rise in most countries, as documented in Part II of this report. Between 1987 and 2017, per-adult average income has increased at 1.3% per year at the world level, while per-adult wealth has increased at 1.9% per year.

Next, if we now look at the top of world wealth distribution—as measured by the *Forbes* billionaire rankings—we find that the top wealth holders' share has increased a lot faster than average wealth holders: 5.3% since 1987 for the top 1/20 million, and 6.4% for the top 1/100 million (see **Table 4.1.1**). By definition, this is an evolution that cannot continue forever: if top wealth holders were to grow on a permanent basis at a speed that is three to four times faster than average wealth in the world, then billionaires would ultimately come to own 100% of the world's wealth.

Figure 4.1.1
Top 1% and Bottom 75% shares of global wealth, 1980–2017: China, Europe and the US



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, 33% of global wealth was owned by the Top 1%. The evolution of global wealth groups from 1980 to 2017 is represented by China, Europe and the US.

Table 4.1.1

Global wealth growth and inequality, 1980–2017

	China + Europe + US		World
	1980–2017	1987–2017	1987–2017
Top 1/100 million (Forbes)	–	7.8%	6.4%
Top 1/20 million (Forbes)	–	7.0%	5.3%
Top 0.01% (WID.world)	5.5%	5.7%	4.7%
Top 0.1% (WID.world)	4.4%	4.5%	3.5%
Top 1% (WID.world)	3.4%	3.5%	2.6%
Average wealth per adult	2.9%	2.8%	1.9%
Average income per adult	1.3%	1.4%	1.3%

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

Between 1987 and 2017, the wealth of the global Top 1% grew by 2.6%. The wealth threshold for an individual to be part of the Top 1% wealthiest in China + Europe + US in 2017 is €1 125 000, the Top 0.1% threshold is €5 209 000, the Top 0.01% threshold is €25 812 000.

The problem with this billionaire data is twofold: first, as was noted above, it is not entirely clear how it was estimated; next, and most importantly, it is not clear at all whether this pattern of very fast growth holds only for billionaires, or whether it can be extended to multimillionaires. This is crucial because there are many more individuals who own $5 million, $20 million, or $100 million than there are billionaires, and the former command a potentially much larger fraction of world wealth than the latter.

We unfortunately do not know the full answer to this question, but at least our estimates for the US, Europe, and China distribution of wealth provide some interesting insights. We find that the top 1% average wealth in the US, Europe, and China has risen at 3.5% per year between 1987 and 2017 (versus 2.8% for per-adult average wealth and 1.9% for average income). The higher we go in the distribution, the faster the growth: the top 0.1% average wealth has increased by 4.4% per year, and the top 0.01% average wealth has increased by 5.6% per year.

These findings, which were obtained by combining a number of independent data sources (household wealth surveys, income tax data using the income capitalization method, and inheritance tax data using the estate multiplier method, when available), appear to be consistent with the *Forbes* billionaire data. But they also suggest that one needs to go really very high in the distribution of wealth to see growth rates on the order of 5%–6% per year. If one considers only the top 1% wealth holders as a whole (that is, all individuals with net wealth higher than about €1.1 million in China, Europe, and the United States in 2016), then the growth rate between 1987 and 2017 has been 3.5% per year. This is faster than average wealth growth (2.8% per year), but the gap is not as huge as for billionaires. This suggests at current speed that rising inequality and the divergence of the wealth distribution will take a couple of decades before it takes really extreme proportions. (See below for a discussion of future prospects.) That being said, the direction in which the distribution is going definitely suggests rising concentration of wealth, and there is no evidence that the financial crisis of 2008 had any impact—other than temporary—on this long-run structural trend.

Our results also show that a large share of the growth of global wealth accrued to the top

1% and even narrower wealth groups. As **Table 4.1.2** shows, the top 1% captured 37% of per capita wealth growth, more than half of which went to the top 0.1%.

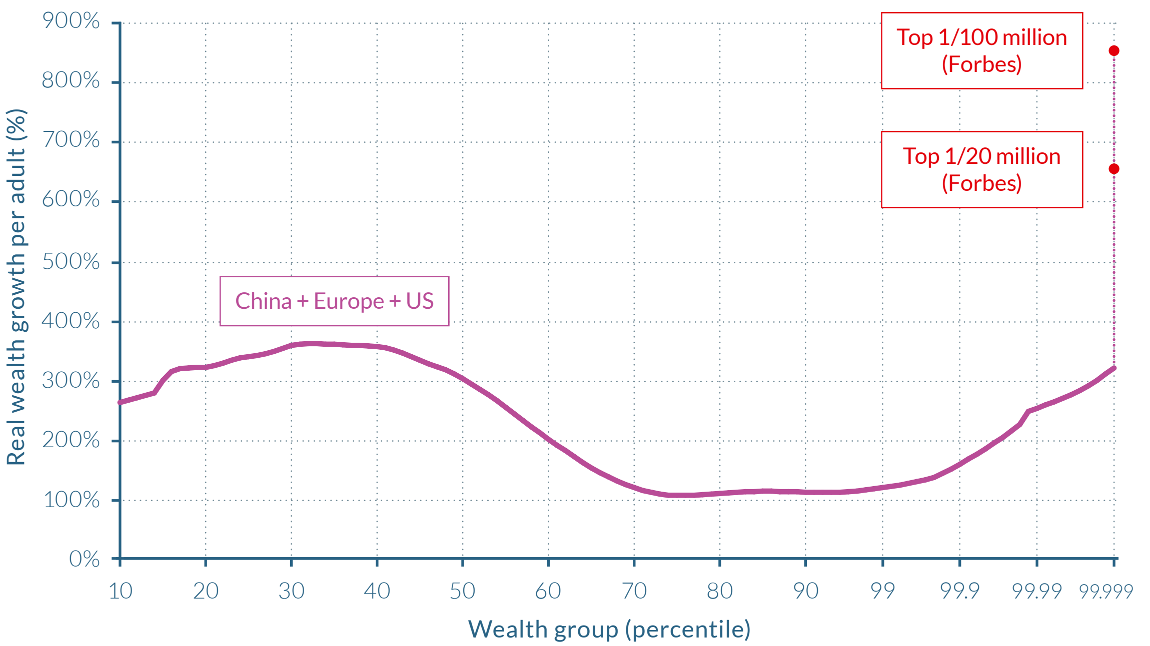
All of this implies growing inequality at the top end of the distribution. Note that the bottom of the distribution has also experienced a significant increase of its wealth, driven by rapid growth in China, as shown by **Figure 4.1.2**. This pattern is reminiscent of the "elephant curve" of global income growth, showing that the global wealth distribution seems to have evolved in ways qualitatively similar to income. The bottom three-quarters of the distribution saw its wealth increase by a sizeable amount, though less than the world's billionaires according to *Forbes*. Between those two groups, wealth growth was at its lowest for the middle class in developed countries. The trends in the wealth growth of different groups have been fairly stable over the last three decades, with narrower wealth top groups experiencing higher growth.

Under a business-as-usual scenario, the top 1% wealth share will increase at 1 percentage point every five years

What will happen to the global distribution of wealth if these trends were to continue for the next few decades? **Figure 4.1.3** seeks to answer that question. The top 0.1% wealth owners would progressively catch up with the global wealth middle class, which we define as wealth holders below the top 10% and above the median—that is, 40% of the world population. In 2050, both groups would own the same share of global wealth—that is, 25%. The global wealth middle class comprises 40% of the world population meaning that the top 0.1% wealthiest would be on average four hundred times wealthier than the global middle class. This evolution would take a couple of decades.

The top 1/20 million and 1/100 million of individuals, which comprise about 250 and 50 adults, could respectively own 1.5% and 0.75% of total wealth as soon as 2030, up from 0.5%

Figure 4.1.2
Global wealth growth by percentile, 1987–2017: China, Europe and the US



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

Between 1987 and 2017, the average wealth of the 50th global wealth percentile grew by 300%. Average global wealth growth per adult was 129%. The evolution of and 0.25% in the early 1990s. The share of the top 1% would keep on increasing by one percentage point every five years. The shares of the top 0.1% and 0.01% would also grow by one percentage point every five years, meaning that the increase in wealth inequality is in fact driven by these small groups. These groups are much broader than billionaires, but nevertheless quite narrow. (To belong to the top 0.1% or top 0.01% of Europe, the United States, and China in 2016, one needs to own more than €5.2 million or €25.8 million, respectively.)

Table 4.1.2

Share of global wealth growth captured by wealth group, 1980–2017

Wealth group	Share of real growth per capita
Bottom 99%	62.9%
Top 1%	37.1%
Top 0.1%	21.6%
Top 00.1%	12.4%

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

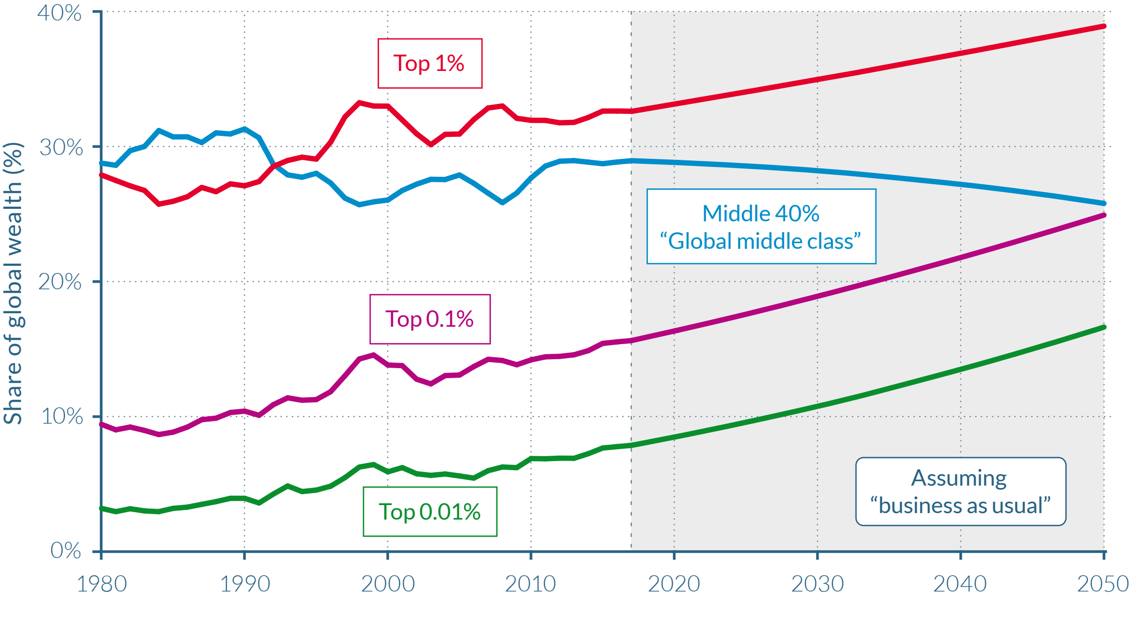
Between 1980 and 2017, the global Top 1% captured 37% of total wealth growth in China, Europe and the US. The wealth threshold for an individual to be part of the Top 1% wealthiest in China + Europe + US in 2017 is €1 125 000, the Top 0.1% threshold is €5 209 000, the Top 0.01% threshold is €25 812 000.

Global wealth inequality is driven by a large number of forces

As discussed in Part II, global income dynamics are driven by both between- and within-country forces. The rise of private wealth has been faster in large emerging economies than in rich countries, a trend driven by high economic growth and large-scale privatization in transition economies. This tends to reduce global wealth inequality. This effect was more than offset at the top, however, by the rise in wealth inequality within countries. Rising wealth inequality within countries is itself due to a number of factors, including rising income inequality amplified by inequality of savings rates and of rates of return. Other factors, such as the progressivity of taxation, can in

Figure 4.1.3

Global wealth inequality, 1980–2050: China, Europe and the US



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2016, in a world represented by China, Europe and the US, the global wealth share of the Top 1% was 33%. Under "Business as usual", the Top 1% global wealth share would reach 39% by 2050, while the Top 0.1% wealth owners would own nearly as much wealth (26%) as the middle class (27%). The evolution of global wealth groups from 1987 to 2017 is represented by China, Europe and the US. Values are net of inflation.

turn mitigate or worsen these dynamics. Hence, future global wealth inequality will depend on both catchup growth in emerging economies, and within-country determinants of inequality. We study them at the country level as further described in the next chapters.

We should stress at the onset that there was nothing inevitable about the fact that the very top of the global wealth distribution would rise so much faster than average world wealth beginning in the 1980s. One of the global factors that might have played a role is the larger transfer from public to private wealth that took place in many countries. (See Part II.) To the extent that privatization disproportionately benefited small groups of the population—for example, Russian oligarchs—this can help explain why top wealth holders' shares rose so fast. It is difficult, however, with the data at our disposal to estimate the global impact of this factor. In particular, there are also some cases where privatization has benefitted mostly the middle class (for example for housing, as we discuss below for the case of the UK, France and Spain). Whether this channel is likely to be important for the future (one might be tempted to conclude that large privatization waves are now behind us) is another important and uncertain issue.

Box 4.1.1

Methodological note: How our projections work

We partition the distribution of wealth into several groups:

- the bottom 99%
- the top 1%, excluding the top 0.1%
- the top 0.1%, excluding the top 0.01%
- the top 0.01%, excluding the top 1/20 million
- the top 1/20 million, excluding the top 1/100 million
- the top 1/100 million

We calculate the average growth rate of wealth of these groups since 1987 (start of the *Forbes* ranking), and extrapolate the average wealth of each of these groups based on these growth rates. We obtain top wealth shares based on these averages.

Because narrower top groups have experienced higher growth in the past, this method forecasts an increase of wealth inequality. Of course, this trend cannot be extended indefinitely into the future, because with the current parameters it will eventually lead to the top group's owning nearly all of the wealth. However, this problem only arises at very long horizons, so the method is still useful for projections over a few decades.

Another potentially important global factors behind booming top wealth is the fact that financial deregulation and innovation might have increased the inequality in rates of return that are accessible to different sizes of financial portfolio. Some of the most convincing evidence for this channel comes from the observed real rates of return on university endowments, which varied from 4–5% per year for the smallest endowments to as much as 8–10% per year for largest ones (after deduction of inflation and management costs) in the United States between 1980 and 2010.[2]

Again one might wonder whether this corresponds to a specific financial period or whether this will continue in the future (available data suggests that large endowments were still getting very good returns in recent years). Also the governance of personal family wealth involves many other issues than that of large academic capital endowments, so one cannot directly apply these findings. Unfortunately there is too little data available to make similar computations for the highest family wealth.

As we shall see below, however, our country studies do show that differential rates of return—together with differential saving rates—can potentially be an important driving force behind rising wealth concentration. (**Box 4.1.1**.)

4.2

COMPARING TRENDS IN PERSONAL WEALTH INEQUALITY ACROSS THE WORLD

- Available data on personal wealth inequality shows that it has been on the rise in most countries since the early or late eighties. Increasing income inequality and the large transfers of public to private wealth which occurred over the past forty years drive these dynamics.
- Large rises in top wealth shares have been experienced in China and Russia following their transition from communism towards a capitalist economy, though the different inequality dynamics experienced between these two countries highlights different economic and political transition strategies.
- In the United States, wealth inequality has increased dramatically over the last 30 years and was mostly driven by the rise of the top 0.1% wealth owners. Growing inequality of income and saving rates created a snowballing effect of rising wealth concentration.
- The increase in top wealth shares in France and the UK was more moderate over the past forty years, in part due to the dampening effect of the rising housing wealth of the middle class and lower income inequality relative to the United States. As a result, while wealth concentration has been historically lower in the United States than in Europe, the situation reversed after the 1970s.
- Property prices also played an important tempering role for wealth inequality in Spain as wealth concentration remained roughly unchanged over the observed period with only short-lived fluctuations.
- In the long run, the differential between rates of return to capital and growth rates, as well as the dynamics of savings rate among wealth groups, drive wealth inequality. When rates of returns available to high-wealth portfolios are higher than average economic growth, wealth inequality increases. The same is true when savings inequality is high.

Wealth inequality within countries fell dramatically from the beginning of the twentieth century in some of the world's largest economies, but since the 1980s there have been widespread increases in wealth concentration. The combination of economic, political and social shocks that led to the long-run decline in wealth inequality experienced throughout Europe and North America from the start of the First World War to the mid-1980s was described in the *Capital in the Twenty-First Century*.[3] These shocks included the Great Depression, the destruction of human and physical capital led by the World Wars, restrictions on capital flows, nationalization of industries and goods provision, and greater government control over the economy. Given the close relationship between wealth and income, the story of the former is similar to that of the latter: collectively, these factors severely impacted the fortunes of the wealthiest and supported the growth of middle class wealth in Europe and the United States.

Unfortunately relatively little is been known about the recent evolution of wealth inequality at a global level. Wealth inequality data discussed in public debates up to now essentially relied on sources which do not allow for a sound analysis of wealth dynamics. It is also difficult to track how wealth inequality statistics are constructed since the methodologies are not always made transparent. This is not merely a technical question: methodological choices can indeed have a large impact on the evolution of measured wealth inequality.

The publicly available information discussed in this report and published on WID.world on the distribution of wealth and cross-border assets is still imperfect. But we see it as a fist systematic attempt at generating data on wealth inequality over the globe. It combines in a consistent manner tax data, wealth surveys and data on cross-border assets. The construction of estimates presented in this report was carried out for China, France, Russia, Spain, the United Kingdom and the United States which are presented in this chapter and the subsequent ones.

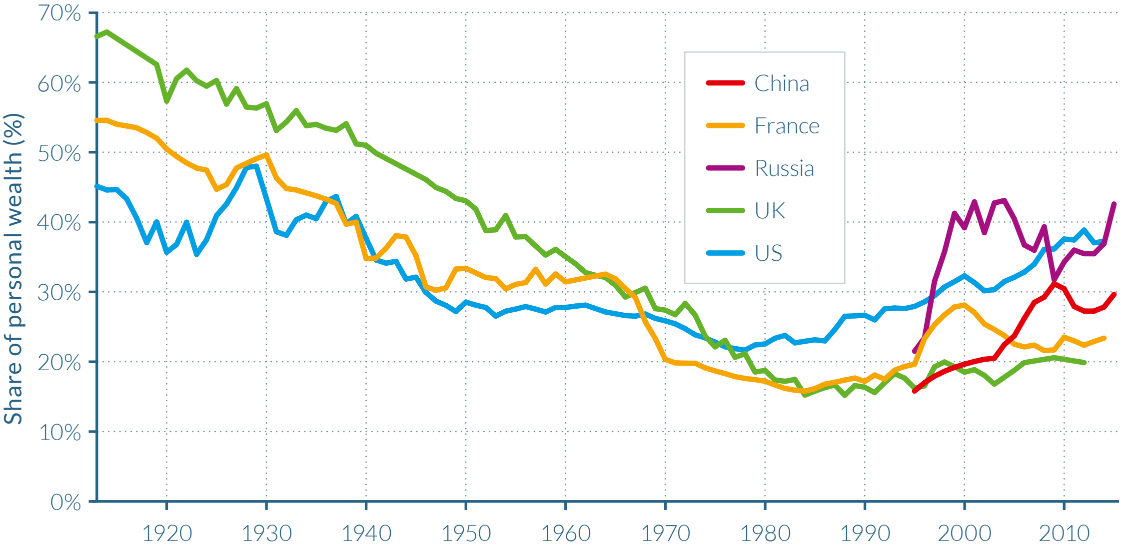
Contrasting transition strategies have generated divergent inequality dynamics in China and Russia

Wealth inequality data for China and Russia is only available from 1995–2015, but even in these last two decades the series confirm huge increases in wealth inequality. Wealth concentration amongst the top 1% in both countries practically doubled, as their share in China's total wealth rose from just over 15% in 1995 to 30% in 2015, and in Russia's from below 22% to approximately 43%. Interestingly, the share of the top 10% in total wealth in 2015 is much closer between the two countries, at 67% in China and 71% in Russia as illustrated by **Figure 4.2.2**, indicating that Russia's transition strategy favored its most wealthy citizens more than China's. As seen in **Figure 4.2.1**, by 2015 Russia had a higher concentration of wealth than the United States, while China's wealth inequality was roughly in between that of France and the United States.

The variations in inequality increases between the two former communist countries were in part due to differences in their strategies for privatizing housing and state-owned enterprises. In Russia, previously state-owned businesses were transferred to the private sector through a voucher privatization process that can be compared to a fire sale of assets given the extremely fast pace at which it was executed. By contrast, the enormous transfer of public capital into private capital with the sale of state-owned enterprises in China occurred more slowly. Its scale, though, was considerable: close to 100 000 firms with ¥11.4 trillion worth of assets were privatized between 1995 and 2005.[4]

The method by which property wealth was privatized was different, however. Chinese citizens experienced huge reductions in welfare housing allocations and the almost complete privatization of the housing

Figure 4.2.1
Top 1% personal wealth share in emerging and rich countries, 1913–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.
In 2015, the Top 1% wealth share was 43% in Russia against 22% in 1995.

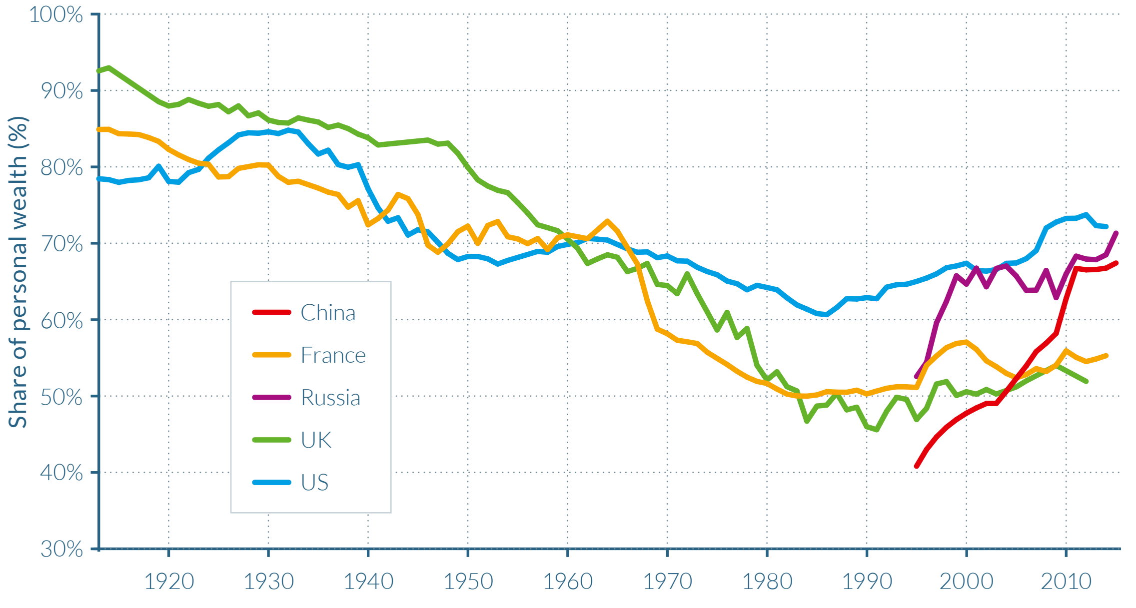
market, and by 2002, 85% of urban housing was privately-owned. This property privatization process was very unequal as access to quoted and unquoted housing assets often depended on how wealthy and politically connected the household was, with the wealthiest end of the distribution able to access privatized public wealth more easily through official markets. In contrast, Russians took a more gradual approach to property privatization. Tenants were typically given the right to purchase their housing unit at a relatively low price and did not need to exercise this right immediately, while uncertainty surrounding the macroeconomic and political environment also meant many Russian households waited until the late 1990s and even the 2000s to exercise this right. Consequently, the property privatization process had a small dampening effect on the rise of wealth inequality. The shares of the middle 40% defined as the top 50% excluding the top 10% fell in both countries across the period. Interestingly, the group's share fell in similar proportions in China and in Russia, from 43% in 1995 to 26% in 2015 in China and from 39% to 25% over the same period in Russia. While the fall was more pronounced in China, it was initially more abrupt in Russia than in China, however, due to the aftereffects of hyperinflation that followed price liberalization in 1992 and wiped out savings.

The growing inequality of income and savings rates have caused rapid wealth concentration in the United States

The rise of wealth inequality in the United States was less abrupt, but no less spectacular in historical terms, than the increases experienced in the former communist countries. Wealth inequality in the United States fell considerably from the high levels of the Gilded Age by the 1930s and 1940s, due to drastic policy changes that were part of the New Deal. The development of very progressive income and estate taxation made it much more difficult to accumulate and pass on large fortunes. Financial regulation sharply limited the role of finance and the ability to concentrate wealth as in the Gilded

Figure 4.2.2

Top 10% personal wealth share in emerging and rich countries, 1913–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 10% wealth share was 67% in China.

age model of the financier-industrialist. But since the mid-1980s, top wealth shares have risen sharply. The key driver of this rapid increase in wealth concentration has been an upsurge of incomes at the top of the distribution and the stagnation of incomes at the bottom. These dynamics follow the reversal of the policies implemented during the previous period, with financial deregulation and lower top tax rates among others. The differentials between the saving rates of the richest and those of the middle- and lower-class also increased wealth inequality. This had a reinforcing, "snowballing" effect as the purchase of financial assets by the wealthy using the savings from their large incomes has led to a rise in capital income concentration, providing greater incomes for the purchase of more assets and hence larger top wealth shares.

In the United States, the share of wealth owned by the top 1% adults grew from a historic low of below 22% in 1978, to almost 39% in 2014, as depicted in **Figure 4.2.1**. This represented a trend reversal from historical patterns as the top 1% wealth share in the United States was almost double that of France and the UK in 2014. These changes enabled the wealthy to purchase more wealth assets with high returns, setting a snowballing effect in motion for those at the top of the distribution, while wealth of the middle class stagnated. Consequently, the wealth share of the middle 40% fell from a historic high of almost 37% of total wealth in 1986, to around 28% in 2014. Pensions and home ownership rates of the middle 40% increased over the preceding period, but after the mid-1980s this trend reversed due to a surge in household debt that included mortgages, student loans, credit card and other debts. These debts increased from 75% of national income in the mid-1980s to 135% in 2009 and, despite some deleveraging in the wake of the Great Recession, still amounted to close to 110% of national income in 2012; this trend can be seen in the negative share of total wealth owned by the bottom 90% between 2008 and 2013.

The rising housing wealth of the middle-class dampened wealth inequality increases in France and the UK

Between the start of the First World War and the early 1980s, France and the UK experienced dramatic falls in wealth inequality. Large wealth shocks between 1914 and 1945 included the great depression, inflation and the destruction of productive capital and housing during the World Wars, and were followed by policies designed to reduce wealth inequality such as nationalizations, rent control and tax policies. These factors collectively led to the creation of a patrimonial middle class, which did not exist in Europe before WWI, contrary to the United States where wealth inequality was relatively lower at the time. Since the mid-1980s wealth inequality has risen in both the UK and France, though to a much lesser extent than in the United States, such that the United States is now more unequal in terms of wealth than Europe. In France and in the UK, strong returns on the financial assets held in proportionately larger quantities by the wealthiest fueled wealth inequality. This factor was, however, moderated by the general rise in house prices that have largely benefited the patrimonial middle-class, which owns relatively more housing than top wealth groups.

The beginning of the twentieth century saw the start of dramatic falls in the wealth share of the top 10% and top 1% in both France and the UK, as depicted in **Figure 4.2.1** and **Figure 4.2.2**. The share of wealth owned by the top 1% in the UK reached almost 75% in the early 1900s, and represented almost 60% of the total in France. But by the early 1980s, a combination of factors including the destruction of capital during the World Wars and greater state control of economic activity and redistribution thereafter saw the top 1% share fall to 16% in 1985 in both countries and that of the top 10% fell to 47% in the UK and 50% in France, near historic lows (they had previously been as high as 93% and 86%, respectively).

But in the midst of then French President Mitterrand's austerity turn and Prime Minister Margaret Thatcher's premiership, wealth inequality began to rise. Greater wealth concentration was the result of a number of factors including: greater earnings disparities between the top and bottom of the distribution, a fall in tax progressivity, higher returns on financial assets disproportionately owned by the wealthy and the privatization of large parts of formerly state-run industry.

In France, there were strong short-run fluctuations around 2000, with a substantial rise in top 10% wealth share (up to 57% in 2000) followed by a decline (53% in 2004). This was entirely due to large movements in relative asset prices. Indeed, stock prices were very high in France during the "dotcom bubble" in 2000, as compared to housing prices, which favored the upper class relative to the middle class.

However, despite these fluctuations, the longer-term trend was unchanged. In 2014, the share of total wealth held by the top 10% had increased to 55% in France and the figure was 52% in the UK in 2012, while the shares of the wealthiest 1% reached 23% and 20%, respectively. The rise in wealth inequality in the 2000s was moderate as the rise in general house prices experienced before and over this period improved the value of property wealth—assets held in greater proportion by the middle 40%—thus comforting the share of the patrimonial middle class.

We should note, however, that high housing prices have ambiguous and contradictory effects on wealth inequality. On the one hand, high housing prices can mitigate rising inequality between the middle and the top, in the sense that property owning middle classes—who typically own most of their assets in housing—benefit from an increase in the value of their wealth that is stronger than the upper groups—who mostly own financial assets. But on the other hand high housing prices make it for difficult for the poorer groups to access real estate property to begin with, and this can lead to rising inequality between the poor and the middle. High property prices also create new forms of inequality, for instance between those who bought real estate at the right time and those who did not, or between young wage-earners who can benefit from parental wealth and inter vivos gifts to become home owners and those who remain tenants forever. These are new forms of inequality which have become increasingly important for the generations born in the 1970s–1980s and after, and which were much less important for the earlier cohorts (in particular for those generations born in the 1940s–1950s, who could purchase housing assets at relatively low price with their labor income only).[5]

Property prices also played an important equalizing role for wealth inequality in Spain

The housing market has also played an important role among other European countries. Spain experienced fluctuations in its wealth concentration across the last decades, but inequality has remained broadly stable as a result of housing market evolutions. Asset price movements were key in determining short-run wealth inequality levels. In particular, the country's housing boom saw property prices triple between 1984 and 1990, and triple again between 1996 and 2008, led to volatility in wealth concentration trends throughout the period between 1984 and 2013. As the wealthiest individuals in Spain bought deeper into the property market through multiple property purchases, the bursting of this bubble in 2008 thus had larger impact on top 10% and top 1%, neutralizing their previously made gains. A similar story is also evident in the midst of the dot-com boom and bust as the wealth share of the top 1% peaks at around 28% in 2000.

Policies and institutions drive long-run wealth inequality through their impact on returns on capital and savings rates.

In the long-run, it is the inequality of savings rates between individuals and the differential between rates of return and growth that determine wealth concentration.[6] Earlier work has shown that wealth inequality within the top wealth groups increases in line with the difference between the rate of return and the rate of growth (r–g).[7] Intuitively, the higher the gap between growth and the rate of return on capital (r > g), the more wealth inequality is amplified as capital is concentrated in the hands of the wealthy. It implies that past wealth is capitalized at a faster pace, and that it is less likely to be overtaken by the general growth of the economy. As was already mentioned above, this effect can be strongly reinforced by the fact that rates of returns tend to increase with the level of wealth: the rates of return available for large financial portfolios usually have little do with those open to small deposits.

Small changes in savings rates can also have a very large impact on wealth inequality, though it may take several decades and even generations for their impacts to play out. These forces have been evident in France, the UK, and the United States, which all exhibit large differences between the savings rates of the wealthiest individuals and the rest of the distribution. In France, the top 10% of wealth holders generally saved between 20%–30% of their annual incomes between 1970 and 2012, but this fraction was much smaller and fell notably over the period for the middle 40%, from 15% of annual income in 1970 to less than 5% by 2012, while savings rates among the bottom 50% fell from 8% to approximately 0%. In the United States, the savings rate of the bottom 90% of families fell sharply since the 1970s, while it has remained roughly stable for the top 1%. The annual saving rate of the bottom 90% fell from around 5–10% in the late 1970s and early 1980s to around -5% in the mid-2000s, before bouncing back to about 0% after the Great Recession. These falls in saving rates amongst the bottom 90% have been largely the consequence of increases in household debt, particularly from mortgages.

Assuming the same inequality of saving rates that were observed in France over the 1984–

2014 period—namely 24.5% for the top 10% and 2.5% for the bottom 90%—will persist, together with the same inequality of rates of return and the same inequality of labor income, the share of total wealth owned by the top 10% in France will gradually increase to the levels that were observed in the nineteenth and early twentieth centuries, that is, approximately 85% of total wealth. If, however, the 1970–1984 trends had persisted after 1984 and continued during the upcoming decades, the top 10% would have owned only slightly more than 45% of total wealth today and this figure would further decrease throughout the twenty-first century.

4.3

WEALTH INEQUALITY IN THE UNITED STATES

Information in this chapter is based on the article "Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data," by Emmanuel Saez and Gabriel Zucman, 2016. *Quarterly Journal of Economics*, 131(2), 519–578.

- Top wealth shares have been risen since the mid-1980s to 2012, with the top 0.1% driving wealth concentration at the top; their wealth share grew threefold from 7% in 1978 to 22% in 2012, a level comparable to that of the early twentieth century.
- United States wealth inequality had previously fallen considerably from the 1930s and 1940s, due to drastic policy changes that were part of the New Deal. These policies included the introduction of progressive income and estate taxation, and greater financial regulation.
- The key driver of this rapid increase in wealth concentration since the 1980s has been an upsurge of top incomes combined with an increase in saving rate inequality across wealth groups. This has had a reinforcing, "snowballing" effect as the accumulation of financial assets by the wealthy has led to a rise in capital income concentrations, allowing for more wealth accumulation at the top.
- The declining wealth share of the bottom 90% of the distribution is the result of plummeting middle-class savings, as their mortgage, consumer credit, and student debt has greatly increased.

Wealth inequality in the United States has risen rapidly and consistently since the mid-1980s

To fix notions of wealth inequality in the United States, it is perhaps best to first consider the distribution of the country's wealth in 2012 that is outlined in **Table 4.3.1**. The average net wealth per family was over $384 000, but this average masks a large heterogeneity. The bottom 90%—a group of almost 145 million families who possess approximately $94 000 on average—collectively own about as much of the total household wealth (22%) as the 161 000 families who are included in the top 0.1%; their average wealth was approximately $82 million, 845 times larger than the bottom 90%. Wealth is much more concentrated than income in the United States, as the top 0.1% wealth share is about as large as the income share of the top 1%.

Rising wealth inequality since the 1980s is almost entirely due to the top 0.1%

Wealth is becoming significantly more concentrated in the United States, but this trend is not the result of tens of millions of Americans seeing a rise in their fortunes. It is rather the spectacular dynamics of a tiny group of the population owning more than $4.4 million—the entry price of the top 1%.

Top wealth shares have risen sharply since the mid-1980s. Indeed, the share of wealth held by the top 10% in 1985 was approximately 63%, the lowest value it had reached since 1917. But by 2012, the wealth share of the top 10% had reached over 77%, an additional 13 percentage points. More than three quarters of all wealth in America was owned by just ten percent of its population.

Table 4.3.1
The distribution of household wealth in the US, 2012

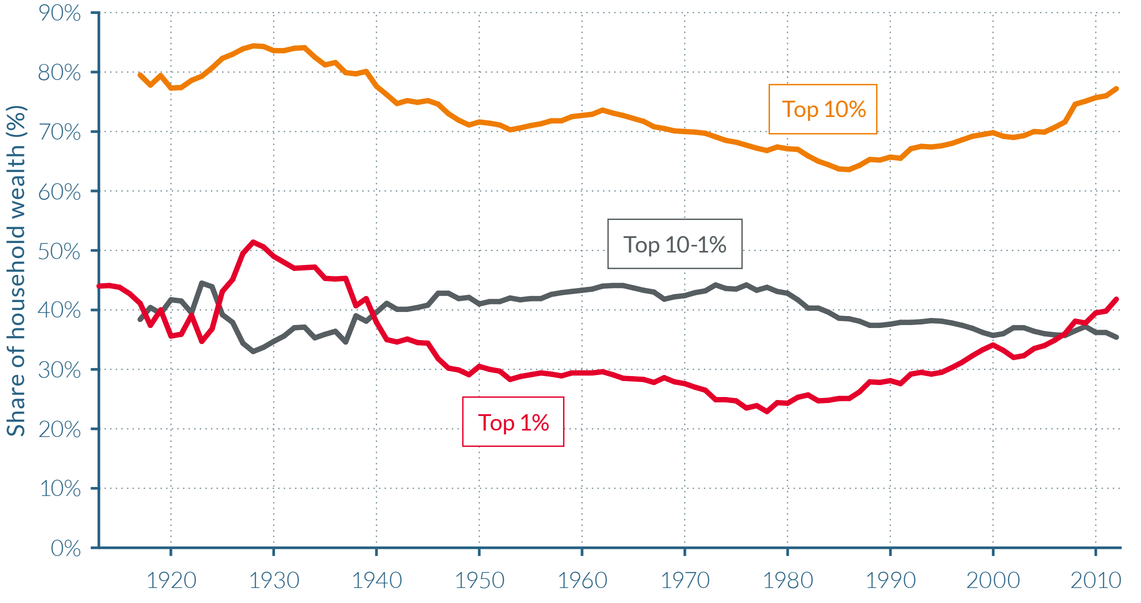
Wealth group	Number of families	Wealth threshold ($)	Average wealth ($)	Wealth share
A. Top Wealth groups				
Full Population	160 700 000	–	384 000	100%
Top 10%	16 070 000	740 000	2 871 000	77.2%
Top 1%	1 607 000	4 442 000	15 526 000	41.8%
Top 0.1%	160 700	23 110 000	81 671 000	22.0%
Top 0.01%	16 070	124 525 000	416 205 000	11.2%
B. Intermediate Wealth groups				
Bottom 90%	144 600 000	–	94 000	22.8%
Top 10–1%	14 463 000	740 000	1 470 000	35.4%
Top 1–0.1%	1 446 300	4 442 000	8 178 000	19.8%
Top 0.1–0.01%	144 600	23 110 000	44 537 000	10.8%
Top 0.01%	16 070	124 525 000	416 205 000	11.2%

Source: Saez & Zucman (2016). See wir2018.wid.world for data series and notes.

In 2012, the average wealth of the Top 10% in the US was $2 871 000. All values have been converted to 2016 constant US dollars (accounting for inflation). For comparison, $1 = €0.9 = ¥6.6 at market exchange rates. Numbers may not add up due to rounding.

Figure 4.3.1a

Wealth shares of the Top 10%, Top 10-1% and Top 1% in the US, 1913–2012



Source: Saez & Zucman (2016). See wir2018.wid.world for data series and notes.

In 2012, the share of household wealth owned by the Top 10% in the US was 77%.

However, since the mid-1980s, the wealth share of families belonging to the top 10% but not to the top 1% has decreased. In fact, the share of total wealth owned by the top 1% increased at a faster pace (up by around 17 percentage points) than the top 10% between 1986 and 2012 (see **Figure 4.3.1a**). The rise in the wealth share of the top 1% itself owes almost all of its increase to the growth of the top 0.1% share which rose from 7% to 22% (15 percentage points). The wealth share of the top 0.1% was thus larger than the share of the top 1–0.1% (that is the top 1% minus the top 0.1%) in 2012, having tripled since 1978. Almost all of the top 1% and top 10% increase over the past four decades has been due to the top 0.1% alone.

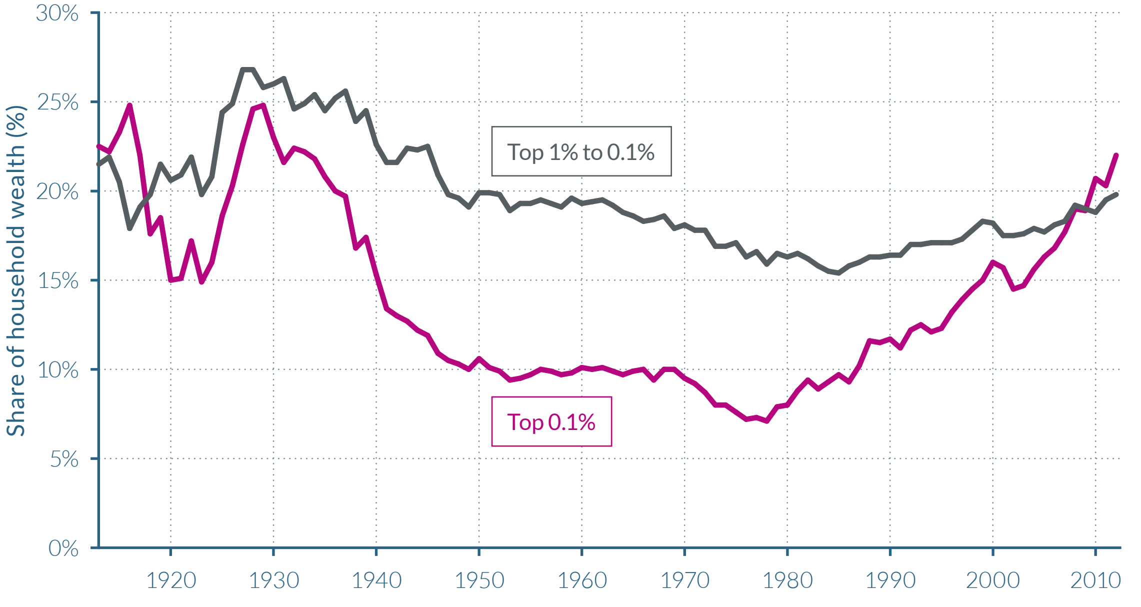
The recent rises in wealth concentration contrasts with continual reductions over the previous half-century

The significant increase in the wealth shares of America's wealthiest since the mid-1980s is in direct contrast to the trend that followed the Great Depression. The Roaring Twenties saw a huge rise in wealth concentration, as the top 1% accumulated a significantly larger share of total wealth over the decade, rising from 35% in 1923 to almost 52% by 1928, and the top 10% wealth share peaked at 84%. But the impact of the Great Depression, and the New Deal policies implemented under Franklin Roosevelt's Presidency, quickly saw this trend reverse.

Wealth inequality fell at a tremendous pace from 1929 until around the end of the Second World War. The loss in the value of financial assets from the collapse of the stock market and the introduction of financial regulation during the New Deal reduced the role of finance and the ability to concentrate wealth relative to the Gilded Age model of the financier-industrialist, while the development of progressive income and estate taxation made it difficult to accumulate and pass on large fortunes. Correspondingly, the share of the top 1% fell from 52% of total wealth to 29%

Figure 4.3.1b

Wealth shares of the Top 1-0.1% and Top 0.1% in the US, 1913–2012



Source: Saez & Zucman (2016). See wir2018.wid.world for data series and notes.
In 2012, the share of household wealth owned by the Top 0.1% in the US was 22%.

by 1949. Their falling shares were not just accumulated by the top 10–1% either, as illustrated by **Figure 4.3.1b**, as the share of total wealth rose from 33% to 42%, leaving the bottom 90% with a 29% share, equal to that of the top 1%.

Following the Second World War, wealth inequality rose moderately, before falling again from the early 1960s onwards. The wealth share of the top 10% grew from around 70% to 74% in 1962, before falling in almost every year until the mid-1980s, by which point their share had dipped below 65% of total wealth. As previously described, the Reagan era of deregulation and reduced tax progressivity formed a turning point in wealth inequalities in America. The top personal income tax rate from 50% in 1986 to 28% in 1988, well below the corporate tax rate of 35%.

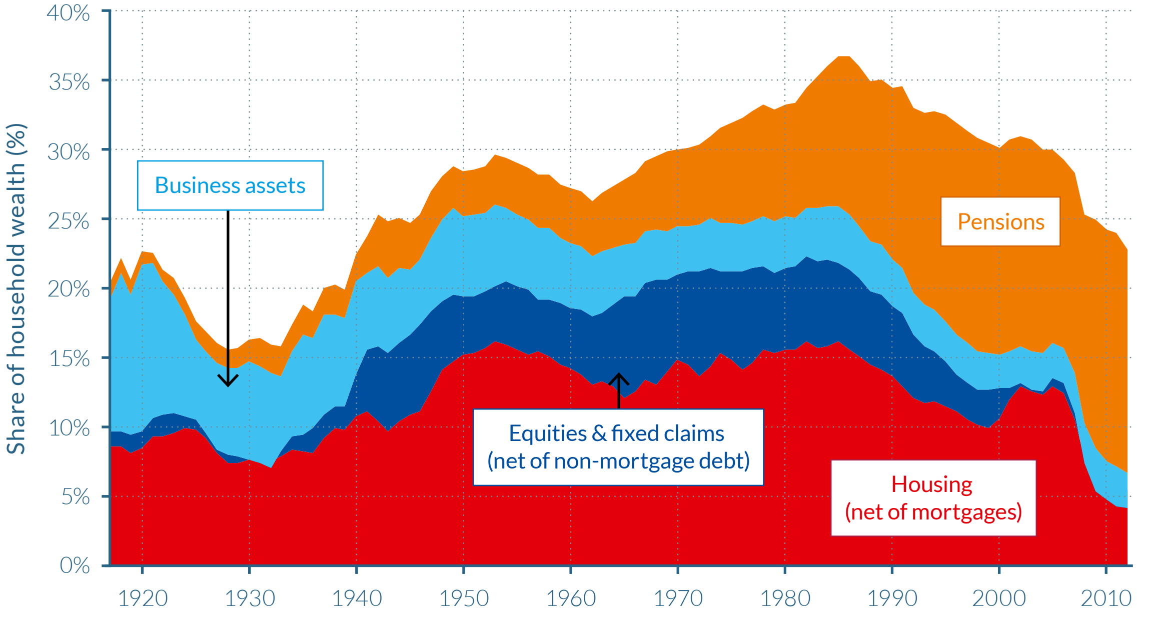
The rise and fall of middle-class wealth

The second key result of the analysis involves the dynamics of the wealth share of the bottom 90%. Since the bottom half of the distribution always owns close to zero net wealth, that is, when including negative wealth such as credit card and housing debt, the wealth share of the bottom 90% is therefore equal to the share of wealth owned by the middle 40% group, above the bottom 50% but below the top 10%. Within this "middle class", the share of total wealth owned in 2012 was the same as it was 70 years earlier, despite a rise in the value of their pensions and an increase in their home ownership rates.

The share of wealth owned by the middle class began to increase from the early 1930s, and peaked in the mid-1980s. It has subsequently undergone a continuous decline, as illustrated by **Figure 4.3.2**. The large rise in the wealth share of the bottom 90%, from 16% in the early 1930s to 35% in the mid-1980s, was driven by the group's accumulation of housing wealth, and to a greater extent by pensions. Pensions were almost nonexistent at the beginning of the

Figure 4.3.2

Composition of the wealth share of the Bottom 90% in the US, 1917–2012



Source: Saez & Zucman (2016). See wir2018.wid.world for data series and notes.

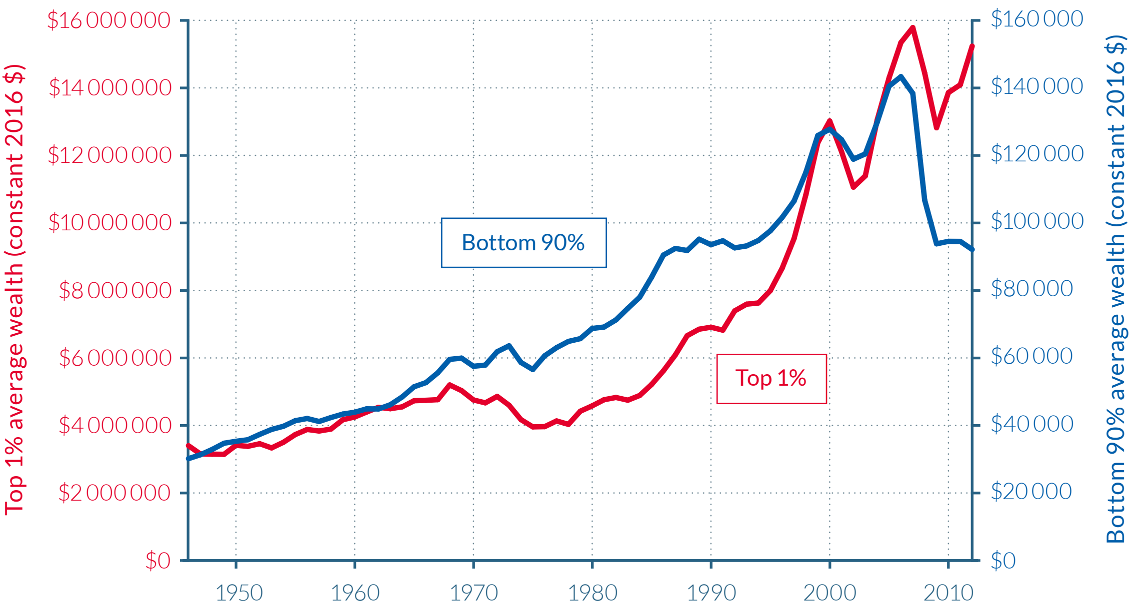
In 2012, the share of household wealth held by the Bottom 90% in the US was 23%. Pensions made up 16 percentage points of the group's household wealth share.

twentieth century, but developed in the form of defined benefits plans, and then from the 1980s in the form of defined contribution plans such as Individual Retirement Accounts and the so called 401(k)s (the latter referring to a section of the United States tax code).

The declining share in the wealth share of the bottom 90% that occurred from the mid-1980s was due to a fall in two components of middle class wealth, namely the housing component (net of mortgage debt) and the fixed income component (net of non-mortgage debt). This fall was mostly the consequence of an upsurge in debt, as aggregate household debt, including mortgages, student loans, credit cards, and other debts, increased from 75% of national income in the mid-1980s to 135% in 2009. The financial crisis of 2007–2009 and the Great Recession then hit the middle class hard. The share of wealth owned by the bottom 90% collapsed between mid-2007 and mid-2008 because of the crash in housing prices, and the subsequent recovery was uneven: over 2009–2012, real wealth per family declined 0.6% per year for the bottom 90%, while it rose 7.9% per year for the top 0.1%.

Despite a reduction in debt levels in the wake of the Great Recession as the middle class sold a proportion of their assets, their debt still amounted to close to 110% of national income in 2012. This upsurge in the debt of the middle class has had a dramatic effect on middle-class wealth as approximately 90% of (non-mortgage) debt belongs to the bottom 90% of the wealth distribution, being sufficiently large to more than offset the rise in the value of their pensions. Strikingly, the average real wealth of the bottom 90% of families was no higher in 2012 than in 1986. Real average wealth of the bottom 90% rose considerably during the late 1990s tech-boom and the mid-2000s housing bubble, peaking at \$143 000 in 2006, but then collapsed to about \$93 800 in 2009 (at constant 2016 \$), as depicted in **Figure 4.3.3**.

Figure 4.3.3
Average wealth of the Bottom 90% and Top 1% in the US, 1946–2012



Source: Saez & Zucman (2016). See wir2018.wid.world for data series and notes.

In 2012, the average real wealth of the Bottom 90% households was $92 100, while the average real wealth of the Top 1% was $15 237 000. All values have been converted to 2016 constant US dollars (accounting for inflation). For comparison, $1 = €0.9 = ¥6.6 at market exchange rates.

The dynamics of savings rates explains much of the evolution of wealth inequality

Inequalities in income shares and savings rates have been shown to have an impact on wealth dynamics in the long run.[8] There has been a significant difference in the savings rates of the different US wealth groups between 1917 and 2012. The bottom 90% of wealth holders saved approximately 3% of their income on average over the period, while the 10–1% grouping saved about 15% of their income and the top 1%, around 20–25%. The main exception was during the Great Depression (1929–1939), during which the savings rate of the top 1% was substantially negative, because corporations had zero or even negative profits, but still paid out dividends. This period of negative saving at the top greatly contributed to the fall in top wealth shares during the 1930s described above.

Savings rate inequality has also increased in recent decades. The saving rate of bottom 90% families has fallen sharply since the 1970s, while it has remained roughly stable for the top 1%. The annual saving rate of the bottom 90% fell from around 5–10% in the late 1970s and early 1980s to around -5% in the mid-2000s, before bouncing back to about 0% after the Great Recession (from around 2008–2011). From 1998 to 2008, the bottom 90% dis-saved (spent on credit) each year due to massive increases in debt, in particular mortgages, fueled by an unprecedented rise in housing prices.[9] Concurrently, the top 1% continued to save at a high rate, and so the relative savings rate of the bottom 90% and the top 10–1% collapsed.

While the fall in the savings of the middle class explains much of the decline in the wealth share of the bottom 90%, rising income inequality has nonetheless had several noteworthy impacts on the dynamics of wealth inequality in the United States. Firstly, the fall in the savings rate of the bottom 90% saving rate might itself be a consequence of the increase in income inequality and the lackluster growth of middle-class income, further accentuating wealth inequality.[10] Secondly, simulations indicate that if the bottom 90% had maintained a constant share of national income, as well as saving at 3% per year then its wealth share would have declined little since the mid-1980s and would be equal to about 33% in 2012 (rather than its actual level of 23%). And finally, rising income inequality at the top has had a significant impact on the wealth shares of the groups at the top of the wealth distribution. For example, the share of income earned by families in the top 1% of the wealth distribution doubled since the late 1970s, to about 16% in recent years. This increase is relatively larger than the increase in the wealth share of the top 1%, suggesting that the main driver of the growth in the wealth share of the top 1% is the upsurge of their income.

4.4

WEALTH INEQUALITY IN FRANCE

Information in this chapter is based on "Accounting for Wealth Inequality Dynamics: Methods, Estimates and Simulations for France (1800–2014)," by Bertrand Garbinti, Jonathan Goupille-Lebret and Thomas Piketty, 2016. WID.world Working Paper Series (No. 2016/5).

- ▷ Wealth inequality rose moderately in France since the mid-1980s. In 2014, the top 10% owned 55% of total French wealth, up from 50% in 1984, its lowest level ever recorded.
- ▷ Wealth inequality has fallen dramatically between 1914 and 1984. In the early 1900s, the wealth share of the top 1% amounted to 55% of total wealth. Large shocks between 1914 and 1945 (depression, inflation, wars) followed by nationalizations, rent control and tax policies reduced the share of the wealthiest 1% to around 16% by the early 1980s.
- ▷ The 1980–1984 period saw the rising prosperity of the middle class as significant increases in the group's absolute wealth levels were experienced. This was in part due to the rise of their saving rates during this high-growth period.
- ▷ The rise in housing prices also played a crucial role in moderating the increase in wealth inequality after 1984, as these assets form a large part of the portfolio of the middle class.
- ▷ The long-run dynamics of wealth inequality are largely governed by the inequality of savings rates, themselves driven by habit formation, income inequality and tax and regulatory policies.
- ▷ Small variations in savings rates and rates of return can have substantial, long term impacts on wealth inequality. If the recent trends are prolonged, wealth inequality could return to its 1900 level by the end of the century.

The top 10% richest French own 55% of total wealth, while the middle 40% owns 38%.

If France's total wealth was equally shared amongst the French adult population in 2014, each adult would own approximately €201 000 in net wealth. However, as **Table 4.4.1** indicates, this was far from the case. The least wealthy half of the adult population have around €25 500 in assets, equal to one-eighth of the national average and which amounted collectively to 6% of the country's total wealth. The average wealth of the middle 40% is almost equal to that of the national average at €193 000, and hence their share of total wealth, at 38%, almost represents what it would have been if French wealth was shared equally. French adults need to own assets totaling over €402 000 to be counted in the top 10%, a group whose average wealth was close to €1.1 million, five-and-a-half times the national average and 43 times the average wealth of the bottom 50%.

Wealth in France is even more highly concentrated among the top 10%. This is immediately obvious when analyzing the wealth share of the top 1%: at 23.4% of total wealth and average net assets of over €4.7 million, their share is almost as large as the wealthiest 10% of the population excluding the top 1%, that is, the 10%–1%. To be amongst the top 0.1%, French adults must have wealth totaling nearly €7.6 million, with the average for the group closer to €16.5 million. The total wealth of this group of 52 000 adults is thus a third larger than that of the 26 million adults in the bottom 50%. At almost €184 million, the average wealth of the 520 adults in the top 0.001% is 914 times the national average and almost 180 times the average of their peers in the top 10% group.

Wealth inequality has fallen dramatically since the early twentieth Century leading to the creation of a patrimonial middle class

Current levels of wealth inequality are far from their early twentieth century levels. During the nineteenth and early twentieth century, wealth concentration remained stable at an extremely elevated rate. As noted in *Capital in the Twenty-First Century*,[11] while the French Revolution is likely to have reduced wealth concentration in France with the end of fiscal privileges new taxes on

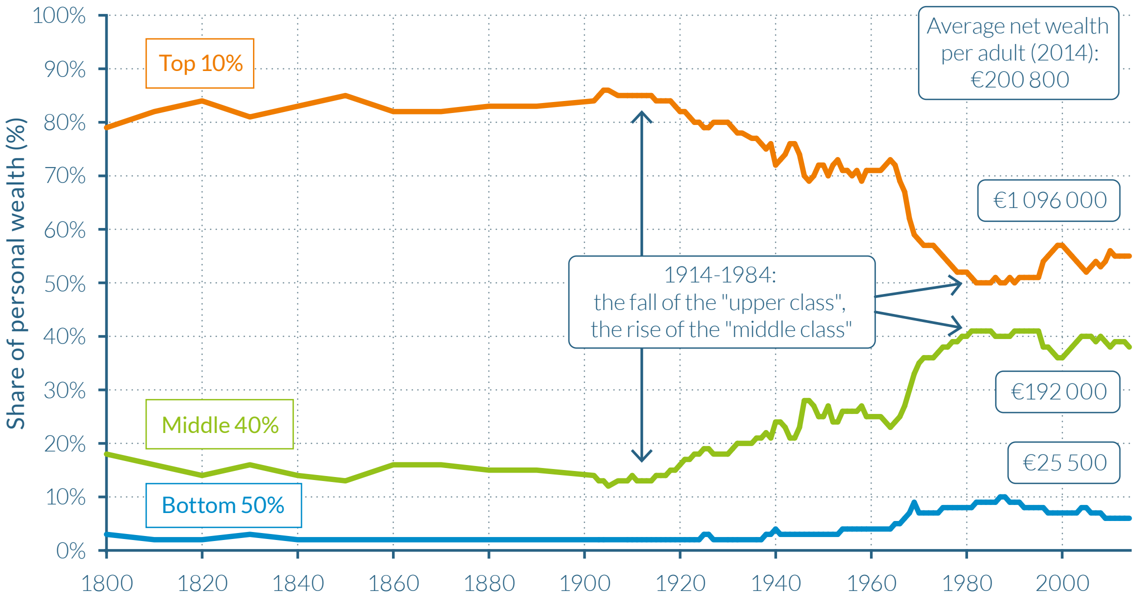
Table 4.4.1
The distribution of personal wealth in France, 2014

Wealth group	Number of families	Wealth threshold (€)	Average wealth (€)	Wealth share
Full Population	51 720 000	–	201 000	100%
Bottom 50%	25 860 000	–	25 500	6.3%
Middle 40%	20 690 000	99 000	193 000	38.4%
Top 10%	5 172 000	402 000	1 097 000	54.5%
Top 1%	517 000	2 024 000	4 703 000	23.4%
Top 0.1%	51 700	7 612 000	16 506 000	8.2%
Top 0.01%	5 170	26 668 000	55 724 000	2.8%
Top 0.001%	517	88 916 000	183 819 000	0.9%

Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, the average wealth of the Top 10% in France was €1 097 000. All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates. Numbers may not add up due to rounding.

Figure 4.4.1
Wealth shares in France, 1800–2014



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, the share of personal wealth held by the Top 10% in France was 55%. All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates.

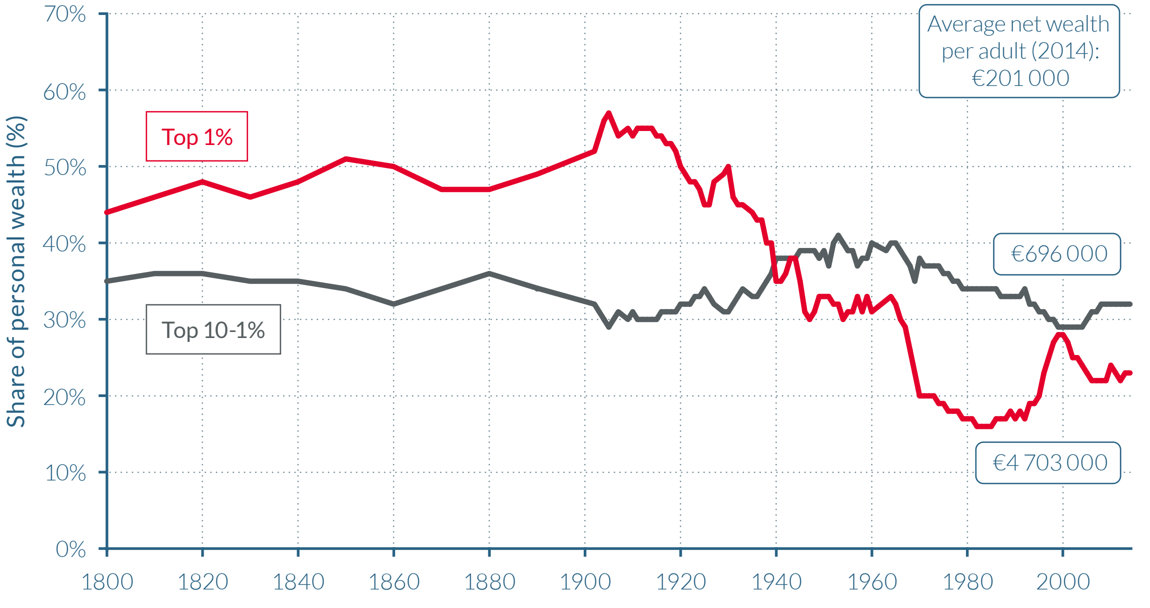
wealth, it is interesting to note that wealth remained highly concentrated in 1800 and throughout the nineteenth Century. During the French Third Republic (1870–1940), which brought forward ideals of republican meritocracy, wealth concentration increased rather than decreased. On the eve of the First World War, the share of the top 10% was around 85% of total wealth, while the middle 40% owned a little less than 15% of French wealth, leaving the bottom 50% with almost no wealth. In a sense, there was no "middle class": the middle 40% was almost as propertyless as the bottom 50%. As can be observed in **Figure 4.4.1**, the wealth held by the top 10% between 1800 and 1914 was dominated by that of the top 1%, who held almost double the wealth of the top 10–1% at the beginning of the 1900s.

The top 10% wealth share started to fall following the 1914–1945 capital shocks. The First and Second World Wars caused huge losses in the aggregate wealth-income ratio—from around 700% to less than 200%—as significant stocks of total wealth were destroyed. This had a profound impact on wealth inequality in France. The share of total wealth held by the top 1% almost halved between the start of the First and the end of the Second World War, falling from around 55% to 30% to the benefit of the middle class.

The rise of the middle 40% during the 1914–1945 period is not due to the fact that the middle class accumulated a lot of wealth during this period: this simply corresponds to the fact they lost less wealth—in proportion to their initial wealth level-than the top 10%. In contrast, during the postwar decades, the rise of the middle class corresponds to a significant rise of their absolute wealth levels partly due to the rise of their savings rates during the high-growth period.

This fall in wealth inequality continued until the early 1980s, and fell to its lowest level recorded in 1983–1984. The share of total

Figure 4.4.2
Top wealth shares in France, 1800–2014



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, the share of personal wealth held by the Top 1% was 24%. All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates.

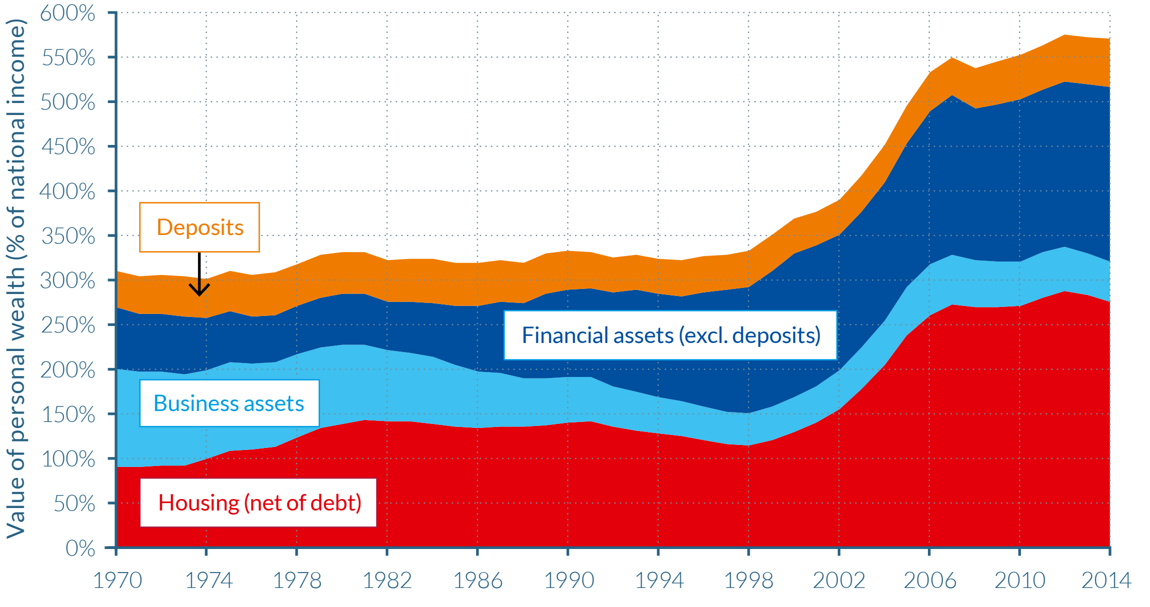
wealth held by the top 1% and the top 10–1% fluctuated during the mid-1940s to mid-1960s, between 30%–35% and around 35%–40%, respectively, while the middle 40% share of total wealth rose from around 20% to 25%. Top 1% shares dropped from around 33% in 1945 to just over 15% by 1984, while the middle 40%, rose from 25% to over 40%. (See **Figure 4.4.1** and **Figure 4.4.2**.)

Wealth has increased moderately since 1984

Wealth inequality increased moderately since the early 1980s. In 1984, French wealth was the least concentrated it had been since data collection began at the beginning of the nineteenth century. But as the 1980s progressed, wealth inequality began to increase notably. The introduction of more laissez-faire economic policies, including the privatizations of large state-owned enterprises and the development of financial markets, that followed then President Mitterrand's austerity turn in 1982–1983 (see Chapter 2.2 for more detail) saw the wealth share of the top 10% wealthiest French adults increase to around 53% by 1990 and 56% by 1995. This came at the expense of the wealth shares of the both the middle-class and the lower class, whose shares fell to around 49% and 6%, respectively, by the mid-1990s.

Wealth concentration then rose at a significant rate in the years of the dot-com boom. By 2000, the wealth share of the top 10% passed 60%, leaving the middle 40% with less than 35% and the bottom 50% with around 6%. The year 2000 did, however, appear to be somewhat of a turning point, illustrating the strong short-run fluctuations in wealth concentration experienced over the last three decades. The shares of the middle 40% then began to rise and those of the top 10% fall as stock prices crashed in the wake of the bursting of the dot-com bubble in 2000, and house prices increased at a solid rate. These

Figure 4.4.3
Composition of personal wealth in France, 1970–2014



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.
In 2014, the value of personal wealth was equal to 571% of national income.

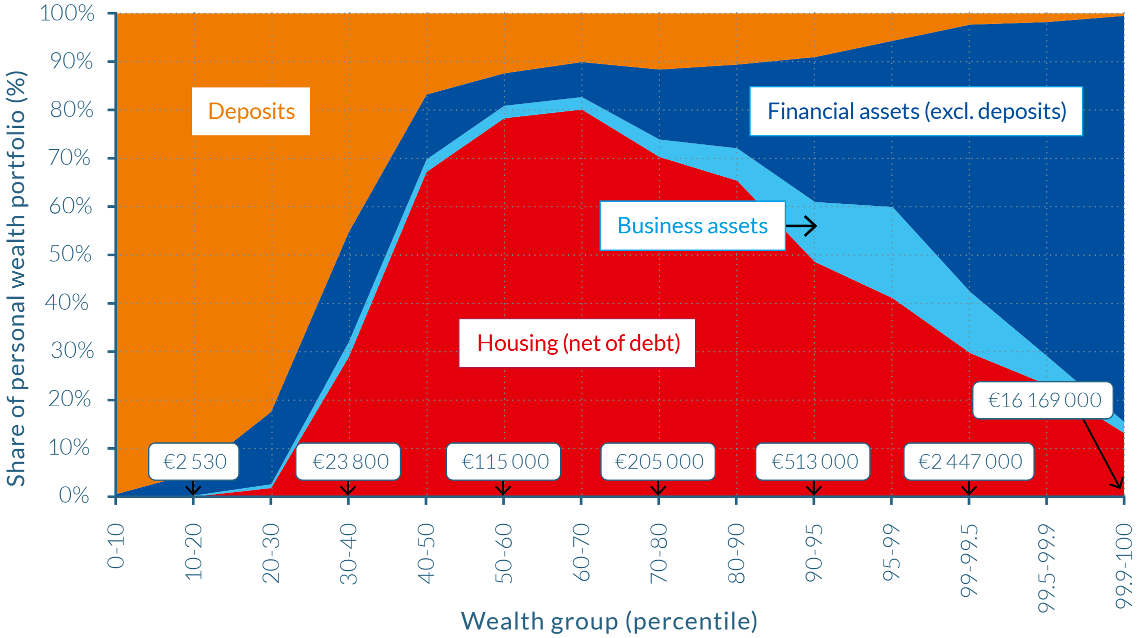
relative movements in asset prices (discussed in more detail below) left the top 10% with approximately 56% of total wealth in 2005, the middle 40% with around 38% and the bottom 50% with the remaining 6%. The share of the bottom 50% thus remained unchanged during the first five years of the new millennium, despite the substantial changes for the other half of France's adult population.

The following years leading up-to and following the global financial crisis of 2008–2009 had a rather muted impact on wealth inequality in France. The share of total wealth held by the top 10% increased to around 59% in 2010, while those of the middle 40% remained almost unaffected. It was the bottom 50% who suffered instead, seeing their share of total wealth fall to just 5%. The following two years show slight falls in the wealth share of the top 10% and a small increase for the bottom 50%, again changes in the shares of the middle 40% were negligible.

Differences in asset portfolios among wealth groups are key in determining wealth inequality dynamics over the recent period

Before we move on to analyzing wealth inequality within asset categories, it is important to recall that the composition and level of aggregate wealth changed substantially in France over the 1970–2014 period, as depicted by **Figure 4.4.3**. Observing this figure, it is clear to see that the shares of housing assets and financial assets have increased substantially, while the share of business assets has declined markedly, the latter largely due to the fall in self-employment. Financial assets, other than deposits, increased strongly after the privatization of the late 1980s and the 1990s and reached a high point in 2000 as the stock market boomed in the run-up to the dot-com crash. In contrast, housing prices declined in the early 1990s, but then rose strongly during the 2000s, while stock prices were falling.

Figure 4.4.4
Asset composition by wealth group in France, 2012



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2012, 67% of the personal wealth of the 5th decile (p50-p60) was composed of housing assets (net of debt). All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates.

These contradictory movements in relative asset prices have an important impact on the evolution of wealth inequality in France, as different wealth groups own very different asset portfolios. As depicted by **Figure 4.4.4**, the bottom 30% of the distribution own mostly deposits in 2012, while housing assets are the main form of wealth for the middle of the distribution. However, as one move towards the top 10% and the top 1% of the distribution, financial assets—other than deposits—gradually become the dominant form of wealth, largely because of their large equity portfolios. These general patterns of asset portfolio construction remain relatively constant throughout the 1970–2014 period, except that business assets played a more important role during the 1970s and early 1980s, particularly among middle-high-wealth holders.

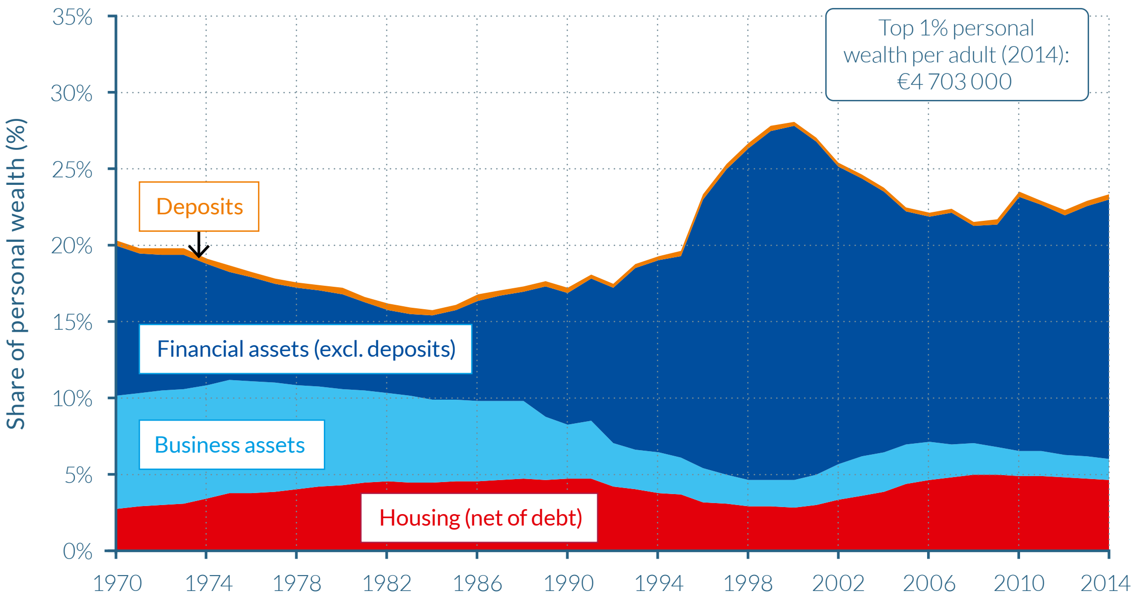
If one now decomposes the evolution of wealth shares going to the bottom 50%, middle 40%, top 10%, and top 1% by asset categories, the impact of asset price movements on inequality is significant. In particular, **Figure 4.4.5**, indicates the significant impact the stock market boom of the 2000s and its slide thereafter had on top wealth shares in particular. It also shows the effect of the general increase in housing prices on the wealth shares of the middle 40% during the 2000s, further discussed below.

Rising housing prices moderated wealth concentration since the 1980s

Changes to house prices played a notable role in reducing wealth inequality in France between 1970 and 2014. Similar to trends in a number of other rich nations, house prices in France increased at a faster pace than consumer price inflation (2.4% faster per year) and thus the total return to French adults owning property was significant, growing at an annual rate of over 6% during

Figure 4.4.5a

Composition of the wealth share of the Top 1% in France, 1970–2014

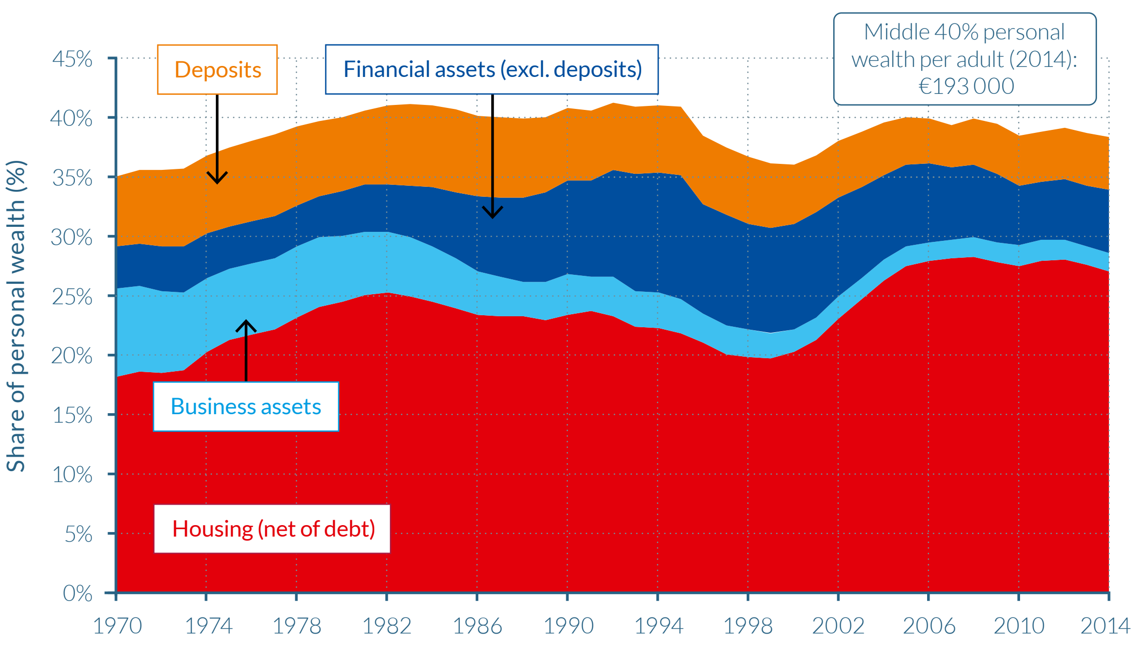


Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, the Top 1% owned 17% of personal wealth in financial assets, excluding deposits. All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates.

Figure 4.4.5b

Composition of the wealth share of the Middle 40% in France, 1970–2014



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2014, the Middle 40% owned 27% of personal wealth in housing (net of debt). All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates.

the observed period. However, this structural increase in house prices has been far from steady, rising particularly strongly between 2000 and 2008, and therefore generated large short-run, rather than long-run, fluctuations in wealth inequality.

The explanation for the short-term fluctuation in wealth concentration experienced as financial asset prices increased up to the beginning of the twenty-first century also follows the same line of reasoning. During the stock market boom, wealth inequality in France increased substantially due to the bias towards financial asset holdings amongst the wealthiest. However, the reasoning also follows that these increases in asset prices can be discounted as an explanation for the long-run increase in inequality over the period, alongside the changes in house prices.

Once variations in asset prices are corrected for, the data indicates that structural factors have caused a rise in the concentration of wealth between 1970 and 2014. The housing boom of the 2000s did, however, play an important role as a mitigating force to limit the rise of inequality, as the structural increase in the wealth shares of the top 10% and top 1% over the 1984–2014 period would have been substantially larger had housing prices not increased so fast during these years relative to other asset prices.

France is also a clear illustration of the fact that housing prices have an ambiguous and contradictory impact on inequality. They raised the market value of the wealth of the middle class—those who were able to access real estate—and thereby raised the wealth share of the middle 40% relative to the top 10%, whose asset portfolios are more diversified and contain relatively less real estate. But, rising housing prices also made it more difficult for people in the lower and working classes (the bottom 50%), and also members of the middle class with no family wealth, to access real estate.

Higher savings rates and returns on assets for the wealthy increased wealth concentration since the 1980s

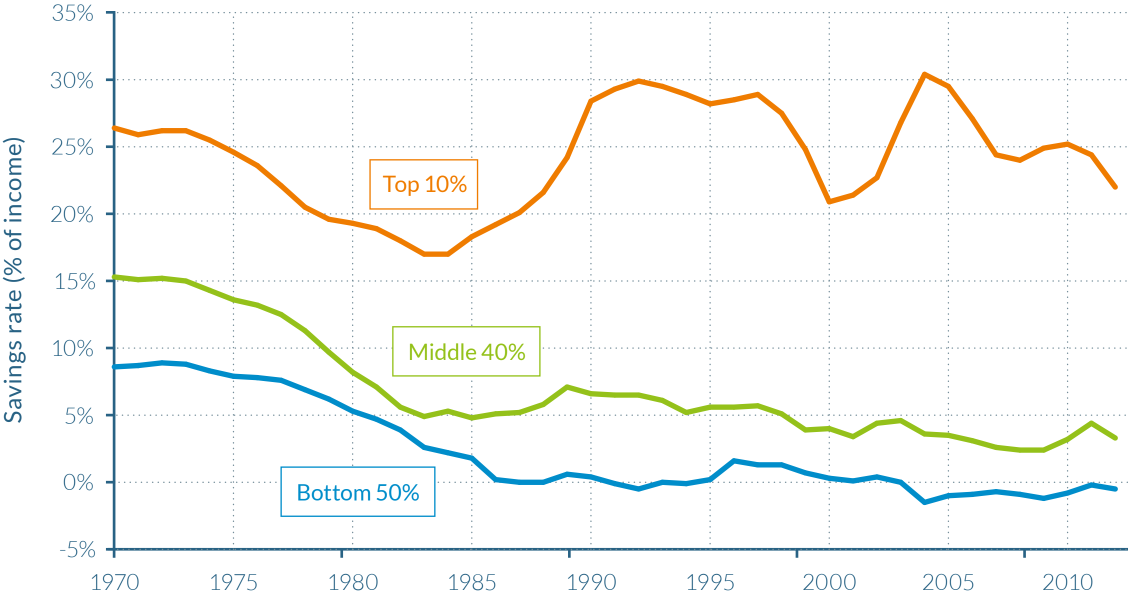
In the long-run, it is the savings rates of groups and the long-run rate of return on the type of wealth (assets) that they hold that determine wealth concentration.[12] In particular, if the savings rates and/or the rates of return of the top wealth groups are higher than the average, this can generate large multiplicative effects, and lead to very high wealth concentrations.

As illustrated by **Figure 4.4.6**, there were significant differences in savings rates between wealth groups in France between 1970 and 2012. While the top 10% of wealth holders generally saved between 20%–30% of their annual incomes over the observed period, this fraction was much smaller and fell notably over the period for the middle 40% and the bottom 50%, from 15% of annual income in 1970 to less than 5% by 2012, and from 8% to approximately 0%, respectively. Similar trends were found in the UK and the United States, reinforcing the assertion that savings rate differentials were the key structural force accounting for rising wealth concentration in many developed economies over this period.

Average rates of return on assets also vary significantly between different wealth groups over the 1970–2014 period. The notable inequalities in rates of return between higher and lower wealth groups is due to significant differences in their respective portfolio of assets, as indicated earlier in **Figure 4.4.5**. In particular, top wealth groups own more financial assets, particularly equities, which can have much higher rates of return than real estate assets or savings deposited in financial institutions. Indeed, the average annual return on financial assets such as equities, shares and bonds is over four-times greater than the returns on housing assets, though this difference falls to a more modest 50% when including real capital gains.[13]

Figure 4.4.6

Savings rates by wealth groups in France, 1970–2012



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2012, the Middle 40% saved 3% of income, while the Bottom 50% spent more than they saved.

The elderly hold the keys to French wealth

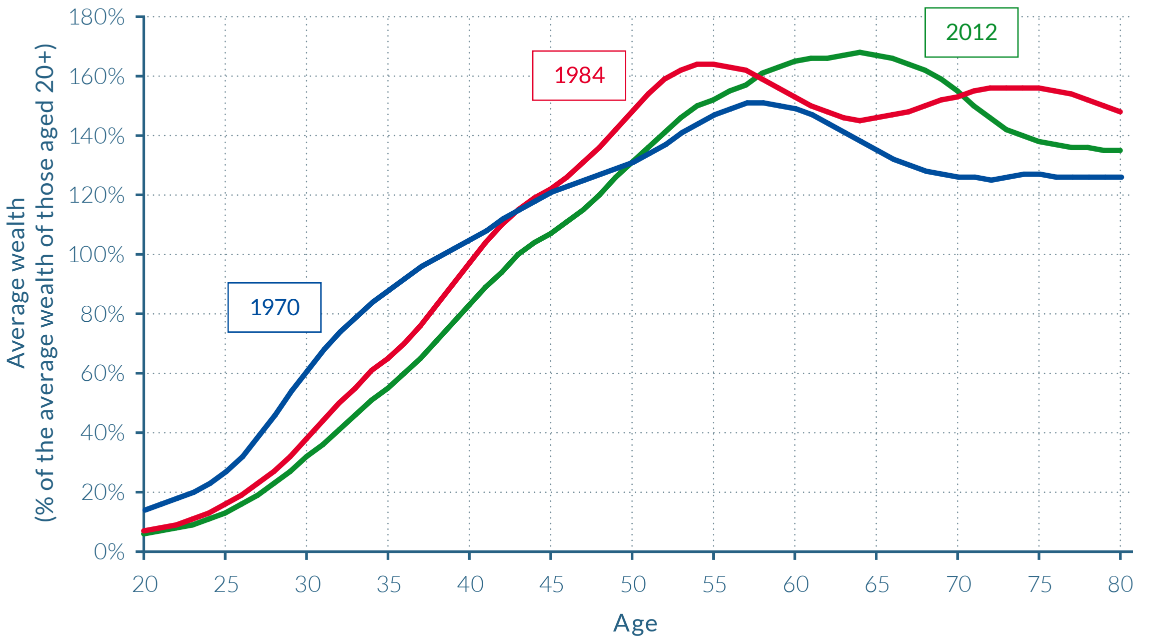
How did wealth inequality evolve across age groups over the recent period? Looking first at the age-wealth profile, it is evident that the average wealth owned by those aged 20 has consistently been very limited at less than 15% of average adult wealth throughout the series history. Wealth then rises sharply with age, peaking between 55–65 years old at 150–170% of average adult wealth depending on which era is examined. Thereafter, wealth slightly declines, but remains at very high levels, around 125%–150% of from age 60 to age 80, as illustrated by **Figure 4.4.7**.

These age-wealth profile slightly evolved over the past fourty years, as wealthiest individuals grew older. In 2010, wealth is accumulated notably later in life than in 1995 and 1970, with wealth peaking at age 65, seven to ten years later than in 1970 and 1995. Note also that old-age individuals make very substantial inter vivos gifts in France, so that average wealth at high ages would be even higher without these gifts, particularly at the end of the period. Gifts are made on average about 10 years before death, and the aggregate gift flow has increased from about 20%–30% of the aggregate bequest flow in the 1970s to as much as 80% of the aggregate bequest flow in the 2000s–2010s.[14]

Habit formation, income inequality dynamics and tax evolutions are likely to drive the inequality of saving rates

While it is not possible to fully explain why saving rates and rates of return change in the way that they do, it is possible to identify key factors that were at play since the early twentieth century. Between 1914 and 1945, one can imagine that the saving rates of the top wealth groups were severely affected by the capital and fiscal shocks of the 1914–1945 period. In particular, there was no progressive taxation prior to 1914, and in the interwar period, effec-

Figure 4.4.7
Age-wealth profiles in France, 1970–2010



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.
In 2010, the average wealth of those aged 50 was 30% more than the average personal wealth of the adult population.

tive tax rates for top income and wealth groups quickly reached very substantial levels, for example 20%–40%, and sometimes even more.[15] In the likely scenario that top wealth holders reacted by reducing their consumption levels and living standards less than the increase in tax (which came in addition to a negative shock to their pre-tax capital incomes), then in effect, they had to reduce their saving rate.

After 1945, those at the bottom and in the middle of the wealth distribution saved at higher rates than before, during the high-growth postwar decades due to some form of "habit formation" effect whereby individuals were prudent with their consumption and saved earnings in case of shocks or crises.[16] It is also possible that rising top income shares in recent decades, together with growth slowdown for bottom and middle groups, has contributed to rising inequality in saving rates, and this has been exacerbated by some form of relative consumption effect (see Chapter 2.5) , whereby the bottom 90% is consuming a greater proportion of their income than the top 10% leaving little savings for investment in assets. This is particularly the case for the bottom 50%.

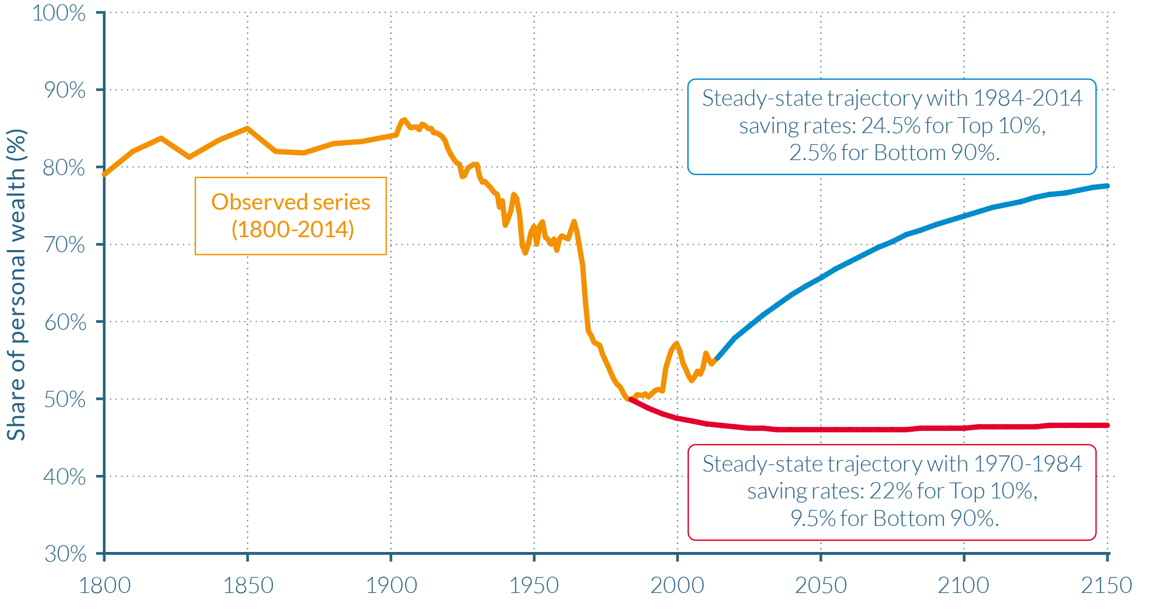
It is clear that changes in the tax system, and in particular in tax progressivity, as seen post World War II and during the 1960s, can have very large impacts on both the inequality of saving rates between groups and on the inequality of rates of return, and therefore on wealth inequality in the long-run. The inequality of rates of return can also be influenced by many other factors, including financial regulation and deregulation seen after the great depression and the reduction in capital controls in the mid- to late-1980s, as well as the introduction and end of rent controls.

Wealth concentration could return to Gilded Age level by 2100

The savings rates and rates of return per wealth group can be used to estimate each

Figure 4.4.8

Top 10% wealth share simulations in France, 1800–2150



Source: Garbinti, Goupille-Lebret and Piketty (2017). See wir2018.wid.world for data series and notes.

In 2150, the share of total wealth owned by the Top 10% will be 78% if the saving rates of the Top 10% and Bottom 90% remain the same as their average during the 1984-2014 period: 24.5% and 2.5%, respectively.

groups' share of total wealth in the coming decades. Assuming the same inequality of saving rates that were observed over the 1984–2014 period—namely 24.5% for the top 10% and 2.5% for the bottom 90%—will persist, together with the same inequality of rates of return and the same inequality of labor income, the share of total wealth owned by the top 10% will gradually increase to the levels that were observed in the nineteenth and early twentieth centuries, that is, approximately 85% of total wealth. If, however, the 1970–1984 trends had persisted after 1984 and continued during the upcoming decades, the top 10% would have experienced a decline in their share of total wealth. Using the same average savings rates, the same inequality of rates of return and the same inequality of labor income as during 1970–1984, the top 10% would have owned slightly more than 45% of total wealth today and this figure would further decrease throughout the 21st Century. (See **Figure 4.4.8**.)

There are two main messages from these relatively simple simulations. Firstly, moderately small evolutions in the inequality of saving rates or rates of return, for example, can have enormous impacts on steady-state wealth inequality. Secondly, these effects can take decades and even generations before they fully materialize. This delayed-impact can explain why declining wealth concentration continued long after the capital shocks of the 1914–1945 period. Once some structural parameters have changed, it takes many decades to reach a new steady-state.

4.5

WEALTH INEQUALITY IN SPAIN

Information in this chapter is based on "Housing Bubbles, Offshore Assets and Wealth Inequality in Spain (1984–2013)," by Clara Martínez-Toledano, 2017. WID.world Working Paper Series (No. 2017/19).

- ▷ The Spanish housing and stock market booms of the last 30 years have seen the country's personal wealth to national income ratio almost double from around 380% in 1984 to 730% in 2007, before falling to just under 650% by 2014.
- ▷ With an average wealth of almost €813 000 per adult, the top 10% owned almost 57% of Spain's personal wealth in 2013. The share of the bottom 50% was 7%, with an average wealth of just over €18 900. The relative shares of personal wealth remained virtually unchanged during the last thirty years.
- ▷ The ability of the wealthy to adapt and diversify their asset portfolio depending on which assets were experiencing the most growth has enabled them to benefit from the Spanish housing boom and shelter somewhat from the impact of its crash.
- ▷ Approximately €146 billion was held by Spanish citizens in offshore wealth in 2012, increasing the concentration of wealth considerably.

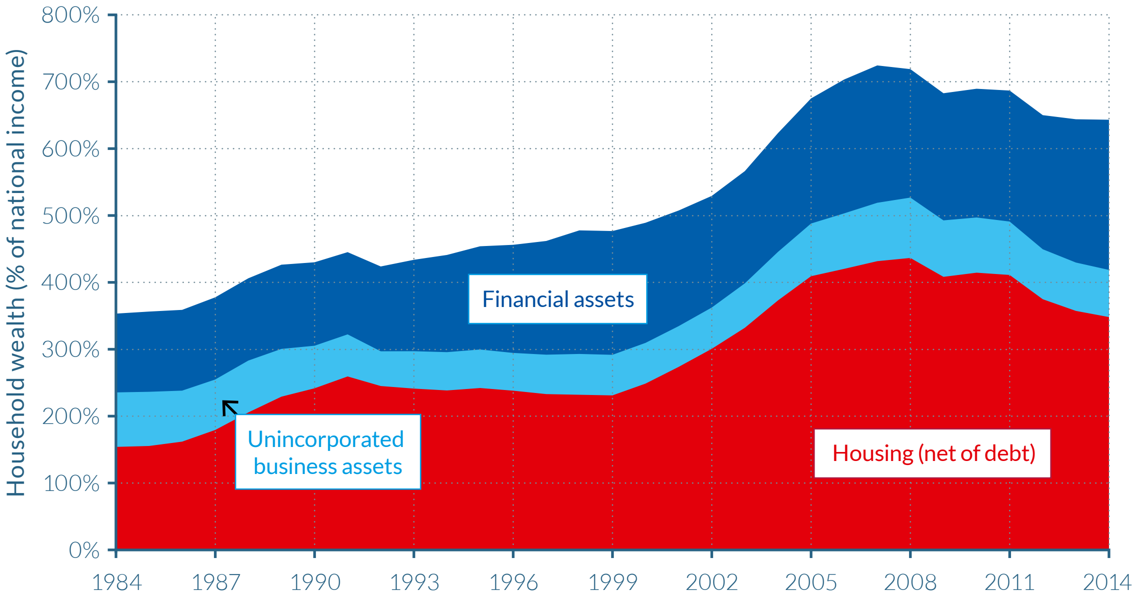
Spain has experienced an unprecedented increase in aggregate wealth over the past thirty years, predominantly due to the housing the country experienced over the last 30 years. Much has been written about this economic phenomenon, when house prices tripled between 1985 and 1991 and tripled again between 1996 and 2008,[17] and the value of the stock market increased sevenfold before halving, but much less so on its distributional effects. In particular, there has been little research into which groups have benefited from this increase in wealth, how much each of these groups have benefited, how differences in wealth between groups have changed over time, whether the importance of asset categories has altered, and which factors are the source of the aforementioned changes?

Using high-quality, publicly available data, Martínez-Toledano's recent paper[18] seeks to answer these questions. The author combines tax records, national accounts and wealth surveys, as well as the capitalization method[19] that is used by Saez and Zucman for the United States,[20] to deliver a consistent, unified wealth distribution series for Spain between 1984 and 2013, with detailed breakdowns by age over the period 1999–2013.

The rising value of housing has fueled the growth of Spanish wealth

The Spanish personal wealth to national income ratio almost doubled between 1984 and 2014. As illustrated by **Figure 4.5.1** personal wealth amounted to around 380% in the late eighties and grew to around 470% in the mid-nineties. From 1995 onwards, personal wealth started to increase more rapidly, reaching its peak at 728% of national income in 2007, before the global financial crisis. After the bubble burst in 2008, personal wealth dropped notably and continued to decrease thereafter. In 2014, the Personal Wealth to National Income ratio amounted to 646%, a level similar to the Personal Wealth to National Income ratio of years 2004 and 2005, but much higher than

Figure 4.5.1
Composition of household wealth in Spain, 1984–2014



Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.
In 2014, the value of financial assets in Spain was 226% of national income.

the ratios of the eighties and nineties, as illustrated by **Figure 4.5.1**.

Figure 4.5.1 also shows how the components of total net Spanish wealth have evolved over the 30-year period. The late eighties saw growth in net housing that was more than double the speed of the increase in financial assets, but this trend was reversed during the nineties as financial assets started to be accumulated at a faster pace than property, due mainly to the rise in stock prices that arose from the dot-com bubble. However, after the stock market crash of 2000, housing prices increased at a pace that surpassed even the significant growth of financial assets. The value of housing then reached its peak in 2008, after which the sizeable housing bubble that had been built up burst and the fall in housing wealth was larger than that of financial assets.

This period was also characterized by the increasing importance of net housing in the asset portfolios of households. While properties are the most important asset held by the average Spanish household between 1984 and 2014, always representing more than 40% of total household net wealth, the composition of personal wealth has not evolved homogeneously. Indeed, personal wealth has lost importance in periods when financial assets significantly increase, such as the one that preceded the dot-com bubble. The increase in the fraction of property in the total portfolio of households has also been exacerbated by the steady decrease in the fraction of unincorporated business assets, which fell from 23% in 1984 to 11% in 2014, due mainly to the relative reduction in the importance of agriculture within the Spanish economy.

The top 10% has owned more than half of Spain's personal wealth since the mid-1980s

Table 4.5.1, displays the wealth level, threshold and shares of personal wealth for Spanish adults in 2013. On average, the net wealth per adult in Spain was approximately €144 000. However, the average wealth within the bottom 50% of the distribution was just 13% of the countrywide average, at €18 900. Cumulatively, the share of personal wealth held by the top 50% was less than 7%. Average wealth within the next 40% of the distribution was slightly over €133 000, giving the group a 37% share of personal wealth, not largely dissimilar to their population share. This left the top 10% holding over 56% of Spanish personal wealth, with an

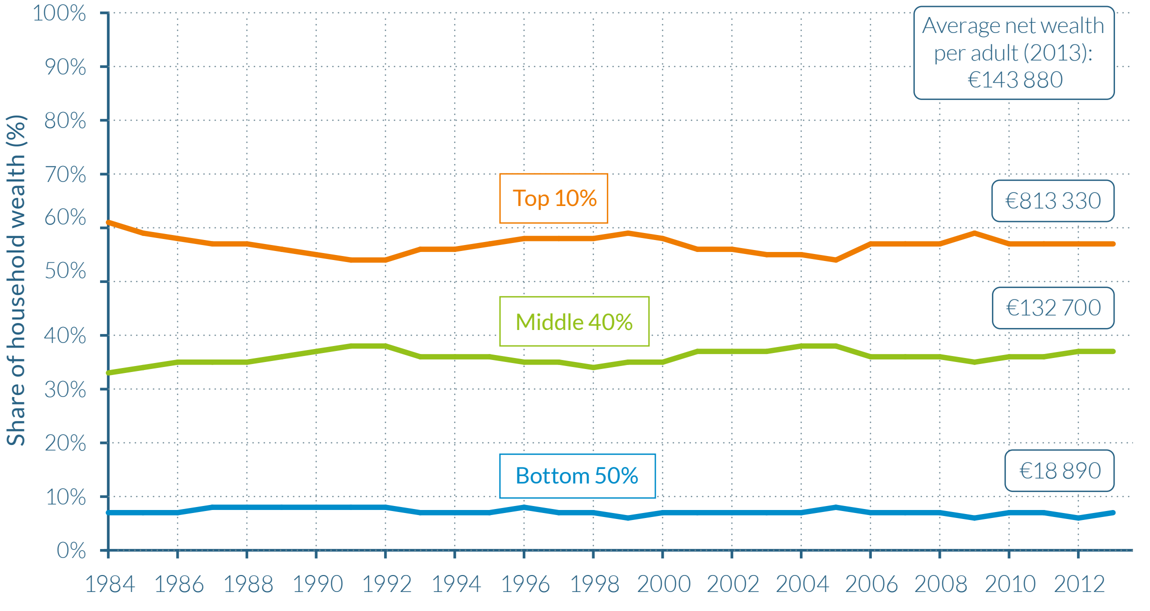
Table 4.5.1
The distribution of household wealth in Spain, 2013

Wealth group	Number of families	Wealth threshold (€)	Average wealth (€)	Wealth share
Full Population	35 083 000	–	144 000	100%
Bottom 50%	17 541 000	–	18 900	6.6%
Middle 40%	14 033 000	43 000	133 000	36.9%
Top 10%	3 508 000	317 000	813 000	56.5%
Top 1%	350 800	1 385 000	3 029 000	21.1%
Top 0.1%	35 080	4 775 000	10 378 000	7.2%

Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

In 2013, the average wealth of the Top 1% in Spain was €3 029 000. All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates. Numbers may not add up due to rounding.

Figure 4.5.2
Wealth shares in Spain, 1984–2013



Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

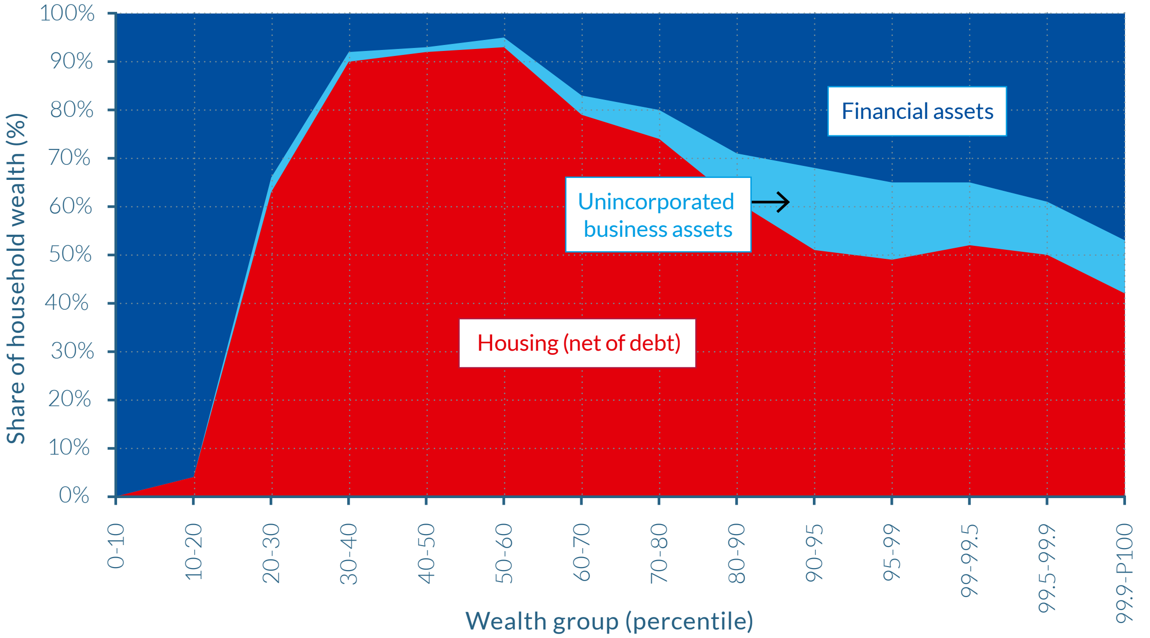
In 2013, the Bottom 50% share of household wealth in Spain was 7%. All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates.

average wealth of approximately €813 000, over five-and-a-half times greater than the national average wealth and 43 times greater than the average wealth of 50% of the Spanish adult population.

The drastic differences in the shares of personal wealth reported in 2013, have remained largely unchanged throughout the preceding 29-year period. As **Figure 4.5.2** shows below, the share of personal wealth held by each group has remained within a band of eight percentage points. The share of personal wealth attributable to the bottom 50% has always been very small, reaching a peak of 9% in 1992, but fell back to just over 6% in 2013, roughly equal to its level at the start of the period. The personal wealth share of the middle 40% has concentrated between 32% and 39% of total net wealth, remaining over 35% for the majority of the observed period, while the share of the top 10% has fluctuated between 53% and 61%. Notably, the top 10% wealth share dropped from the mid-eighties until the beginning of the 1990s, at the expense of the increased shares of both the middle 40% and the bottom 50% of the distribution, as house prices rose threefold across Spain. The top 10% wealth share then increased during the nineties, as the stock market grew strongly, before decreasing until the mid-2000s and increasing again until the start of the global financial crisis and burst of the housing bubble in 2008. Since then, the share of the top 10% decreased, before stabilizing at a similar level to that during the mid-nineties.

While the changes in relative assets prices have had a rather limited impact on overall wealth inequality in Spain, there are important differences in the portfolio of assets owned by different wealth groups. As shown by **Figure 4.5.3**, in 2013, the bottom 20% of the Spanish wealth distribution mostly owned financial assets, which largely came in the form of savings and current deposits in banks. As one move towards the center of the wealth distribution, property becomes the most

Figure 4.5.3
Asset composition by wealth group in Spain, 2013



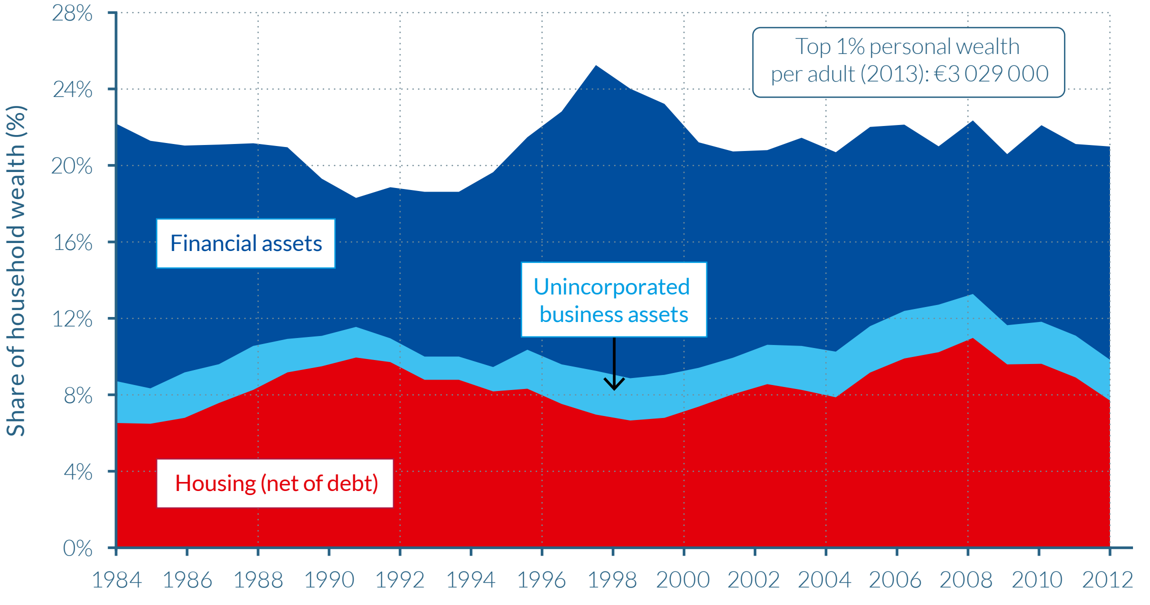
Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.
In 2013, 93% of the household wealth of the 5th decile (p50-p60) was composed of housing assets (net of debt).

dominant form of wealth (approximately 90% between the 30th and 60th percentiles). Thereafter, the dominance of financial assets within wealth portfolios grows larger as the individuals analyzed become wealthier. However, unlike the bottom 50%, bank deposits form only a minor part of financial assets for the top 10% and the top 1% of the distribution. Instead, the wealthiest Spanish adults own a combination of equities, investment funds, fixed income assets such as bonds, currency, life insurance reserves and pension funds. The same general pattern of asset composition by wealth group also applies for the period between 1984 and 2012, as can be seen in Figures 4.5.4 and 4.5.5. The only notable difference has been the falling importance of unincorporated assets over the 28-year period, which can mainly be attributed to the reduction in agricultural activity among the self-employed.

By decomposing the evolution of wealth in Spain by asset categories and by wealth group, it is possible to see how asset price movements between 1984 and 2013 affected their respective asset portfolios and shares of personal wealth. The figures within **Figure 4.5.4** clearly show how the impact of the stock market boom of 2000 and the burst of the housing bubble in 2007 affected portfolios and shares of the top 1%. Reviewing the trend in the financial assets component of the wealth of the top 1%, there is an obvious spike in the value of financial assets and its dominance in their portfolio in 1999, the year preceding the dot-com crisis.

One particularity of the Spanish case relative to other rich nations is the importance of housing assets in the portfolio of households, even at the top of the distribution. This has been the case during the whole of the 29-year period analyzed, but this trend became even more striking in the years up to 2007, when the increase in the value of dwellings was largest. In Spain, the top 10% and top 1% of the wealth distribution own 26% and 8% of

Figure 4.5.4
Composition of the wealth share of the Top 1% in Spain, 1984–2013



Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

In 2013, the Top 1% owned 11% of household wealth in financial assets. All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates.

total net wealth in housing, respectively, whereas in France these figures are 19% and 5%, respectively.[21]

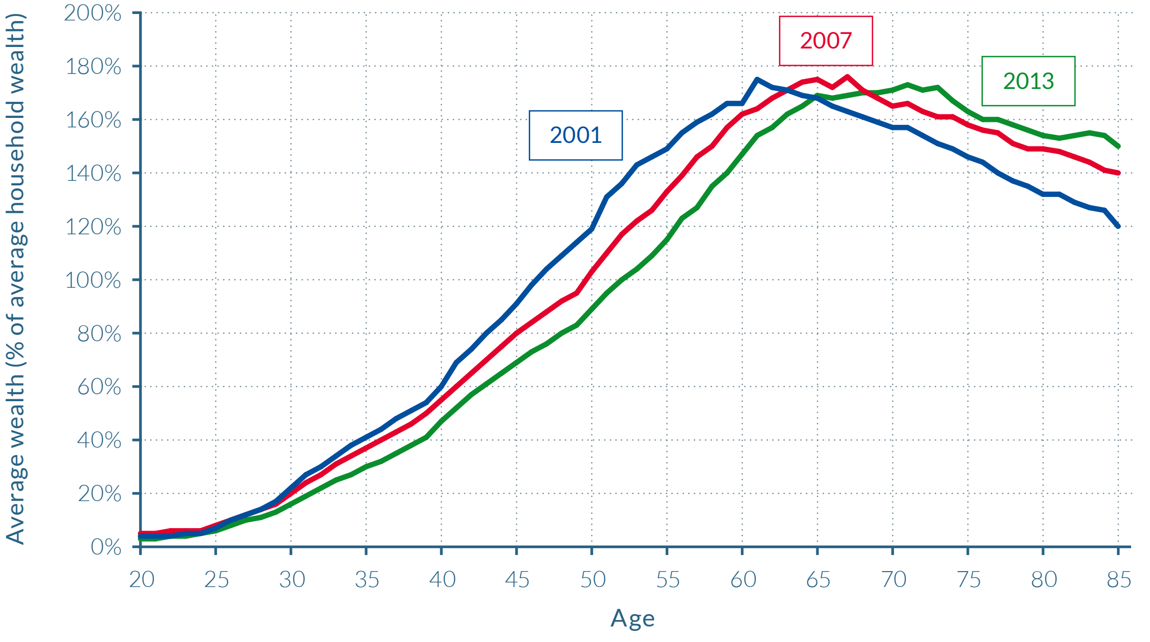
Increasingly greater sums of wealth are being passed on to the offspring of the wealthy

The detailed micro-files available in Spain from 1999 also allow Martínez-Toledano to analyze how wealth varies between different age groups, and how this has changed over time. As **Figure 4.5.5** shows, average wealth has been consistently very small for those aged 20 during the 14-year period studied, at less than 10% of total wealth. Wealth exhibits a rising trend with age. At age 40, individuals own approximately 50% of average wealth whereas at age 60, they own more than 150% of average wealth. After 60, the average adult wealth declines moderately but never falling below 120%. As average wealth does not decline sharply after age 60 and remains at a level that is notably above average wealth, old-age individuals thus pass away with substantial wealth and transmit this to their offspring.

There are, however, important differences in relative wealth levels across age groups over the 1999–2013 period. Old individuals (+60) are better off and the young (20–39) worse off after the economic crisis, since the average wealth for the old relative to total average wealth is larger in 2013 than in 2001. This is consistent with the large increase in youth unemployment[22] after the burst of the bubble and at the same time the stability in Social Security pension payments. When decomposing the wealth distribution series by age, it appears that wealth inequality is more pronounced for the young (20–39) than for the old (+60) and middle-old (40–59), for which wealth inequality is almost as large than for the population taken as a whole. A plausible explanation is the importance of bequests that transfer the wealth of the older generations to the younger generation.

Figure 4.5.5

Age-wealth profiles in Spain, 2001–2013

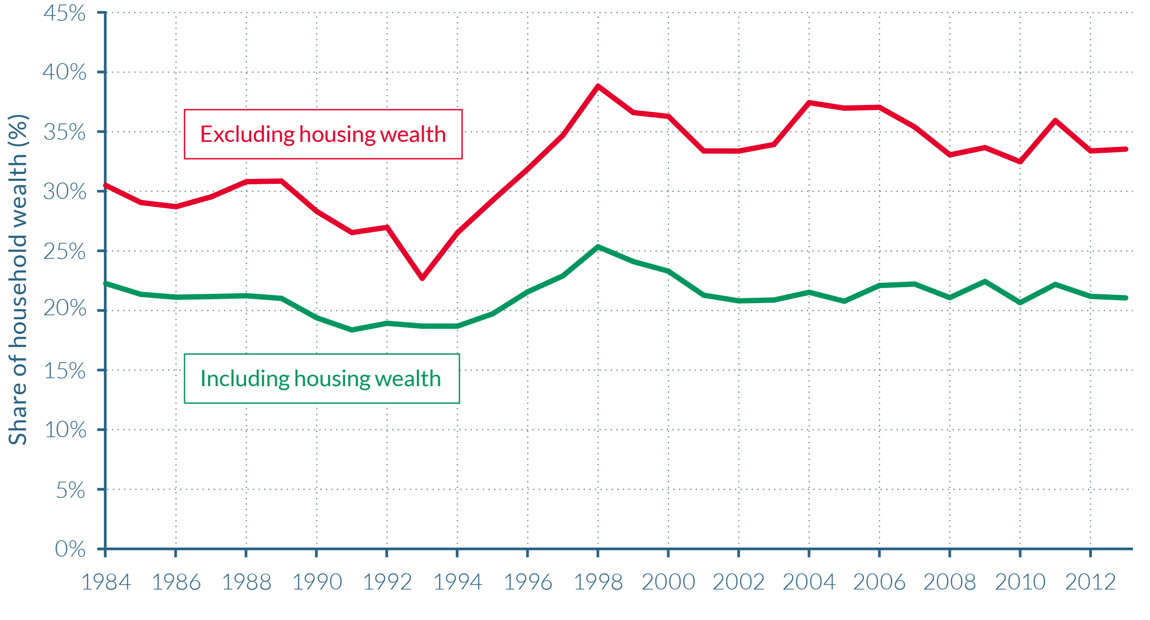


Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

In 2013, the average wealth of those aged 50 was 89% of the average wealth of all Spanish households.

Figure 4.5.6

Top 1% wealth share in Spain, 1984–2013



Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

In 2013, the wealth share of the Top 1% was 21% of total wealth. However, when excluding housing wealth, the Top 1% share was 34%.

Higher transfer rates among wealthy families, combined with high youth unemployment rates and consequently a low wealth accumulation through labor income savings by the young (which would moderate wealth inequality), can explain higher inequality levels among the young than among the elderly.

The Spanish property bubble had a neutral effect on wealth inequality

The high level of disaggregation in Martínez-Toledano's wealth distribution series also helps to explain why Spain's housing bubble had a curiously neutral effect on the level of wealth inequality in the country. In Spain, as in many European countries, the increased ownership of property among the bottom 90%, and the significant share that housing represents in their asset portfolios, has contributed to reducing wealth inequality. **Figure 4.5.6** illustrates that wealth concentration for the top 1% is approximately 10 percentage points lower between 1984 and 2013 when housing wealth is included. But moreover, the figure also shows that wealth inequality including and excluding housing followed a similar trend post 2000, confirming that the housing boom and bust had little impact on wealth inequality.

In order to understand this puzzling result, it is important to see how the composition of net housing wealth has changed over time. The fraction of total net housing owned by the top 1% increased considerably between 2005 and 2009, the years in which housing prices skyrocketed, at the expense of the proportion of homes owned by the middle 40%. This increased concentration of home ownership was principally the result of the increase in the number of secondary properties bought by the top 1%, relative to the middle 40%, and not due to relatively larger increases in the price of properties owned by the wealthiest. The ratio of the house prices of the top 10% (and top 1%) to the value of dwellings of the middle 40% remained constant between 2005 and 2009.

But if housing concentration increased at the top during the bubble and decreased thereafter, why has total wealth concentration remained virtually unchanged? One plausible explanation is that individuals within the top 1% substituted financial assets for property during the period of the housing boom, but then accumulated greater financial assets when house prices began to fall. The fraction of total financial assets held by the top 1% decreased during the boom years. This is consistent with the idea that wealthy individuals can better diversify their portfolios, and have the capabilities to invest more in risky assets, when prices are increasing—and can more easily disinvest when prices fall, to then acquire other assets.

Disparities in savings rates and returns on assets drive long-run wealth inequality

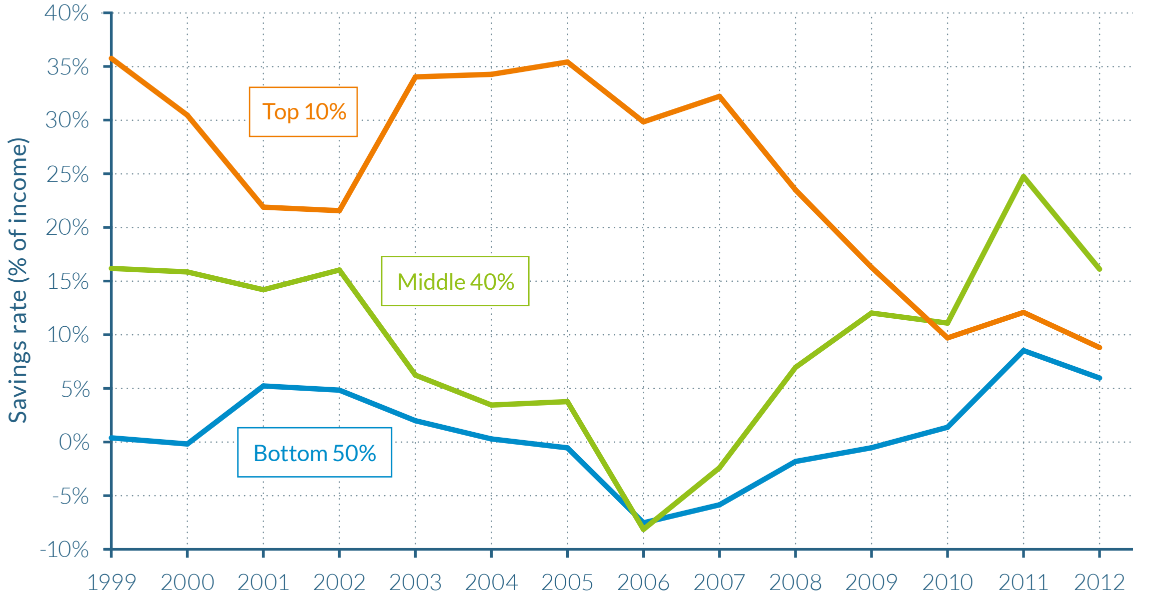
In order to understand the underlying forces driving wealth inequality dynamics in Spain, it is useful to analyse how income, savings rates and the rate of inequality have evolved between 1999 and 2012.

There are significant differences in the savings rates between wealth groups in Spain and these have changed over time, as illustrated by **Figure 4.5.7a-c**. These disparities reflect the high levels of wealth concentration observed in Spain, with an average savings rate of 27% of income for the top 10% over this period, compared to 10% among the middle 40% and just 1% for the bottom 50%.

Analyzing the evolution of savings rates more closely reveals one important point. The housing bubble increased the difference in saving rates between the wealthy and the less-wealthy during the boom years and reduced their stratification during the bust period. **Figure 4.5.7a** shows that during the years prior to the property bubble bursting, the savings rate of the top 10% remained high as they accumulated more housing, while the savings rate for the middle 40% and the bottom 50% decreased, as their accumulation

Figure 4.5.7a

Saving rates in Spain, 1999–2012

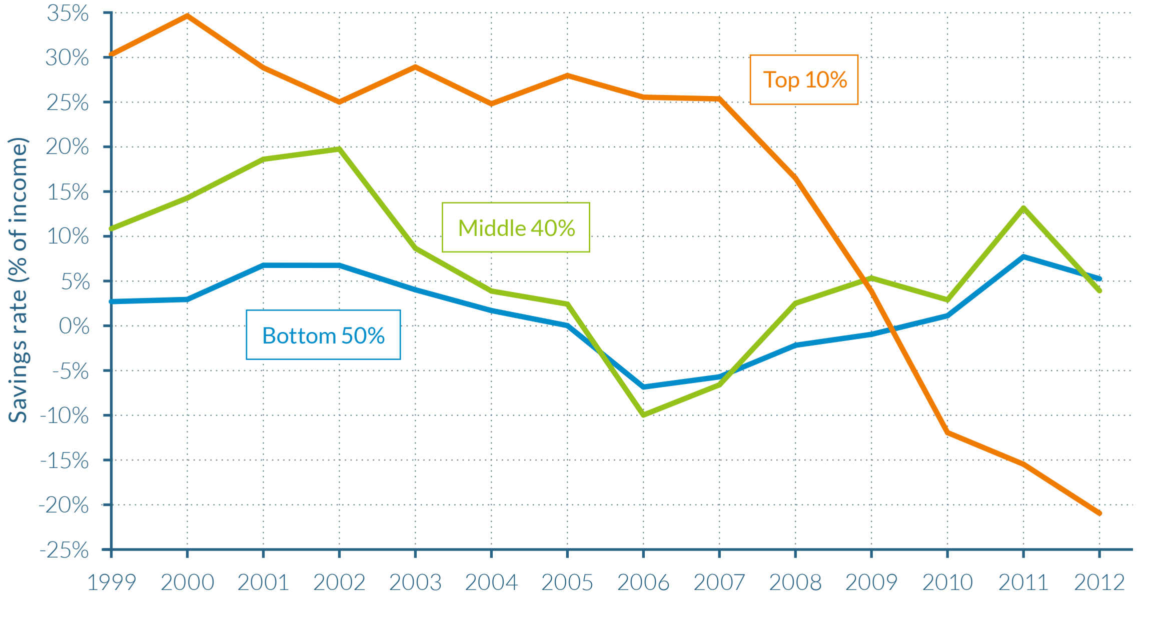


Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

In 2012, the Middle 40% saved 16% of income, while the Bottom 50% saved 6% of income.

Figure 4.5.7b

Saving rates on net housing in Spain, 1999–2012



Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

In 2012, the Bottom 50% saved 5% of their income on housing.

of housing assets was facilitated through borrowing. After the property bubble burst, the top 10% sold some of their housing assets and started to accumulate more financial assets to compensate for the decrease in housing prices. Nonetheless, the total savings rate for the top 10% decreased during these years, likely because they needed to consume a larger fraction of their income. The middle 40% instead started to save more in order to repay their housing mortgages, and therefore the difference in saving rates across the two wealth groups was reduced. These two trends thus contributed to neutralizing wealth concentration during Spain's tumultuous period of housing price swings.

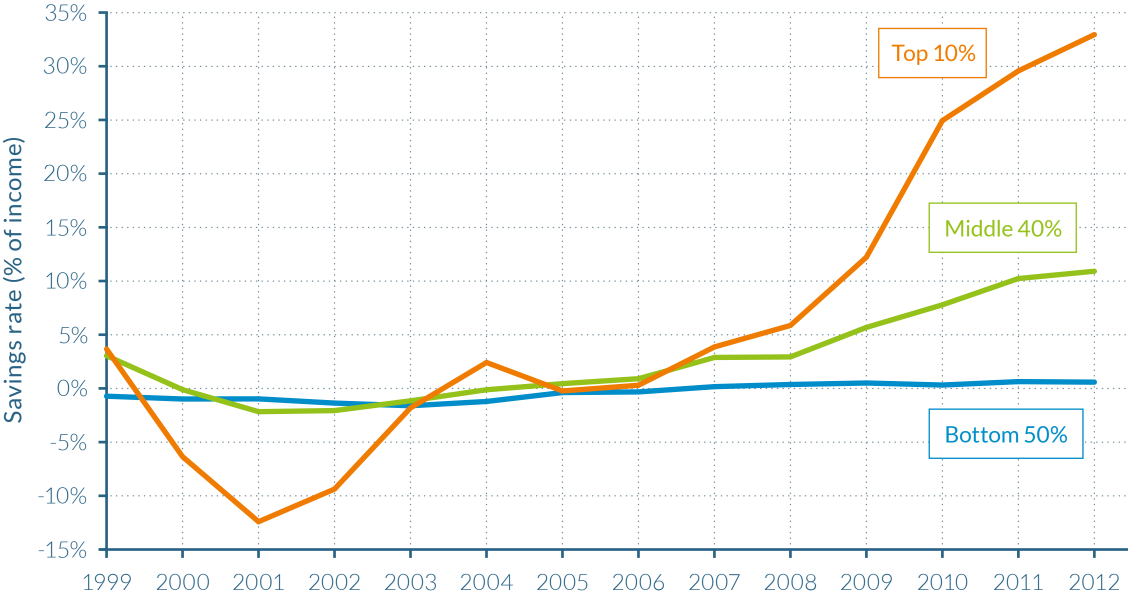
Wealth inequality has also been amplified by the variance in the rates of return on assets owned by different wealth groups in Spain over the 1986–2012 period.[23] This finding is consistent with the large differences in the asset portfolios of Spanish wealth groups documented earlier in the chapter (**Figure 4.5.1**), whereby top wealth groups are more likely to own financial assets such as equity that often have higher rates of return than other assets, including deposits and housing.

Factoring in offshore wealth into the Spanish wealth distribution reveals a higher level of inequality

As is common in many other countries, official financial data in Spain fails to capture a large part of the wealth held by households abroad. Research has shown that Spanish citizens use offshore financial institutions in tax havens for their portfolios of equities, bonds, and mutual fund shares. It is estimated by Zucman[24] that these assets amounted to approximately €80 billion in 2012—the equivalent of 9% of households' net financial wealth in Spain—of which three-quarters goes unrecorded. Thus, by omitting offshore wealth from the Spanish wealth distribution series, both total assets and wealth concentration are substantially underestimated.

Figure 4.5.7c

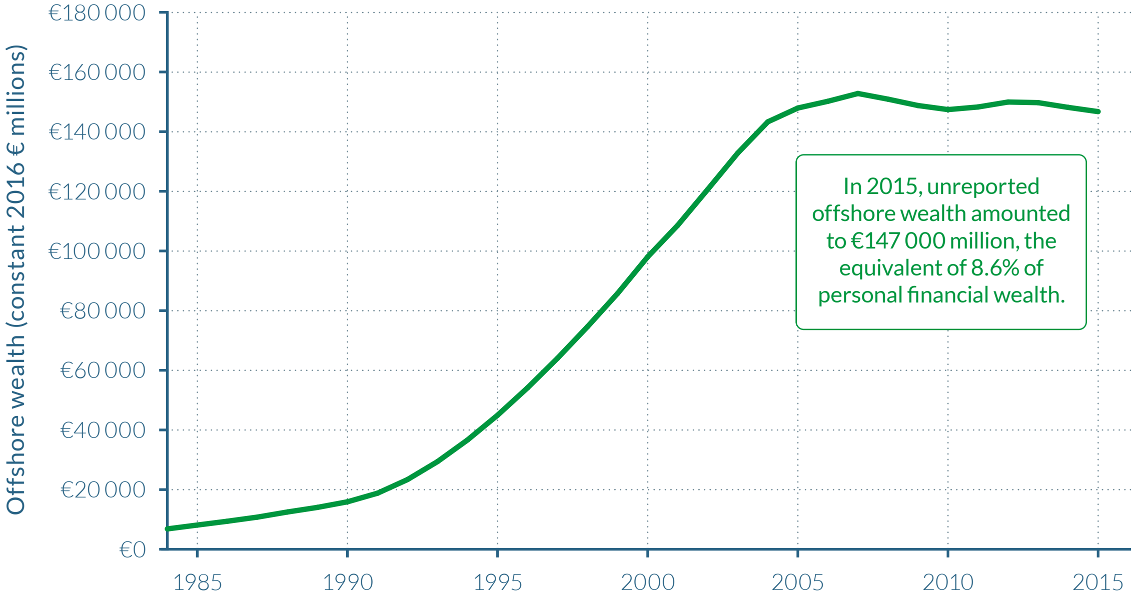
Saving rates on financial assets in Spain, 1999–2012



Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

In 2012, the Bottom 50% saved 1% of their income on financial assets.

Figure 4.5.8
Total unreported offshore assets in Spain, 1984–2015



Source: Martínez-Toledano (2017). See wir2018.wid.world for data series and notes.

Notes: In 2015, unreported offshore wealth amounted to €147 billion. All values have been converted to 2016 constant euros (accounting for inflation). For comparison, €1 = $1.1 = ¥7.3 at market exchange rates.

Using data series from the Swiss National Bank, offshore wealth taxation forms and the 2012 tax amnesty, Martínez-Toledano is able to adjust her wealth distribution series for offshore assets. As illustrated by **Figure 4.5.8**, the value of offshore assets increased rapidly during the eighties, nineties and at the beginning of the 2000s, before stabilizing after 2007, when Spanish tax authorities became stricter with tax avoidance and evasion schemes. Unreported offshore wealth amounted to almost €150 billion in 2012, representing 8.6% of personal financial wealth. Investment funds represented 50% of total unreported offshore assets in 2012, followed by stocks, 30%, and deposits and life insurance, which made up 18% and 2%, respectively.

The Spanish wealth distribution series is then corrected by assigning the annual estimate of unreported offshore wealth proportionally to the wealthiest 1%. This is consistent with official documentation from the Spanish Tax Agency that states that the majority of foreign assets reported by Spanish residents are held by the top wealth holders and that these assets represented 12% and 31% of the total wealth tax base in 2007 and 2015, respectively. When offshore wealth is included in the wealth distribution, wealth concentration rises considerably, across the period between 1984 and 2013. Including offshore wealth shows that the concentration of wealth was in fact larger during the 2000s than in the eighties, contrary to what it is observed when these offshore assets are not taken into account. The wealth share of the top 1% averages approximately 24% from 2000–2013, notably larger than the 21% estimated when offshore wealth is disregarded.[25] This difference is quite remarkable, particularly given that during this period of time the country experienced a housing boom and both nonfinancial and financial assets held in Spain grew considerably as discussed earlier in this chapter.

4.6

WEALTH INEQUALITY IN THE UK

Information in this chapter is based on "Top Wealth Shares in the UK over more than a Century," by Facundo Alvaredo, Anthony Atkinson, and Salvatore Morelli, 2017. WID.world Working Paper Series (No. 2017/2).

- UK wealth inequality has shown a moderate increase since the 1980s, with the share of total wealth owned by the top 1% (almost half million individuals) rising from 15% in 1984 to 20–22% by 2013.
- The increase in wealth concentration in the last four decades is very much a phenomenon confined to the top 0.5 per cent, and, in particular, to the top 0.1 per cent (the richest 50 000 Britons), whose share of total wealth doubled from 4.5 to 9% between 1984 and 2013.
- Today's wealth inequality remains, however, notably lower than a century ago. In the wake of the first globalization era in 1914, the share of personal wealth going to the wealthiest 1% of UK individuals was around 70%, but their share began to fall thereafter. This encompassed two world wars, and much attention has been paid to the loss of capital during the periods 1914 to 1918 and 1939 to 1945. Top shares certainly fell in the UK during the war years, but these only accounted for a part of the large reduction that took place over the period as a whole. The large decline in top wealth shares in the UK in the twentieth century was very much a peacetime phenomenon.
- The substantial rise in owner-occupation during the twentieth century, additionally fostered by the sale of public housing, aided the reduction in wealth inequality to historically low levels in the 1980s, as the wealth share of the top 1% fell to 15%. But in the 1990s there was a change, with the return of private landlords as a result of the "buy to let."
- The concentration of non-housing wealth (financial and business assets) increased substantially between 1995 and 2013. At the same time, the increase in total wealth inequality has been smaller. It appears that housing wealth has moderated a definite tendency for there to be a rise in recent years in top wealth shares in financial wealth. When people talk about rising wealth concentration in the UK, then it is probably the latter that they have in mind.

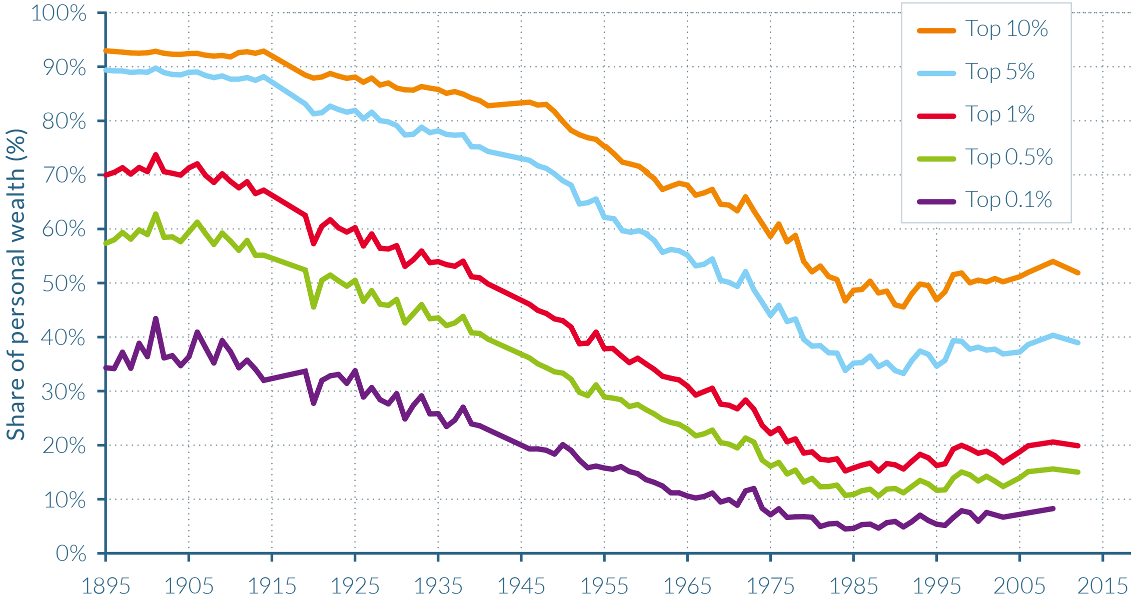
Wealth concentration in the UK underwent enormous transformation during the twentieth century

The evidence in the UK covers an extensive period, starting in the "Gilded Age" before the First World War. The long-run series since 1895 highlight the enormous transformation that has taken place in the distribution of wealth within the UK over more than a century.[26] Before the First World War, the top 5 per cent of wealth holders owned around 90 per cent of total personal wealth. There were very few owner-occupiers. A hundred years later, the share was around 40 per cent. The top 1 per cent used to own two-thirds of total wealth; their share is around one fifth today, when two thirds of households own a house.

Figure 4.6.1 shows the upper tail of the wealth distribution from 1895 to 2013. The changes in top shares can be summarized in terms of three periods. The first of these is the twenty-year period leading up to the First World War: in the wake of the first modern globalization, the share of personal wealth going to the wealthiest 1 per cent of UK individuals remained relatively stable at around 70 per cent. The second period covers more than half of the twentieth century: the share began to fall after 1914 and the decline continued until around 1980. This encompassed two world wars, and much attention has been paid to the loss of capital during the periods 1914 to 1918 and 1939 to 1945. Although UK top wealth shares certainly fell during the war years, most of the reduction was very much a peace phenomenon. By 1980, the share of the richest 1 per cent had decreased to some 17 per cent. This is still 17 times their proportionate share, but represents a dramatic reduction. The fall, however, came to an end in the mid 1980s, marking the beginning of the third period. Since the early 1980s the share of the top 1 per cent—representing approximately half a million individuals today—has moved in the opposite direction, rising from 15% in 1984 to 20–22% by 2013.

Figure 4.6.1

Top wealth shares in the UK, 1895–2013



Source: Alvaredo, Atkinson and Morelli (2017). See wir2018.wid.world for data series and notes.

In 2013, the Top 10% owned 47% of personal wealth.

Wealth inequality has increased in the UK since the 1980s, and is by no means insignificant

With the 1980s, the downward trend in top shares came to an abrupt stop and went into reverse. The inequality of wealth has moderately increased over the past four decades. In the early 1980s, when wealth inequality was at historical lows, the top 10% richest owned 46% of total wealth, and the top 1% share was 15%. Since then, the concentration of wealth rose mainly at the very top of the distribution. The top 10% richest individuals in the UK owned more than half of total wealth in 2013. A fifth of total wealth accrued to the top 1% individuals. The lower half of the top 1% (those between the 99th and the 99.5th percentiles) saw a relative stability in their share of total wealth, whereas the upper half saw an increase between 1985 and 2013. Indeed, most of the rise in the share of the top 1% is due to the top 0.5%, and mainly to the top 0.1%—whose share of total wealth doubled from 4.5 to 9% over the period. Consequently, the increase in the concentration of wealth in the last four decades is very much a phenomenon confined to the hands of the top 0.5 per cent (the richest 250 000 Britons), and in particular, of the top 0.1 per cent (the richest 50 000).

By 2013, the average wealth of British adults was approximately €173 000 (£141 000) in constant 2016 market values, but as can be seen in **Figure 4.6.2**, this wealth was far from equally distributed. The average wealth of the bottom 90% of the population was approximately a third of this nationwide average at just €83 200 (£68 000), suggesting that a significant proportion of the bottom 50% of the distribution have negligible wealth. The gap with the average wealth of the top 10–5%, 5–1%, top 1–0.5% and top 0.5% is then huge: their average wealth goes from €393 000 (£321 000) to €723 000 (£591 000), respectively, and further still from €1.48 million (£1.21 million) to €4.54 million (£3.71 million), indicating the exponential trend in wealth holdings the higher up the distribution one examines.

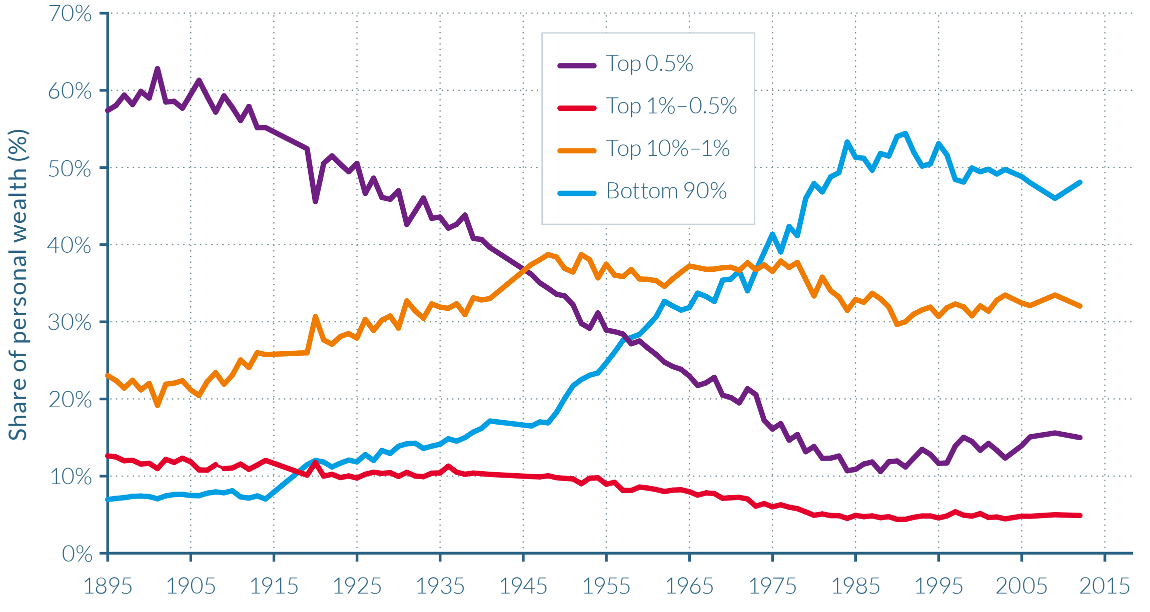
Despite recent rises, the level of wealth concentration is far from its extreme values at the beginning of the twentieth century. The first globalization era (1870–1914) brought with it extremely high shares of total wealth, with the top 10% of the wealth distribution owning almost 95% of total wealth on the eve of World War I. The 0.1% richest individuals then owned at least one third of total wealth, meaning that they had more than 333 times their proportionate share of total personal wealth. The share of the top 1% was around 70%, and that of the top 5% around 90%.

Inequality within top wealth groups substantially decreased from 1914 to 1980

The past century saw important transformations within top wealth groups, which did not all follow the same trajectory. **Figure 4.6.1** demonstrates the importance of looking within the top 10 per cent, and even within the top 1 per cent: it is not just the share of the wealthy that has changed but also the shape of the distribution at the top—that is, the inequality amongst the wealthiest. The share in total wealth of those in the top 10 per cent, but not in the top 1 per cent (that is, the "next 9 per cent") saw a rise in their share for the first half of the twentieth century at the expense of the top 1 per cent, followed by a period of stability until the end of the 1970s. The lower half of the top 1 per cent (those between the 99th and the 99.5th percentiles) saw a relative stability in their share until the 1950s, years when the share of the top 0.5 per cent was decreasing dramatically. Since 1980, the share of the lower half of the top 1 per cent has been again stable, but at a much lower level, while the upper half has been going up.

The extent of wealth concentration at the top depends on the inequality within the top wealth groups themselves (how unequal are top 1% wealth owners?) but also on the wealth required to become part of the wealthiest groups, the "entry price" (relative to mean wealth). Analyzing the "entry price", the minimum level of wealth required to be part of the

Figure 4.6.2
Wealth shares of the Top 10% and Bottom 90% in the UK, 1895–2012



Source: Alvaredo, Atkinson and Morelli (2017). See wir2018.wid.world for data series and notes.
In 2012, the Top 0.5% owned 15% of personal wealth.

top 10% and top 5% (relative to mean wealth) increased from the start of the series up to the end of the 1970s, and then levelled off. However, at the other end of the scale, the entry price to become part of the top 0.1% fell steadily from 1911 to the 1980s, and then began to rise, as depicted by **Figure 4.6.3**. The entry price required to become part of the top 1% has halved since 1914. To sum up, the wealth required to enter the top 1 per cent in the UK is now some half the level required before the First World War, but it is also the case that wealth became less concentrated within the top 1 per cent.

Changes in the composition of property ownership played a key role in reducing wealth inequality before 1980

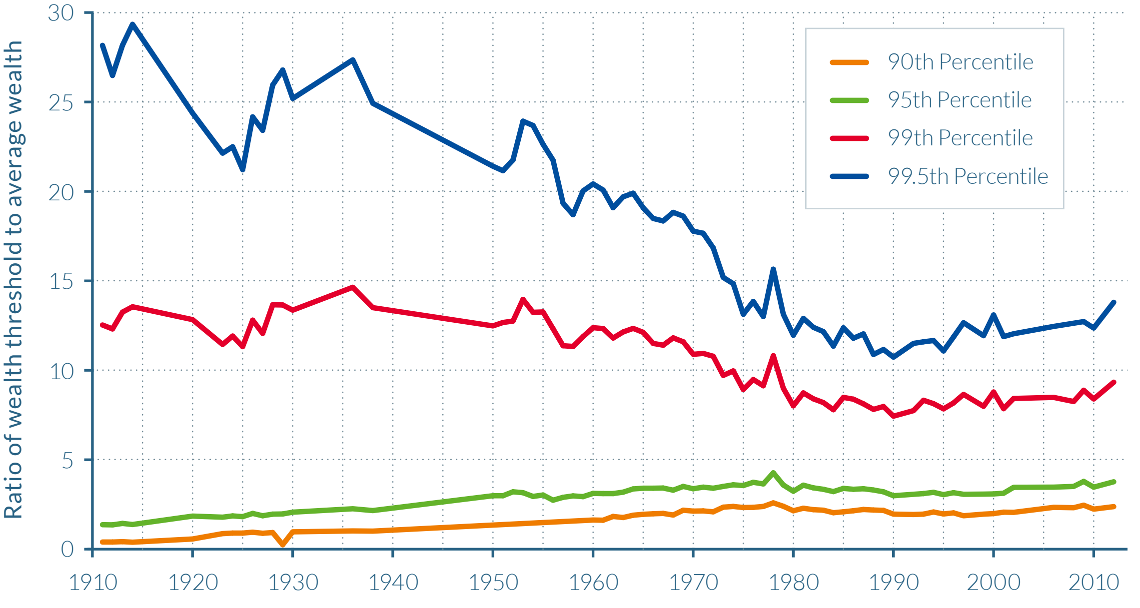
The role of housing wealth in increasing average total wealth in the UK has been widely discussed. In particular, Tony Atkinson and co-authors identified back in 1989,[27] that "popular wealth", that is, the sum of owner-occupied housing and consumer durables such as automobiles and household appliances, was one of the key determinants of the dynamics of UK top wealth shares up to the end of the 1970s, and moreover, that house price rises had reduced share of the top 1%. However, since then, there have been a number of major changes in the UK housing market.

It is perhaps most illuminating to analyze how tenure changes in the UK have impacted the role of housing wealth in total wealth dynamics, especially how housing policy affected both property prices and the extent of owner occupation. With this framing, the evolution of the housing market in the UK between the end of the First World War and 2011 can be split into three main develop-ments as described below.

Firstly, private landlords were progressively replaced with owner-occupation and social ownership of housing between 1918 and the end of the 1970s. The proportion of owner-occupied properties in England and Wales rose from 23% of households in 1918 to 50%

Figure 4.6.3

Wealth thresholds of the top wealth groups in the UK, 1910–2012



Source: Alvaredo, Atkinson and Morelli (2017). See wir2018.wid.world for data series and notes.

In 2012, the value of personal wealth required to enter the Top 5% in the UK was 3.8 times greater than average wealth per adult. Wealth estimates account for inflation.

in 1971, and then to 58% by 1981.[28] This coincided with a fall in the share of housing owned by private landlords, from 76% in 1918 to 11% in 1981. Both factors led to a decline in the total wealth share of the top 1%, which contained a disproportionate number of landlords. This shift from a private-rented to owner-occupied housing market did not in itself change the ratio of housing wealth to total personal wealth (different people owned the same house at different points of time), but it was affected by the growth of social housing from 1% of the housing market in 1918 to 31% in 1981.

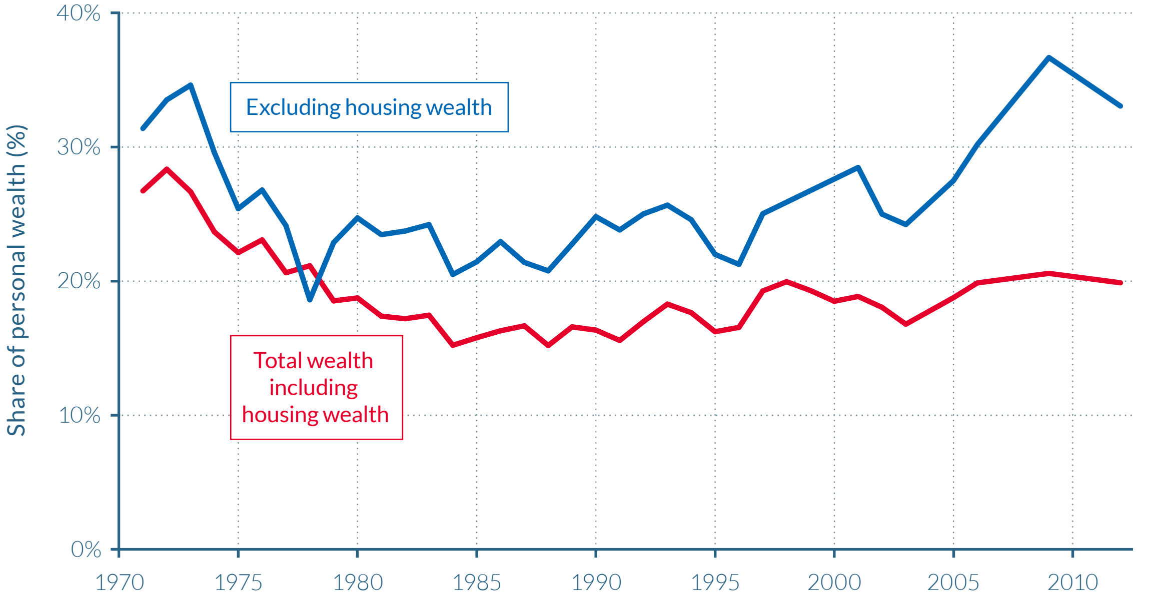
Secondly, council houses were widely sold off and housing rose as a percentage of total wealth in the 1980s. The decision to sell public housing by the conservative governments of the 1980s reduced the share of social housing in housing stock to 23%, with owner-occupation going up to 68% and private renting having fallen to 9%. More of the housing stock therefore entered personal wealth, and the ratio of residential housing wealth to total wealth rose by some ten percentage points in the 1980s.

Thirdly, the 1990s saw the return of private landlords. Their share in the housing market doubled from 9% in 1991 to 18% in 2011, as a result of "buy to let" schemes under successive conservative and labor governments. This increased share of private landlords came at the expense of a fall in owner-occupation (-4 percentage points) and a fall in social housing (-5 percentage points). Furthermore, whereas the selling of council properties may have meant that increases in housing wealth were equalizing in the past, the return of the private landlord is likely to imply that increases in housing wealth may now have a more moderate equalizing effect than in the past.

Housing wealth has moderated the recent tendency for rising wealth concentration

All of this suggests that it is interesting to decompose the assets within the top brackets

Figure 4.6.4
Top 1% wealth share in the UK, 1971–2012



Source: Alvaredo, Atkinson and Morelli (2017). See wir2018.wid.world for data series and notes.
In 2013, the wealth share of the Top 1% was 20% of total wealth. However, when excluding housing wealth, the Top 1% share was 33%.

of the wealth distribution between housing and non-housing assets. Indeed, housing only accounts for a limited fraction of total wealth at the top: since 1970, the share of housing wealth for the top 1 percent has been bounded between 10 and 25 percent of total net worth. It is instructive to look at the distribution of wealth minus residential housing, net of mortgage liabilities. **Figure 4.6.4** shows the top shares of total wealth and of wealth excluding housing for the period since 1971. It appears that, as we should expect, the top shares of the distribution of non-housing wealth are higher: the share of the top 1 per cent averages 25 per cent over the period 1971 to 1997, compared with 18 per cent for the corresponding share for all wealth. Although there is more variability in the shares excluding housing wealth (shares are smoothed to some degree by the housing element), overall there is little difference in their evolution over the last quarter of the twentieth century. Up to 2000, we do not get a very different story if one just takes non-housing wealth, with a decided fall in the top shares until the end of the 1970s, and with broad stability until the mid 1990s.

However, in the twenty-first century, there is a distinct difference: the gap between the share of the top 1 per cent in wealth excluding housing and the share for all wealth widened. The changes over time are also different, with the concentration of non-housing wealth (financial and business assets) increasing substantially between 1995 and 2013. It appears that housing wealth has moderated a definite tendency for there to be a rise in the concentration of other forms of wealth apart from housing. When people talk about rising wealth concentration in the UK, then it is probably the latter that they have in mind.

NOTES

1 In comparison, the top 10% of the global income distribution typically receives between 50% and 60% of total income (depending on whether one uses purchasing power parity or market exchange rates). See Part II.

2 See T. Piketty, *Capital in the Twenty-First Century* (Cambridge, MA: Belknap Press of Harvard University Press, 2014), ch. 12, table 12.2.

3 Piketty, *Capital in the Twenty-First Century*

4 Y. Guo, J. Gan, and C. Xu, "A Nationwide Survey of Privatized Firms in China," *Seoul Journal of Economics* 21, no. 2 (2008): 311–331.

5 T. Piketty, "On the Long-Run Evolution of Inheritance: France 1820–2050," *Quarterly Journal of Economics* 126, no. 3 (2011): 1071–1131.

6 For more detail, see B. Garbinti, J. Goupille-Lebret, and T. Piketty, "Accounting for Wealth Inequality Dynamics: Methods, Estimates, and Simulations for France (1800–2014)," WID.world Working Paper no. 2016/5, December 2016, http://wid.world/document/b-garbinti-j-goupille-and-t-piketty-wealth-concentration-in-france-1800-2014-methods-estimates-and-simulations-2016/.

7 See Piketty, *Capital in the Twenty-First Century*; and T. Pikettyand E. Saez, "Inequality in the Long Run," *Science* 344, no. 6186 (2014): 838–-843.

8 Piketty, *Capital in the Twenty-First Century.*

9 See A. Mian and A. Sufi, *House of Debt: How They (and You) Caused the Great Recession and How We Can Prevent It from Happening Again* (Chicago: University of Chicago Press, 2014).

10 M. Bertrand and A. Morse, ''Trickle-Down Consumption,'' NBER Working Paper no. 18883, National Bureau of Economic Research, March 2013, http://www.nber.org/papers/w18883.pdf.

11 Piketty, *Capital in the Twenty-First Century.*

12 For more detail, see Garbinti, Goupille-Lebret, and Piketty, "Accounting for Wealth Inequality Dynamics."

13 Garbinti, Goupille-Lebret, and Piketty, "Accounting for Wealth Inequality Dynamics", Table 2.

14 Piketty, "On the Long-Run Evolution of Inheritance."

15 T. Piketty, *Les hauts revenus en France au XXème siècle* (Paris: Bernard Grasset, 2001); and Piketty, *Capital in the Twenty-First Century.*

16 C. D. Carrol J. Overland, and D. N. Weil, "Saving andGrowth with Habit Formation," *American Economic Review* 90, no. 3 (2000): 341–355.

17 O. Rullan and A. A. Artigues, "Estrategias para Combatir el Encarecimiento de la Vivienda en España. ¿Construir Más o Intervenir en el Parque Existente?" *Revista Electrónica de Geografía y Ciencias Sociales* 11, no. 245 (28), Universidad de Barcelona, August 1, 2007, http://www.ub.edu/geocrit/sn/sn-24528.htm.

18 C. Martínez-Toledano, "Housing Bubbles, Offshore Assets and Wealth Inequality in Spain (1984-2013)," WID.world Working Paper no. 2017/19

19 The capitalization method entails applying a capitalization factor to the capital income distribution in order to arrive at the wealth distribution.

20 E. Saez and G. Zucman, "Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data," *Quarterly Journal of Economics* 131, no. 2 (2016): 519–578.

21 Garbinti, Goupille-Lebret, and Piketty, "Accounting for Wealth Inequality Dynamics."

22 S. Scarpetta, A. Sonnet, and T. Manfredi, "Rising Youth Unemployment during the Crisis: How to Prevent Negative Long-Term Consequences on a Generation?" OECD Social, Employment and Migration Working Papers, no. 106, OECD Publishing, Paris, April 14, 2010, http://www.oecd-ilibrary.org/docserver/download/5kmh79zb2mmv-en.pdf?expires=1510199048&id=id&accname=guest&checksum=729E512C84DEDEA22B73D10993 7D5AD0.

23 See C. Martínez-Toledano, "Housing Bubbles, Offshore Assets and Wealth Inequality in Spain (1984–2013)," WID.world Working Paper no. 2017/19, Figure A21.

24 See G. Zucman, "The Missing Wealth of Nations: Are Europe and the U.S. Net Debtors or Net Creditors?" *Quarterly Journal of Economics* 128, no. 3 (2013): 1321–1364; and G. Zucman, *The Hidden Wealth of Nations: The Scourge of Tax Havens*, trans. T. L. Fagan (Chicago: University of Chicago Press, 2015).

25 Martínez-Toledano, "Housing Bubbles, Offshore Assets and Wealth Inequality in Spain (1984–2013)," Figure A26.

26 The study focuses on the shares of total personal wealth, that is, the value of the assets owned by individuals, net of their debts. Assets include financial assets, such as cash, bank accounts or bonds or company shares; and real assets, such as houses and farmland;, consumer durables; and household business assets. The total wealth considered in the paper differs in important respects from total national wealth, as measured in the national accounts balance sheets. Contrary to personal wealth, total national wealth includes the wealth of nonprofit institutions serving households. Estimation methods also differ between the two concepts.

27 See A. B. Atkinson, J. P. F. Gordon, and A. Harrison, "Trends in the Shares of Top Wealth-Holders in Britain, 1923–1981," *Oxford Bulletin of Economics and Statistics* 51, no. 3 (1989): 315–332.

28 See Office for National Statistics, "A Century of Home Ownership and Renting in England and Wales," Release, 2011 Census Analysis, ONS, London, April 19, 2013, http://webarchive.nationalarchives.gov.uk/20160107120359/http://www.ons.gov.uk/ons/rel/census/2011-census-analysis/a-century-of-home-ownership-and-renting-in-england-and-wales/short-story-on-housing.html.

PART V

TACKLING ECONOMIC INEQUALITY

5.1

WHAT IS THE FUTURE OF GLOBAL INCOME INEQUALITY?

- ▷ The future of global income inequality is likely to be shaped by both convergence forces (rapid growth in emerging countries) and divergence forces (rising inequality within countries). No one knows which of these forces will dominate and whether these evolutions are sustainable.
- ▷ However, our benchmark projections show that if within-country inequality continues to rise as it has since 1980, then global income inequality will rise steeply, even under fairly optimistic assumptions regarding growth in emerging countries. The global top 1% income share could increase from nearly 20% today to more than 24% in 2050, while the global bottom 50% share would fall from 10% to less than 9%.
- ▷ If all countries were to follow the high inequality growth trajectory followed by the United States since 1980, the global top 1% income share would rise even more, to around 28% by 2050. This rise would largely be made at the expense of the global bottom 50%, whose income share would fall to 6%.
- ▷ Conversely, if all countries were to follow the relatively low inequality growth trajectory followed by Europe since 1980, the global top 1% income share would decrease to 19% by 2050, while the bottom 50% income share would increase to 13%.
- ▷ Differences between high and low inequality growth trajectories within countries have an enormous impact on incomes of the bottom half of the global population. Under the US-style, high inequality growth scenario, the bottom half of the world population earns €4 500 per adult per year in 2050, versus €9 100 in the EU-style, low inequality growth scenario (for a given global average income per adult of €35 500 in 2050 in both scenarios).

The past four decades have been marked by steeply rising income inequality within countries. At the global level, inequality has also risen sharply since 1980, but the situation more or less stabilized beginning in the early 2000s. What will happen in the future? Will growth in emerging countries lead to a sustained reduction in global income inequality? Or will unequal growth within countries drive global income inequality back to its 2000 levels? In this chapter, we discuss different possible global income inequality scenarios between now and 2050.

The projections of global wealth inequality presented in the previous chapter showed that the continuation of current unequal rates of growth among wealth groups would lead to a compression of the global middle-class wealth share and a further rise in wealth inequality. These projections must, however, be interpreted with great care; only China, Europe, and the United States are included in the analysis of the previous chapter given large limitations in wealth inequality data.

Fortunately, more data are available to measure income inequality, and in this chapter we present more elaborate projections of global income inequality. Before discussing the results, it is necessary to stress what can and cannot be reliably projected. As the saying goes, "all models are wrong; some are useful." Our projections are attempts to represent possible states of global inequality in the future, so as to better understand the role played by key determinants. The purpose of our projections is not to predict the future. The number of forces (or variables) that we consider in our analysis is limited. This makes our projections straightforward and simple to understand, but also limits their ability to predict the future. Our projections of global income inequality dynamics are based on the modeling of three forces: within-country income inequality, national level total income growth, and demographics.

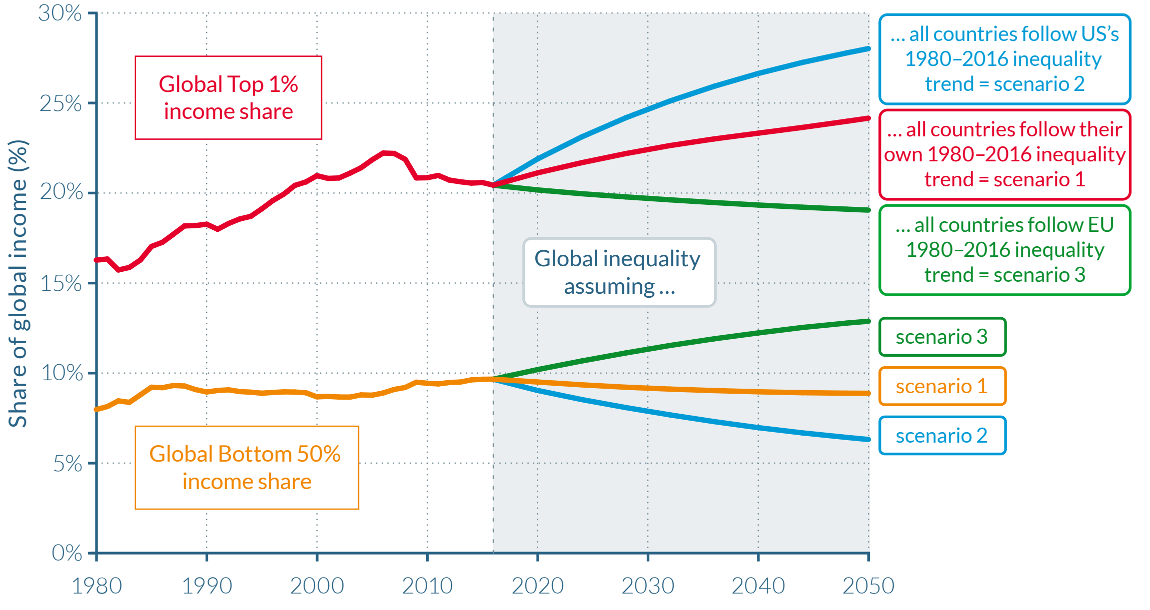
One of the key questions we seek to address is the following: will between-country convergence—that is, Asian, African, and Latin American countries catching up with rich countries—dominate in the future and lead to a reduction of global income inequality? Or will forces of divergence (the increase of inequality within countries) take over? Demographic dynamics are also important to take into account. Fast population growth in countries where inequality is rising, for instance, will tend to accentuate global divergence. It is difficult to say which of these forces will dominate *a priori*. Such an exercise can thus help us understand under what conditions different outcomes might result.

Defining three scenarios to project global income inequality up to 2050

Three scenarios are defined to project the evolution of inequality up to 2050. All our scenarios run up to the halfway mark of the twenty-first century; this has us looking out at a time span similar to the one that has passed since 1980—the starting date of our analyses in the previous chapters. Our first scenario represents an evolution based on "business as usual"—that is, the continuation of the within-country inequality trends observed since 1980. The second and third are variants of the business-as-usual scenario. The second scenario illustrates a high within-country inequality trend, whereas the third scenario represents a low within-country inequality trend. All three scenarios have the same between-country inequality evolutions. This means that a given country has the same average income growth rate in all three scenarios. It also has the same population growth rate in all three scenarios. For estimations of future total income and population growth we turned to the OECD 2060 long-term forecasts.[1] We also relied on the United Nations World Population Prospects.[2]

In the first scenario, all countries follow the inequality trajectory they have followed since the early 1980s. For instance, we know that the bottom 50% income earners in China captured 13% of total Chinese growth over the 1980–2016 period.[3] We thus assume that

Figure 5.1.1
Global income share projections of the Bottom 50% and Top 1% , 1980–2050



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

If all countries follow the inequality trajectory of the US between 1980 and 2016 from 2017 to 2050, the income share of the global Top 1% will reach 28% by 2050. Income share estimates are calculated using Purchasing Power Parity (PPP) euros. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

bottom 50% Chinese earners will capture 13% of Chinese income growth up to 2050. The second scenario assumes that all countries follow the same inequality trajectory as the United States over the 1980–2016 period. Following the above example, we know that bottom 50% US earners captured 3% of total growth since 1980 in the United States. The second scenario then assumes that within all countries, bottom 50% earners will capture 3% of growth over the 2017–2050 period. In the third scenario, all countries follow the same inequality trajectory as the European Union over the 1980–2016 period—where the bottom 50% captured 14% of total growth since 1980.

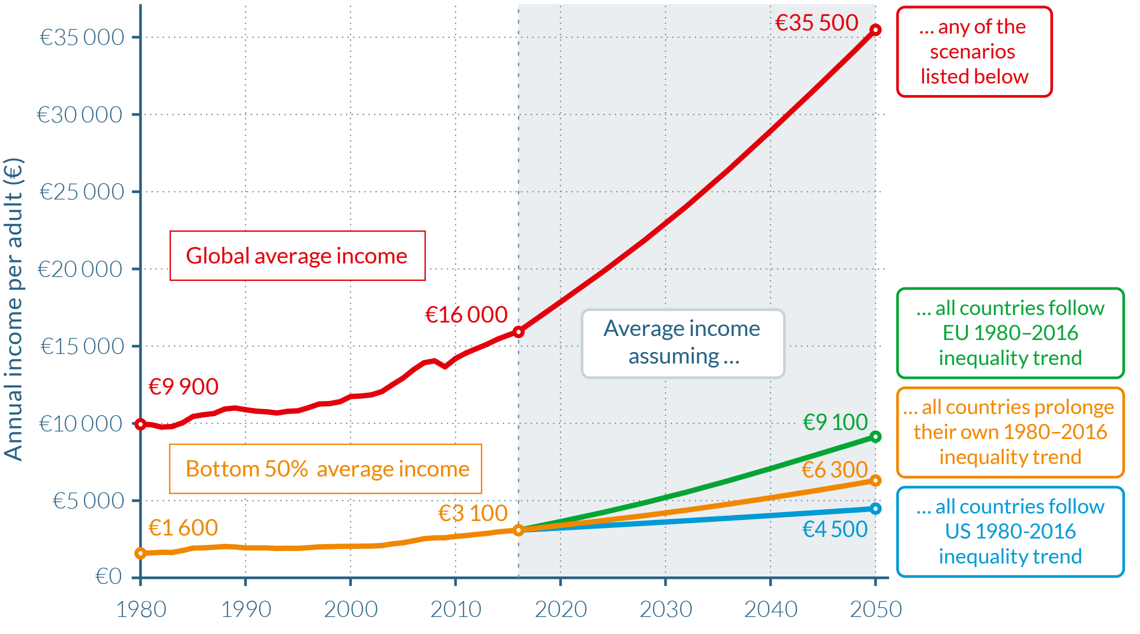
Under business as usual, global inequality will continue to rise, despite strong growth in low-income countries.

Figure 5.1.1 shows the evolution of the income shares of the global top 1% and the global bottom 50% for the three scenarios. Under the business-as-usual scenario (scenario 1), the income share held by the bottom 50% of the population slightly decreases from approximately 10% today to less than 9% in 2050. At the top of the global income distribution, the top 1% income share rises from less than 21% today to more than 24% of world income. Global inequality thus rises steeply in this scenario, despite strong growth in emerging countries. In Africa, for instance, we assume that average per-adult income grows at sustained 3% per year throughout the entire period (leading to a total growth of 173% between 2017 and 2050).

These projections show that the progressive catching-up of low-income countries is not sufficient to counter the continuation of worsening of within-country inequality. The results also suggest that the reduction (or stabilization) of global income inequality

Figure 5.1.2

Global average income projections, 1980–2050



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

By 2050, the global average income will reach €35 500, compared to €16 000 in 2016. If all countries follow Europe's inequality trajectory between 1980 and 2016, the average income of the Bottom 50% of the world population will be €9 100 by 2050. Income estimates are calculated using Purchasing Power Parity (PPP) euros. For comparison, €1 = $1.3 = ¥4.4 at PPP. PPP accounts for differences in the cost of living between countries. Values account for inflation.

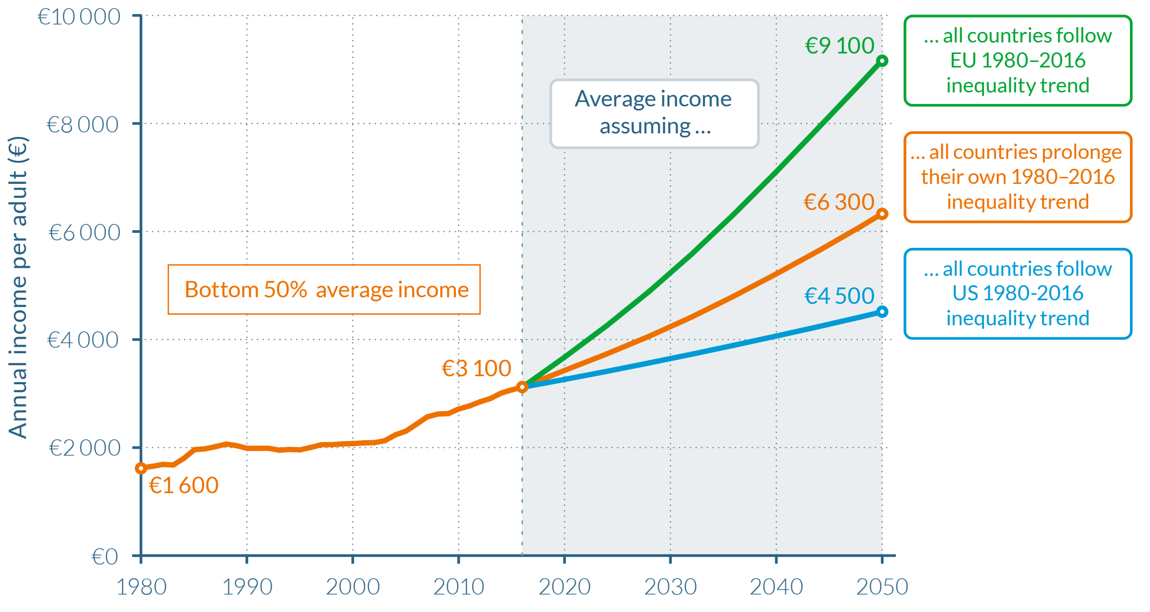
observed since the financial crisis of 2008, discussed in Chapter 2, could largely be a short-run phenomenon induced by the shocks on top incomes, and the growth slowdown in rich countries (particularly in Europe).

In scenario two, future global income inequalities are amplified as compared to scenario one, as the gap between the global top 1% share and the global bottom 50% share in 2050 widens. In this scenario, the global top 1% would earn close to 28% of global income by 2050, while the bottom 50% would earn close to 6%, less than in 1980, before emerging countries started to catch up with the industrialized world. In this scenario, the increase in the top 1% income share (a positive change of eight percentage points over the 2016–2050 period) is largely, but not entirely, made at the expense of the bottom 50% (a negative change of four percentage points).

Scenario three presents a more equitable global future. It shows that global inequality can be reduced if all countries align on the EU inequality trajectory—or more equitable ones. In this scenario, the bottom 50% income share rises from 10% to approximately 13% in 2050, whereas the top 1% decreases from 21% to 19% of total income. The gap between the shares held by the two groups would, however, remain large (at about six percentage points). This suggests that, although following the European pathway in the future is a much better option than the business-as-usual or the US pathway, even more equitable growth trajectories will be needed for the global bottom 50% share to catch up with the top 1%. Achieving a world in which the top 1% and bottom 50% groups capture the same share of global income would mean getting to a point where the top 1% individuals earn on average fifty times more than those in the bottom half. Whatever the scenarios followed, global inequalities will remain substantial.

Figure 5.1.3

Global average income projections of the Bottom 50%, 1980–2050



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

If all countries follow the inequality trajectory of Europe between 1980 and 2016, the average income of the Bottom 50% of the world population will be €9 100 by 2050. Income estimates are calculated using Purchasing Power Parity (PPP) euros. For comparison, €1 = $1.3 = ¥4.4 at PPP. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

Within country inequality trends are critical for global poverty eradication

What do these different scenarios mean in terms of actual income levels, and particularly for bottom groups? It is informative to focus on the dynamics of income shares held by different groups, and how they converge or diverge over time. But ultimately, it can be argued that what matters for individuals—and in particular those at the bottom of the social ladder—is their absolute income level. We stress again here that our projections do not pretend to predict how the future will be, but rather aim to inform on how it *could* be, under a set of simple assumptions.

Figure 5.1.2 depicts the evolution of average global income levels and the average income of the bottom half of the global population in the three scenarios described above. The evolution of global average income does not depend on the three scenarios. This is straightforward to understand: in each of the scenarios, countries (and hence the world as a whole) experience the same total income and demographic growth. It is only the matter of how this growth is distributed within countries that changes across scenarios. Let us reiterate that our assumptions are quite optimistic for low-income countries, so it is indeed possible that global average income would actually be slightly lower in the future than in the figures presented. In particular, the global bottom 50% average income would be even lower.

In 2016, the average per-adult annual income of the poorest half of the world population was €3 100, in contrast to the €16 000 global average—a ratio of 5.2 between the overall average and the bottom-half average. In 2050, global average income will be €35 500 according to our projections. In the business-as-usual scenario, the gap between average income and the bottom would widen (from a ratio of 5.2 to a ratio of 5.6) as the bottom half would have an income of €6 300. In the US scenario, the bottom half of the world population earn €4 500 per year and per adult—rising the global average income to bottom 50% income ratio of 7.9. Average income of the global bottom half will be €9 100 in the EU scenario, reducing the bottom 50% to average income ratio to 3.9.

The gap between global average income and the average income of the bottom half of the population is particularly high in all scenarios. However, the difference in average income of the bottom 50% between the EU scenario and the US scenario is important, as well. Average income of the global bottom 50% would be more than twice higher in the EU scenario than in the US scenario at €9 100 versus €4 500. This suggests that within-country inequality trajectories matter—and matter substantially—for poverty eradication. In other words, pursuing high-growth strategies in emerging countries is not merely sufficient to lift the global bottom half out of poverty. Reducing inequality within countries is also key.

The scenarios point toward another crucial insight: global inequality is not bound to rise in the future. Our analysis (in Part II) of the different income inequality trajectories followed by countries showed that, if anything, more equitable growth does not mean dampened growth. This result is apparent when time periods are compared (the United States experienced higher growth in the 1950s–1960s when inequality was at its lowest) or when countries are compared with one another (over the past decades, China grew much faster than India, with a lower level of inequality, and the EU had a more equitable path than the United States but a relatively similar growth rate). This suggests that it is possible to pursue equitable development pathways in a way that does not also limit total growth in the future.

What can governments do to prevent the rise of national and global inequality? The next and final chapters of this report discuss various policy options which need to be democratically debated, on the basis of sound and transparent economic data, if societies are to seriously address the issues raised by rising levels of income and wealth concentration. We do not attempt to resolve any of these policy debates, and nor do we claim to have the right answer as to which set of policies will be best suited to a given country given its own economic, political, social, and cultural situation. Recent research, however, points to fundamental economic issues that have not been discussed enough over the past decades. These include the role of progressive taxation and global financial transparency to tackle rising inequality at the top of the distribution, as well as more equal access to education and good paying jobs to put an end to the stagnation of incomes at the bottom. Reassessing the role of public capital to invest in the future should also, in our view, be a key component of these future discussions.

5.2

TACKLING RISING INEQUALITY AT THE TOP: THE ROLE OF PROGRESSIVE TAXATION

- There has been a rise global top shares, but different countries have experienced widely different inequality trajectories. Institutional and policy changes implemented since the 1980 stand as the most powerful explanations for the different inequality trajectories.
- Income tax progressivity is a proven tool to combat rising income and wealth inequality at the top. Tax progressivity does not only reduce post-tax inequality; it also impacts pre-tax inequality, by discouraging top earners to capture a higher share of growth via aggressive bargaining for higher pay.
- Tax progressivity was sharply reduced in rich countries from the 1970s to the mid-2000s. During this period, the top marginal income tax rate in rich countries was brought from 70% to 42% on average. Since the global financial crisis of 2008, the downward trend has been halted and reversed in certain countries. Future evolutions remain, however, uncertain.
- Progressive taxation of wealth and inheritances is also a key component of redistribution. In some of the most unequal nations of the world (Brazil, South Africa, India, Russia, and the Middle East), inheritance tax is almost inexistent while the poor often face high tax rates on the basic goods they purchase.
- More generally, tax systems are highly regressive in large emerging countries. Evidence from recent inequality trends (for example, Brazil between 2000 and 2015) suggests that progressive tax reform should be given a higher priority in the future.

The previous chapters of this report confirm that income and wealth inequality largely increased at the top of the distribution. The rise in inequality has been driven by the substantial growth rates enjoyed by the very top groups as compared to the rest of the distribution. A common explanation for this growth is skill-biased technological change. That is, the evolution of technology is said to have increased the relative productivity—and hence the relative pay—of skilled labor relative to unskilled labor, thereby increasing the demand for skilled workers. Globalization could have had a similar impact in developed countries as discussed in chapter 2.1. As we have already repeatedly stressed, there are many limitations to this purely technological explanation. First, rising income inequality is a broad-ranging phenomenon which also involves capital income and wealth dynamics, and not only the distribution of labor income. The supply of skilled labor is determined by education. That is, the expansion of education leads to a rise in the supply of skills, while globalization and technological may change increase the demand for skills. Depending on which process occurs faster, the inequality of labor income will either fall or rise. This idea has been described as the race between education and technology.[4] In other words, different policies can make a large difference.

Another complementary explanation for rising top labor incomes is the "superstar effect."[5] According to this theory, technological change and globalization have made it easier for those who make it to the top to reap a higher share of growth. For instance, recording a song has more or less the same cost today as thirty years ago, but a successful music production can now reach a much broader audience. Because international firms have become larger, managers making it to the top control a much larger business than before, and their pay has increased as a result.[6] Due to the superstar effect, tiny differences in talent—or sometimes in bargaining power and other attributes—can translate into very large income differentials. It should be noted that these global "superstars" are not necessarily more productive or talented than they were thirty years ago. They are perhaps simply luckier to have been born a few decades after their elders.

In any case, the problem behind these two theories—education and superstar—is that they cannot fully account for cross-country divergences in top income trajectories. In a comparison of top remunerations in global firms, it stands out that there are important variations across countries—in particular, between the United States, Europe, and Japan. Germany's largest companies, for instance, are present in all global markets and are not less productive than their US counterparts, though CEO remunerations there are on average half as high as in the United States.[7] As discussed in chapter 2.3, the rise of labor income inequality was relatively limited in Europe compared to the United States, despite similar technical change and penetration of new technologies over the past forty years in both regions.

For the bottom and middle parts of the distribution, the importance of training and education designed to help individuals adapt to new modes of production cannot be overlooked. Unequal access to education is likely to have played a role in the stagnation of incomes of the bottom half of the distribution in recent decades—in particular, in the United States. These dynamics are discussed in the next chapter. They should, however, be distinguished from rising inequalities at the very top of the income distribution. Changes in policy and institutional contexts better account for the diversity of top income trajectories over the world. In particular, recent research shows that changes in tax progressivity have played an important role in the surge of top incomes over the past decades.

Top marginal tax rates have strong effects on both pre- and post-tax income inequality at the top

Progressive tax rates contribute to the reduction of post-tax income inequality at the top of the distribution via their highest marginal tax rates (that is, tax rates applicable above a certain level of income earned). Indeed, if an individual earns $2 million and if the top marginal tax rate is 50% above one million dollars, this individual will net out only $500 000 on the second million. If the top marginal tax rate is 80% above one million dollars, then the earner will net out only $200 000 on the second million. The reduction of inequality can be further enhanced if the public spending funded by this tax revenue is aimed at fostering equitable growth.

One often-neglected role of top marginal tax rates is their ability to reduce pre-tax income inequality. This can occur via two channels. The most obvious one is that when top marginal income tax rates are high, top earners have less money to save and accumulate wealth, and therefore potentially less income from capital next year. Another way to understand the impact on top income tax rates on income inequality is to focus on rich individuals' bargaining incentives. When top marginal tax rates are low, top earners have high incentives to bargain for compensation increases—for instance, by putting a lot of energy into nominating the right people to the compensation committees who decide on pay packages. Alternatively, high top marginal tax rates tend to discourage such bargaining efforts.[8] Reductions in top tax rates can thus drive upwards not only post-tax income inequality but pre-tax inequality, as well.

Higher top tax rates may, however, also discourage work effort and business creation among the most talented. In this scenario, higher top tax rates would lead to less economic activity by the rich and hence less economic growth. In this case, top tax rates are not a desirable policy. In principle, there should be room to discuss these conflicting and legitimate claims on the basis of dispassionate analyses and sound data.

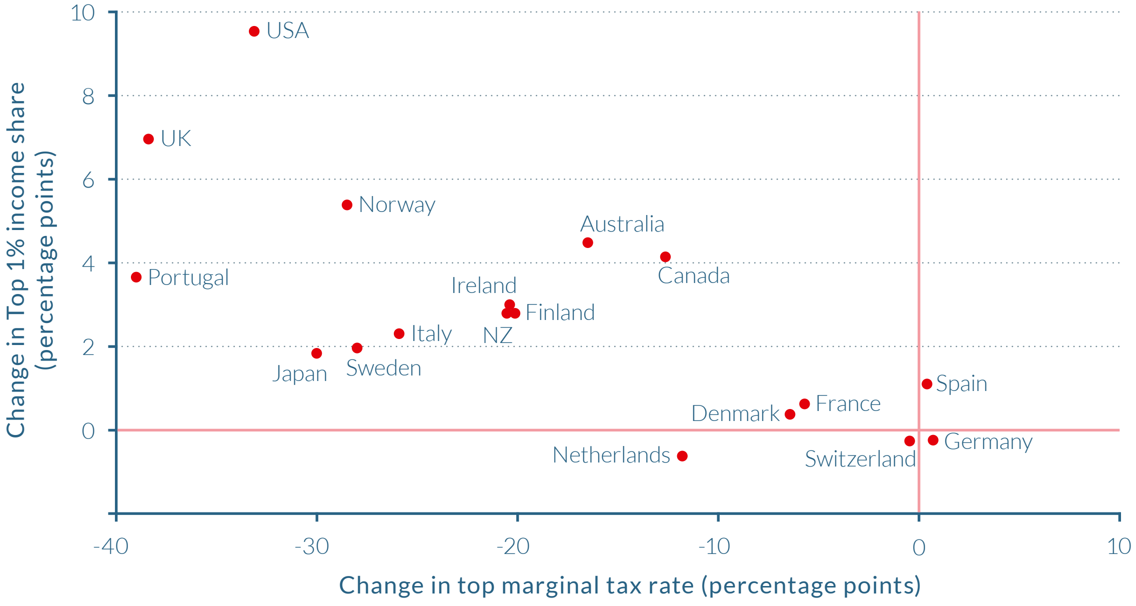
Piketty, Saez, and Stantcheva (2014) have developed a theoretical model and an empirical framework taking into account these different effects.[9] By using a database on CEO compensation and performance in developed countries, they conclude that bargaining elasticities are an important part of the story—in particular, to understand the high rise of US CEOs' pay relative to their counterparts in Japan and Europe (with comparability established by shared corporate sector, firm size, and performance levels). By calibrating the theoretical model, they show top tax rates could rise up to 80% and be welfare-enhancing for everyone apart from the very top of the distribution.

The data at our disposal is still imperfect, and we certainly do not pretend that a mixture of econometric evidence and mathematical formula should replace public deliberation and political decision making on these complex issues. But at the very least, we feel that there is enough evidence to reopen this discussion about sharply progressive taxation at the very top.

It is also important to remember that top tax rates reached more than 90% in the United States and in the UK in the era of the 1940s to the 1970s. Such high tax rates do not appear to have harmed growth. In fact, over the past fifty years, all rich countries have grown more or less at the same rates despite very large tax-policy variations.

Figure 5.2.1 shows the relationship between changes in top marginal tax rates and in the top 1% pre-tax income share in OECD countries, which occurred between the early 1970s and the late 2000s. The correlation is particularly strong: on average, a 2 percentage point drop in the top marginal tax rate is associated with a 1 percentage point increase in the top 1% pre-tax income share. Countries such as Germany, Spain, Denmark, and Switzerland, which did not experience any significant top rate tax cut, did not experience increases in top income shares. Conversely, the United States, UK, and Canada experienced important reductions in top marginal tax rates and saw their top 1% income shares substantially increase. This graph strongly

Figure 5.2.1
Changes in top marginal tax rates and top income shares in rich countries since the 1970s



Source: Piketty, Saez and Stantcheva (2014). See wir2018.wid.world for data series and notes.

In the US, the top marginal income tax rate was reduced by 33 percentage points between the early 1970s and the early 2010s. During the same period of time, the Top 1% income share increased by 9.5 percentage points.

suggests that top tax rates play a key role in moderating pre-tax top incomes. In addition, there was no significant impact on growth, suggesting again that bargaining elasticities are more important than incentive effects.

A window of opportunity for tax progressivity?

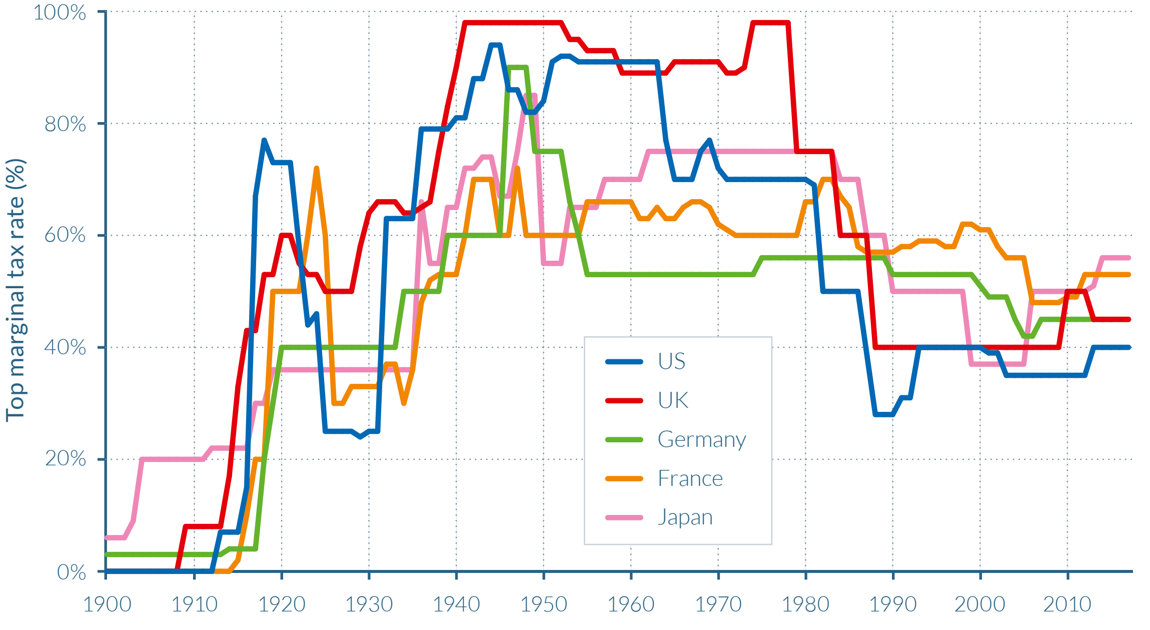
Figure 5.2.2 presents in detail the evolution of top marginal income tax rates in the United States, the UK, Germany, France, and Japan since 1900. In the five countries, there was either no personal income taxation or there was a very modest of it at the turn of the twentieth century. Income tax was then introduced, partly to finance the First World War, and top marginal tax rates were brought to very high levels in the 1950–1970s. (Top tax rates rose up to 94% in the United States, 98% in the UK.) Top rates were then drastically reduced from the 1970s onwards (from 70% on average in these countries to 42% on average in the mid-2000s).

How to account for these movements? Up until the 1970s, policymakers and public opinion probably considered—rightly or wrongly—that at the very top of the income ladder, compensation increases reflected mostly greed or other socially wasteful activities rather than productive work effort. This is why the United States and UK were able to set marginal tax rates as high as 80%. More recently, the Reagan/Thatcher revolution succeeded in making such top tax rate levels unthinkable, at least for a while. But after decades of increasing income concentration that has brought about mediocre growth since the 1970s, and a Great Recession triggered by financial sector excesses, a rethinking of the Reagan and Thatcher policies is perhaps underway—at least in some countries.

Top marginal income tax increased in the United States, UK, Germany, France, and Japan over the past ten years. The United Kingdom, for instance, increased its top

Figure 5.2.2

Top income tax rates in rich countries, 1900–2017

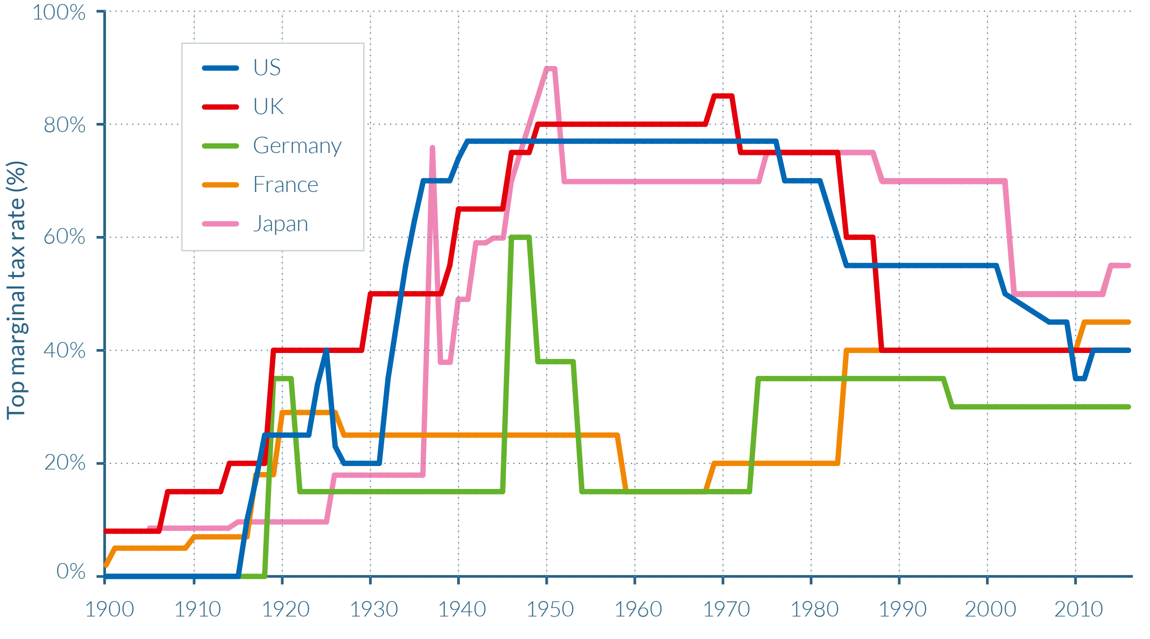


Sources: Piketty (2014) and updates. See wir2018.wid.world for data series and notes.

Between 1963 and 2017, the top marginal tax rate of income tax (applying to the highest incomes) in the US fell from 91% to 40%.

Figure 5.2.3

Top inheritance tax rates in rich countries, 1900–2017

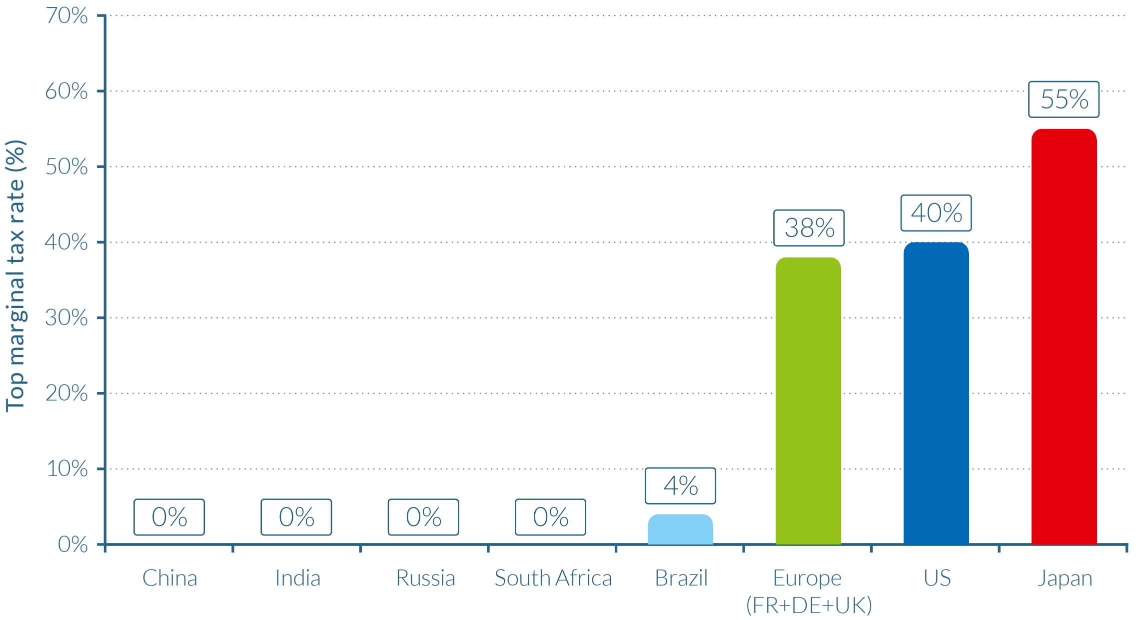


Source: Piketty (2014) and updates. See wir2018.wid.world for data series and notes.

Between 1980 and 2017, the top marginal tax rate of inheritance tax (applying to the highest inheritances) in the UK fell from 75% to 40%.

Figure 5.2.4

Top inheritance tax rates in emerging and rich countries, 2017



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2017, the top marginal tax rate of inheritance tax (applying to the highest inheritances) was 55% in Japan, compared to 4% in Brazil. Europe is represented by France, Germany and the UK.

income tax rate from 40% to 50% in 2010 in part to curb top pay excesses. In the United States, the Occupy Wall Street movement and its famous "We are the 99%" slogan also reflected the view that the top 1% gained too much at the expense of the 99%. Whether this marked the beginning of a new tax policy cycle that will counterbalance the steep fall observed since the 1970s remains a question. In the UK, the 2010 increase in top income tax rate was followed by slight reduction down to 45% in 2013. As we are writing these lines, the new US Republican administration and congress are preparing a major tax overhaul plan. The French government also projects to reduce tax rates on top incomes and wealth owners.

Top inheritance tax rates were recently increased in France, Japan, and the United States, as shown on **Figure 5.2.3**. In Japan and in the United States, this increase halted a progressive reduction in top inheritance tax rates initiated in the 1980s. In France and Germany, top inheritance tax rates have been historically lower than in the United States, UK, and Japan. In earlier chapters of this report we described the two world wars and various economic and political shocks of the twentieth century.[10] These durably reduced wealth concentration through other means than tax policy. As with the question of income tax progressivity, it is impossible to know whether this increase marks a new era of progressivity. The US tax overhaul plan plans to abolish the inheritance tax.

Inheritance is exempted from tax while the poor face high consumption taxes in emerging countries

While the past ten years saw some increases in tax progressivity in rich countries, it is worth noting that major emerging economies still do not have any tax on inheritance, despite the extreme levels of inequality observed there. Inheritance is taxed at a particularly small rate in Brazil (at a national average of around 4%, with a maximum federal rate of 8%). In India, China, and Russia, there is no inheritance tax—in contrast to rich countries (see **Figure 5.2.4**). In India, an 85% tax rate was in place in the 1970s and early 1980s before it was brought to 0% in 1984. One can plausibly argue that India's tax administration—or even Indian society as a whole—was not ready for very high top inheritance tax rates to begin with. But international evidence—in particular, from developed countries—suggests that a fairly progressive income and inheritance tax system can be an important component of a successful development strategy.

In emerging countries, it is also noteworthy that consumption taxes can be particularly high while inheritance tax is inexistent. In Brazil, for instance, the tax rate on electricity is around 30%, and high rates also apply to many other basic goods purchased by the poor. Extreme income and wealth inequality levels are thus sustained and reinforced by a regressive tax system. On a more positive note, the absence of inheritance taxes in emerging countries suggests that there is ample room for progressive tax policies. In a country like Brazil, as shown in chapter 2.11, incomes at the bottom rose over the past decades, but that this was partly to the detriment of the middle class, whose share of national income was reduced. This situation is bound to happen when the richest do not contribute fairly to the financing of the welfare state. Indeed, additional fiscal revenues collected through newly introduced progressive inheritance taxes could be used to fund educational or health programs and provide relief for the middle class in Brazil and other emerging countries.

5.3

TAX POLICY IN A GLOBAL ENVIRONMENT: THE CASE FOR A GLOBAL FINANCIAL REGISTER

- Although the tax system is a crucial tool to tackle inequality, it also faces potential obstacles, among which is tax evasion. The wealth currently held in tax havens is equivalent to more than 10% of global GDP and has increased considerably since the 1970s.
- The rise of tax havens makes it difficult to properly measure and tax wealth and capital income in a globalized world. Reducing financial opacity is critical to improve data on wealth and its distribution; to foster a more informed public debate about redistribution; and to fight tax evasion, money laundering, and the financing of terrorism.
- One key challenge involves recording the ownership of financial assets. While land and real-estate registries have existed for centuries, they miss a large fraction of the wealth held by households today, as wealth increasingly takes the form of financial securities. A global financial register recording the ownership of equities, bonds, and other financial assets would deal a severe blow to financial opacity.
- Little-known financial institutions called central security depositories (CSDs) already gather information about who owns financial assets. These data could be mobilized to create a global financial register. CSDs, however, are private actors in most OECD countries and will not transfer information to authorities in the absence of regulations compelling them to do so.
- Another difficulty lies in the fact that most CSDs do not directly record the names of the ultimate owners of financial securities, but only the names of the intermediaries.
- However, technical solutions have been identified by the CSDs themselves to allow end-investor identification. Moreover, more transparent systems exist in countries like Norway and China, which suggest that end-user transparency is technically and economically feasible at the CSD and at the global level.

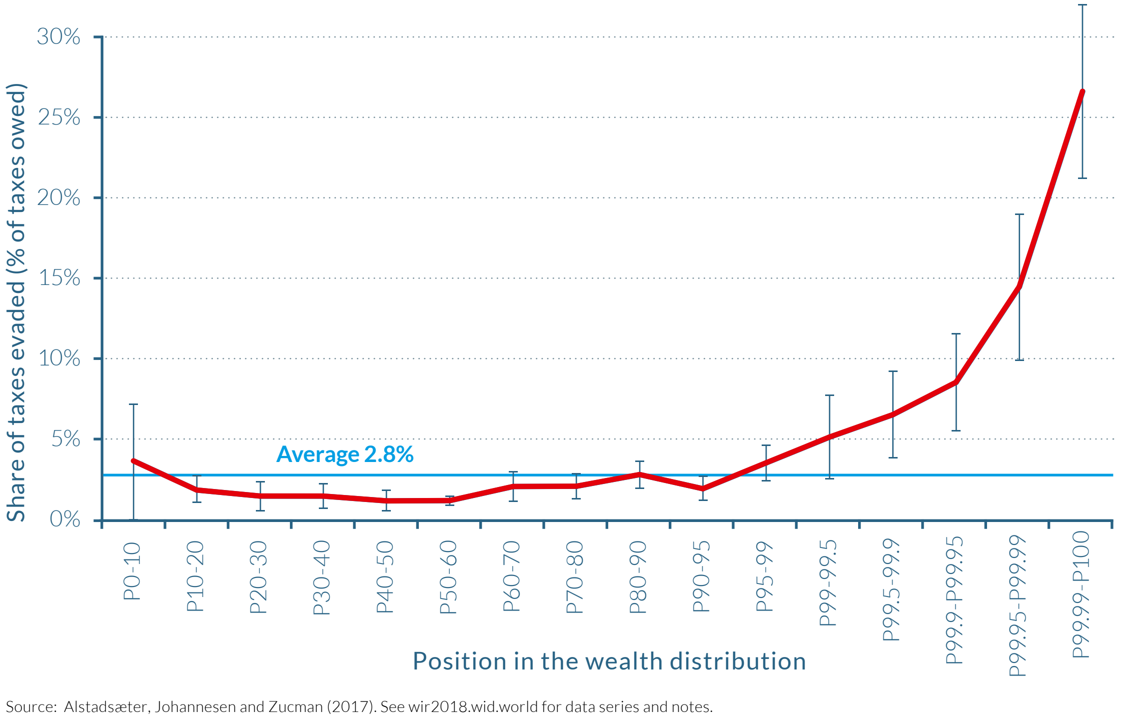
Multinational corporations and wealthy individuals are increasingly using tax havens to avoid or evade taxes. Fully 63% of all the foreign profits made by US multinationals are booked in a handful of offshore financial centers—Bermuda, Ireland, the Netherlands, Switzerland, Singapore, and Luxembourg—where they face very low tax rates, ranging from 0% to 5%. This represents a tenfold increase since the 1980s.

Assets worth the equivalent of 10% of world GDP are stored in tax havens by wealthy individuals. This figure rises to almost 40% in countries like Greece and Argentina, and to more than 50% in Russia, according to novel research by A. Alstadsæter, N. Johannesen, and G. Zucman.[11] At the global level, tax evasion deprives governments from about €350 billion in tax revenue each year.[12]

Tax evasion also seriously undermines tax progressivity. **Figure 5.3.1** shows the amount of taxes evaded as a share of taxes owed across the wealth distribution, in the case of Scandinavia. These statistics were produced by Alstadsæter, Johannesen, and Zucman (2017), who combine recent, massive data leaks (the "Panama papers" and the Swiss Leaks from HSBC Switzerland) with random audits and administrative records on income and wealth. While most of the population in advanced economies does not evade much tax—because most of its income derives from wages and pensions, which are automatically reported to the tax authorities—leaked data show pervasive tax evasion at the very top. The top 0.01% of the Scandinavian wealth distribution—a group that includes households with more than $45 million in net wealth—evades 25% to 30% of its personal taxes, an order of magnitude more than the average evasion rate of about 3%. Because Scandinavian countries rank among the countries with the highest social trust, lowest corruption, and strongest respect for the rule

Figure 5.3.1

Share of taxes evaded in Scandinavian countries, 2006



Source: Alstadsæter, Johannesen and Zucman (2017). See wir2018.wid.world for data series and notes.

In 2006, the Top 0.01% wealthiest individuals in Scandinavian countries evaded 27% of the total taxes they owed.

of law, that evasion among the wealthy may be even higher elsewhere.

Several recent policy initiatives have attempted to tackle offshore tax evasion. Before 2008, tax havens refused to share any information with foreign tax authorities. In 2010, the US Congress enacted the Foreign Account Tax Compliance Act, which compels foreign banks to disclose accounts held by US taxpayers to the IRS automatically each year, under the threat of economic sanctions. OECD countries have obtained similar commitments from most of the world's tax havens. Apparently, tax havens can be forced to cooperate if threatened with large enough penalties.

However, current enforcement efforts face important obstacles. Many tax havens and offshore financial institutions do not have incentives to provide accurate information, as they do not face large enough sanctions for non- or poor compliance. Second, a large and growing fraction of offshore wealth is held through intertwined shell companies, trusts, and foundations, which disconnect assets from their actual owners. This makes it easy for offshore banks to claim, falsely, that they do not have any European, American, or Asian clients at all—while in fact such persons are the beneficial owners of the assets held through shell companies.

As advocated by Gabriel Zucman in recent work, a global financial register would be a powerful tool for cutting through this opacity.[13] Such a register would allow tax and regulatory agencies to check that taxpayers properly report assets and capital income independently of whatever information offshore financial institutions are willing to provide. It would also allow governments to close corporate tax loopholes by enforcing a fair distribution of tax revenue globally for corporations with increasingly complex overseas operations. A global financial register could also serve as the informational basis for the establishment of a global wealth tax. The establishment of such a register would not, however, mean that ownership of assets would be disclosed to the general public. Such information could remain confidential in the same way that current income tax data is kept confidential.

The establishment of a global financial register could be based on the information already gathered by (mostly private) financial institutions known as central securities depositories (CSD). CSDs are the ultimate bookkeepers of the equities and bonds issued by corporations and governments. They can maintain accounts as end-investor segregated accounts—which is the most transparent model, as it links an individual to an asset. Or they can maintain omnibus accounts—a less transparent model, given that assets held by different investors are lumped into a single account under the name of a financial intermediary, making it difficult to identify end-investors. (See **Box 5.3.1**.)

One key issue with using CSDs as the building brick of a global financial register is that omnibus accounts prevail in most large western markets. (The Depository Trust Company in the United States and Clearstream in Europe, for instance, operate with omnibus accounts.) However, technical solutions facilitated by developments in information technologies already exist to allow the identification of ultimate asset holders in large Western CSDs. Moreover, in certain countries such as Norway, or large emerging markets such as China and South Africa, CSDs operate through systems which allow the identification of ultimate asset owners. In short, the creation of a global financial register does not face any insuperable technical problems. (See **Box 5.3.1**.)

Box 5.3.1

Towards a Global Financial Register?

This box draws upon Delphine Nougayrède, "Towards a Global Financial Register? Account Segregation in Central Securities Depositories and the Challenge of Transparent Securities Ownership in Advanced Economies," a working paper presented at a Columbia Law School Blue Sky workshop, April 2017.

Central Security Depositories as building blocks for a global financial register

In the modern financial system, shares and bonds issued by corporations are represented not by paper certificates but by electronic account entries. Holding chains are no longer direct—that is, do not connect issuers directly with investors, but involve many intermediaries often located in different countries. At the top of the chain, immediately after the issuers, are the central securities depositories (CSDs). Their role is to record the ownership of financial securities and sometimes to handle the settlement of transactions. The clients of CSDs are domestic financial institutions in the issuer country, foreign financial institutions, and other CSDs. After the CSD participants are several other layers of financial intermediaries, and at the end of the chain, a final intermediary, often a bank, holding the relationship with the investors.

Because so many intermediaries are involved, the issuers of financial securities are disconnected from end-investors; public companies that issue securities no longer know who their shareholders or bondholders are. CSDs, as a part of the chain of financial intermediation, both enable and obscure this relationship. The system was not intentionally designed for anonymity but it evolved this way over time because of the regulatory complexity of cross-border securities trading. The evolution toward non-transparency was also facilitated by the fact that the topic is too technical to be affected by public opinion.

Non-transparent accounts prevail in most Western CSDs

There are two broad types of accounts in the CSD world. "Segregated accounts" allow the holding of securities in distinct accounts opened in the name of the individual end-investors. This model thus allows transparency. The opposite model is that of "omnibus accounts" (or in the United States, "street name registration") where securities belonging to several investors are pooled together into one account under the name of a single account-holder, usually a financial intermediary, thereby obscuring the identity of the end-investors.

One of the key issues for a global financial register is that non-transparent accounting (that is, "omnibus accounts") prevails in most Western markets. For instance, the US CSD, the Depository Trust Company (DTC), uses omnibus accounts. In its books, the DTC identifies only brokerage firms and other intermediaries, not the ultimate owners of US stocks and bonds. "Omnibus accounts" also prevail in most European countries—in particular, within the Euroclear and Clearstream CSDs. This makes it difficult to construct a global financial register on the basis of the currently existing Western CSDs.

More transparency is possible, however

More transparency within Western CSDs can however be envisioned. The current system creates a number of risks for the financial industry, of which it is very aware. In 2014, Luxembourg's Clearstream Banking agreed to a $152 million settlement with the US Treasury following allegations that it had held $2.8 billion in US securities through an omnibus account for the benefit of the Central Bank of Iran, which was subject to US sanctions. As a result, the securities industry discussed a number of options that could be put in place to allow greater transparency of information on end-investors. This might include discontinuing the use of omnibus accounts, introducing new covering message standards (as is done in the payments industry) or ex-post audit trails, which would enable information on the identity of the ultimate beneficiary of financial transactions to circulate throughout the chain. New technologies such as distributed ledger technology (blockchain) could also foster greater transparency.

Transparent market infrastructures already exist today. In Norway, the CSD lists all individual shareholders in domestic companies, acts as formal corporate registrar, and reports back directly to the tax authorities. In China, the China Securities Depository Clearing Corporation Limited ("Chinaclear") operates a system that is fully transparent for shares issued by Chinese companies and held by domestic Chinese investors. At the end of 2015, it held $8 trillion worth of securities in custody, broadly the range of the CSDs of France, Germany, and the UK, and maintained securities accounts for ninety-nine million end-investors. Some segregation functionalities already exist within some of the larger Western CSDs (like DTC or Euroclear), which could be expanded. Many believe that segregated CSD accounting would support better corporate governance by giving greater voice to small investors. All of this suggests that more could be done within the large Western CSDs to implement greater investor transparency.

5.4

TACKLING INEQUALITY AT THE BOTTOM: THE NEED FOR MORE EQUAL ACCESS TO EDUCATION AND GOOD PAYING JOBS

- More equal access to education and good paying jobs is key to countering the stagnation and sluggish income growth rates of the bottom half of the population. Recent research shows that there can be enormous gaps between the beliefs evinced in public discourses about equal opportunity and the realities of unequal access to education.
- In the United States, for instance, out of one hundred children whose parents are among the bottom 10% income earners, only thirty go to college. The figure reaches ninety when parents are within the top 10% earners.
- On the positive side, research shows that elite colleges in the United States may improve openness to students from poor backgrounds without compromising their outcomes.
- In rich or emerging countries, it might be necessary to set transparent and verifiable objectives—together with changes in the financing and admission systems—in order to equalize access to education.

As is now well known that inequality has risen at the top of income and wealth distributions in recent decades. However, this report also sheds light on the stagnation or sluggish growth rates of the bottom 90%, and especially of the bottom 50% of the distribution. The situation has been particularly extreme in the United States, as shown in Chapter 2.4. To a lesser extent, bottom income groups have also lagged behind the rest of the population in terms of income growth in European countries as well as in fast-growth emerging countries. To counter such dynamics, progressive income and wealth taxes are not sufficient. More equal access to education and good paying jobs is key. This chapter explores recent findings on the interaction between educational inequalities and income inequalities.

Novel research allows us to better understand the determinants of educational inequalities and their interactions with income inequality

To what extent are income and wage inequality the result of a fair, meritocratic process? How do family resources determine the opportunities of their children? Publicly available data to assess these questions is still scarce in most countries around the globe. But recent research has contributed to answering the question. In particular, using US administrative data on more than fifty million children and their parents, Raj Chetty, Nathaniel Hendren, Patrick Kline, Emmanuel Saez, and Nicholas Turner were able to provide remarkable results on intergenerational mobility.[14]

Intergenerational mobility, broadly speaking, refers to the link between children's economic trajectories and their parents' economic situations. In the United States, estimations show that mobility levels are low as compared to other countries: fewer than eight American children out of a hundred born in the 20% poorest families manage to get to the top 20% of earners as adults, as compared to twelve in Denmark and more than thirteen in Canada. Another powerful way to illustrate the extent of educational inequality in the United States is to focus on the percentage of children attending college by income groups. Out of a hundred children whose parents are within the bottom 10% income earners, only thirty go to college. The figure reaches ninety when parents are within the top 10% earners.

The findings displayed by **Figure 5.4.1** show that there is sometimes an enormous gap between official discourses about equal opportunity, meritocracy, and so forth and the reality of unequal access to education. This also suggests that it might be necessary to set transparent and verifiable objectives—together with changes in the financing and admission systems—in order to equalize access to education.

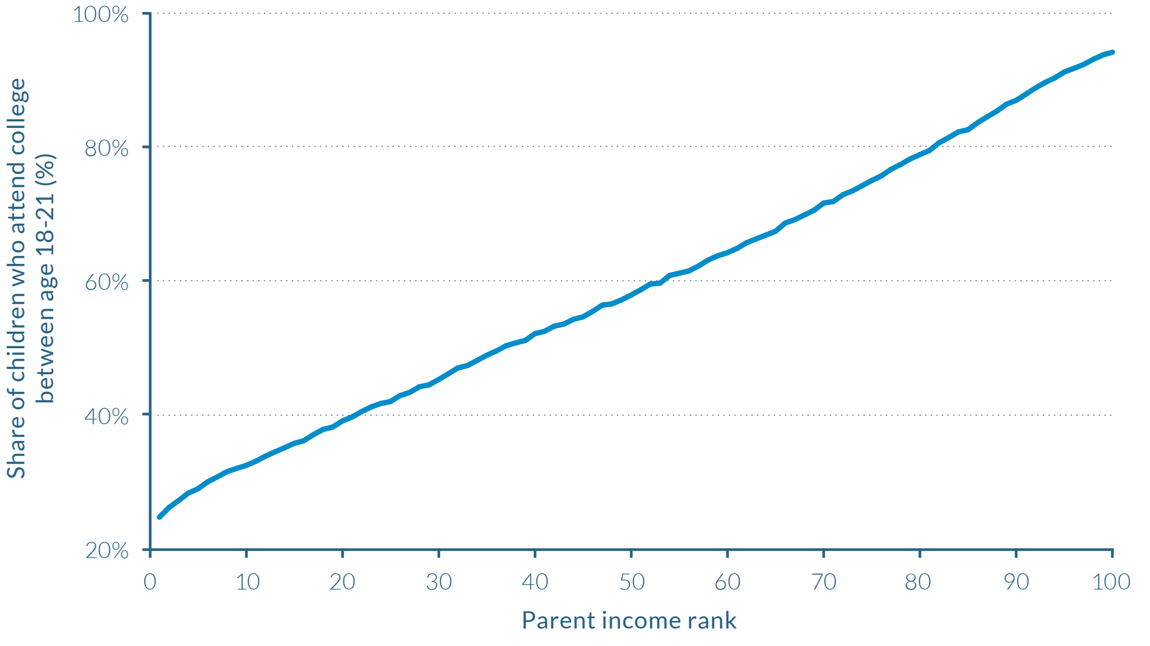
In the United States, intergenerational mobility is also a local issue

In the case of the United States, strong geographic inequalities also interact with educational inequalities. In geographical areas with the highest mobility, a child born in a family from the bottom 20% of the income distribution has a 10% to 12% chance of reaching the top 20% as an adult (that is about as much as in the highly mobile countries of Canada or Denmark). Examples of highly mobile places include the San Francisco Bay and Salt Lake City in Utah. In areas with low intergenerational mobility, a child born in a family from the bottom 20% of the income distribution has only a 4% to 5% chance of reaching the top 20% as an adult. No advanced economy for which we have data has such low rates of intergenerational mobility. Cities in the US south (such as Atlanta) or the US rust belt (such as Indianapolis and Cincinnati) typically have such low mobility rates.

What factors best explain these geographical differences in mobility? Detailed analysis shows that race and segregation play an important role in the United States. In general,

Figure 5.4.1

College attendance rates and parent income rank in the US for children born in 1980–1982



Source: Chetty, Hendren, Kline and Saez (2014). See wir2018.wid.world for data series and notes.

30% of children whose parents are in the Bottom 10% of the income distribution attend college between age 18 and 21. Almost 90% of children whose parents are in the Top 10% of the income distribution attend college between age 18 and 21.

intergenerational mobility is lower in areas with larger African-American populations. However, in areas with large African-American populations, both blacks and whites have lower rates of upward income mobility, indicating that social and environmental causes other than race, such as differences in history and institutions, may play a role. Spatial and social segregation is also negatively associated with upward mobility. In particular, longer commuting time decreases opportunities to climb the social ladder, and spatial segregation of the poorest individuals has a stronger negative impact on mobility. This suggests that the isolation of lower-income families and the difficulties they experience in reaching job sites are important drivers of social immobility.

Income inequality at the local level, school quality, social capital, and family structure are also important factors. Higher income inequality among the poorest 99% of individuals is associated with lower mobility.[15] Meanwhile, a larger middle class stimulates upwards mobility.[16] Higher public school expenditures per student along with lower class sizes significantly increase social mobility. Higher social capital also favors mobility (for example, areas with high involvement in community organizations).[17] Finally, family structure is also a key determinant; upward mobility is substantially lower in areas where the fraction of children living in single-parent households, or the share of divorced parents, or the share of non-married adults is higher.

What is remarkable is that combining these factors explains very effectively social mobility patterns. Taken together, five factors—commuting time, income inequality among the 99% poorest individuals, high-school dropout rates, social capital, and the fraction of children with single parents—explain 76% of inequalities in upward mobility across local areas in the United States. The vast geographic disparities in mobility in the United States, and the fact that they can be best explained by a combination of social factors at the commuting zone level, show that intergenerational mobility is largely a local issue.

Access to quality higher education is particularly unequal in the United States

The link between school quality and upward mobility that was highlighted above suggests that educational policies, school organization, and access rules can play a key role in promoting intergenerational mobility. Raj Chetty, John Friedman, Emmanuel Saez, Nicholas Turner, and Danny Yagan recently characterized intergenerational mobility in US colleges over a period of nearly fifteen years, from 1999 to 2013.[18] They show the extent of inequality in access to higher education, but also reveal tremendous scope for improvement: if all institutions could be made as efficient as the highest 10% colleges in terms of social mobility, then mobility in the United States would be perfect. Children's outcomes would be unrelated to their parents'.

Intergenerational mobility at the level of a given college may be defined as bringing together two components: the access rate and the success rate. Access rate refers to the openness of that college to students from lower-income groups, and can be measured as the proportion of students in it who come from the poorest 20% families. Success rate refers to that college's ability to help children from poor backgrounds reach higher income groups throughout their life. It might, for instance, be evaluated as the share of students ending up in the top 20% income group, given that they come from families in the bottom 20% of the national income distribution. Putting these together, one might define the mobility rate as the fraction of all students in a given college who come from the poorest 20% families *and* end up in the top 20% group. Theoretically, the mobility rate of a perfectly mobile society would be 4%.[19] The fact that it is currently just 1.7% in the United States as a whole shows that there is room for substantial improvement in providing low-income children with fair opportunities.

It is important to note, nevertheless, that family income differences only weakly predict the income positions of children from the same college. We saw that, at the national level, parental income strongly determined future position in the income distribution. However, within a given college, the relationship between parental income and student income is five times lower. At the national US level, children from the top 20% income groups end up 30 percentiles higher in the distribution than those from the bottom 20%; but among students attending a given elite college, this gap shrinks to close to 7 percentiles on average.

Contribution to mobility varies greatly across US colleges

Access to elite colleges remains highly unequal in the United States. Approximately 3% of children at Harvard University born between 1980 and 1982 come from the bottom 20% poorest families, whereas 70% come from the top 10%. In Ivy-Plus colleges (the most selective colleges in the United States) in general, there are more students coming from the top 1% richest families (14.5%) than from the bottom half (13.5%) of the population.

Such figures contrast sharply with public colleges. At Glendale Community College in Los Angeles, for instance, 32% of students come from the bottom quintile and only 14% from the top quintile. What is interesting is that high access rate colleges can also have high success rates (outcomes similar to highly selective colleges), translating into high mobility rates. Colleges helping many low-income students to reach the top of the income distribution tend to be public colleges welcoming a large number of low-income students. The existence of such institutions is particularly meaningful as it indicates that elite colleges may improve openness to students from poor backgrounds without compromising their outcomes.

Trends in mobility are heterogeneous, but show that little progress has been made overall

How did access and success rates evolve in the past decade in the United States? The data allow us to track their evolution between 2000 and 2011. During this period, the fraction of low-income college students increased from 10.6% to 12.8%, and this growth has been concentrated at for-profit institutions and two-year colleges. Access rates increased by only 0.65 percentage points among the most selective colleges, even though most Ivy-Plus colleges implemented tuition reductions and other policies to welcome more students from disadvantaged backgrounds. This does not mean that these policies were inefficient. Given the context of rising inequality in the United States, mobility may have worsened without them. All that is visible is that the net combination of these factors left access to elite colleges mostly unchanged.

Differences in mobility rates show that improving poor children's access to high-performing schools could substantially improve the contribution of education to upward mobility. Given that children from low-income families have similar success rates than their peers of a given college, opening them access to good colleges can hardly be considered as misplacement. Until now, efforts to expand access has mostly focused on elite colleges. Considering changes in admissions criteria may be an important way forward. Improving access and increasing funding to high-mobility-rate colleges may also be critical. These colleges have very good outcomes, admit a large number of low-income students, and operate at relatively low cost compared to elite colleges.

Educational inequalities can also be important in countries with lower levels of income and wealth inequality

European countries experienced a smaller rise of income and wealth inequality than that observed in the United States in recent decades (see Parts II–IV). This certainly does not mean, however, that the issue of education inequality is not relevant in Europe. In particular, France is one of the most unequal OECD countries in terms of educational inequality, as highlighted by the 2015 Programme for International Student Assessment (PISA). While the PISA survey provides information on France's general performance in terms of educational inequalities, still very little is known about the local characteristics explaining the large differences in outcomes between students from low- and high-income backgrounds. Gabrielle Fack, Julien Grenet, and Asma Benhenda have made significant contributions in this respect; their findings based on new data on middle schools and high schools in the Parisian region illustrate a particularly extreme case of educational inequality, but also are encouraging as they reveal how public policies can address these issues.[20]

As their work shows, in 2015, 115 public middle schools and 60 private schools welcomed more than 85 000 students, many of whom came from higher socio-professional groups (49%) and few from disadvantaged backgrounds (16%). Overall, Parisian middle schools appear to be extremely segregated, with the share of students from lower socio-professional groups ranging from 0.3% to 63% in middle schools of the capital. Private schools play a key role in social segregation by concentrating wealthier families: most private schools in Paris included less than 10% of students from low-income groups, and the private school with the highest level of social diversity welcomed only 25%. Therefore, it appears that private schools succeed in crowding out less-advantaged students and contribute directly to the polarization of the French educational system.

Social segregation is closely related to spatial segregation

This polarization is reinforced by territorial segregation. Paris is strongly divided into distinct areas—the north, northeast, east, and south, where median yearly income levels are below €30 000, and the center and west, where they are usually above €40 000. At the same time, access to Parisian middle schools is determined by location in the city. The French system allocates students in restricted geographical areas according to a "school map" *(carte scolaire)*, which implies that a student living at a given address can in principle access only one public middle school. Unsurprisingly, the repartition of students coming from poor and rich backgrounds therefore closely resembles that of parental income: certain middle schools in the relatively modest areas of Paris have more than 50% of students from low-income families, while most of schools in the richest areas of the city have less than 10%.

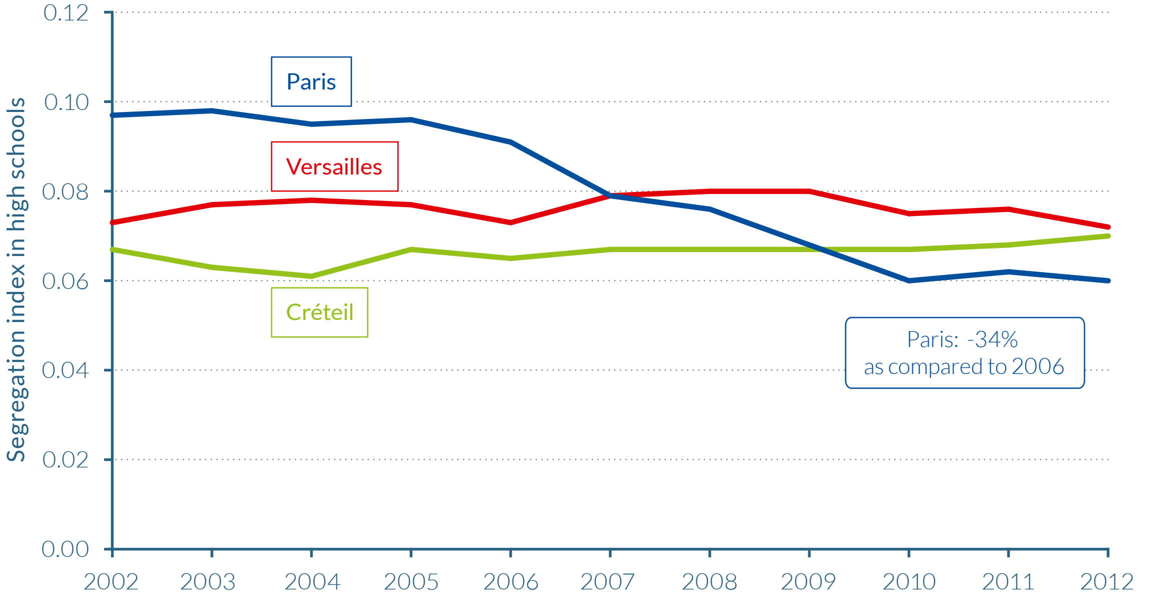
Spatial segregation, however, goes far beyond these geographical areas, and also exists at a very narrow level within Parisian districts *(arrondissements)*. In the eighteenth district, for instance, the share of students coming from poor backgrounds ranges from 9% to 58%, among high schools that are just a few hundred meters apart from one another. This effect is also reinforced by private schools, as wealthy families have the option to escape the public middle-school system.

Transparent data is a necessary condition to improve public debates on education

Tracking the evolution of educational segregation is fundamental to understanding why France displays such extreme disparities in students from low- versus high-income groups—and it is of crucial importance to evaluate existing policies. Concerning middle schools, segregation has been much higher in Paris than in Versailles or Créteil (both neighboring towns, all managed under different

Figure 5.4.2

The impact of an allocation policy on segregation in France, 2002–2012



Source: Fack, Grenet & Benhenda (2014). See wir2018.wid.world for data series and notes.

Between 2006 and 2012, the segregation index for high schools in Paris decreased by 34%.

administrative units) since 2002, and has remained relatively stable in the three cities.

However, new evidence from the evolution of segregation in high schools shows a very different picture. In 2007–2008, Paris implemented a new system of student allocation to high schools. Contrary to neighboring towns of Versailles and Créteil, where geographic proximity remained decisive, Paris decided to allocate students to their schools on the basis of their grades, across areas larger than before, to encourage social mixing. Students coming from disadvantaged backgrounds also obtained bonus points and therefore had more flexibility in the choice of their high schools.

Social segregation in public high schools in Paris decreased by one-third between 2002 and 2012 (see **Figure 5.4.2**), so that Paris has achieved a rate lower than in both Versailles and Créteil since 2010. The analysis of the new high-school allocation system based on students' grades shows that it played an important part in this evolution. Between 2005 and 2012, the share of students with grants based on social criteria, studying in the top 25% Parisian high schools, nearly doubled—from 12% to 21%, while this share remained stable in the neighboring cities, as well as in Parisian middle schools which did not implement the allocation procedure.

This evaluation shows that reducing social segregation is possible. Evaluating and designing new allocation systems is therefore of crucial importance to giving equal opportunities to all children regardless of their socioeconomic origin. In this respect, citizens can engage in a transparent, democratic debate informed by reliable information. Indeed, this issue is not limited to rich countries. Emerging countries such as India are also confronted with large educational inequalities. Some have for a long time established reservation systems based on quotas. These are complex and far from perfect, but the study of their strengths and limits can help others countries make progresses (see **Box 5.4.1**).

Indeed, reservation systems cannot be sufficient to ensure equal access to education. If public schools and universities do not have enough resources to pay for good teachers, buildings, and furniture, even the most equalizing allocation system will have little impact on the democratization of quality education. Large public investments in this are essential today, in emerging and rich countries countries alike. In addition, educational policies alone are not sufficient to tackle inequality at the bottom—policies supporting fair wages are also key (see **Box 5.4.2**).

Box 5.4.1

Reservation policies in India

In order to tackle extreme social inequalities, India developed a vast system of preferential admission to the universities (as well as in public sector employment) for children from the lowest castes (the SC/ST or "Scheduled Castes/Scheduled Tribes," the former highly discriminated untouchables, or almost 30% of the population). This nationwide program started in the 1950s. The implementation of reservation policies based on social and cultural segregation, however, faces complex measurement and political challenges. What is the correct way to identify legitimate beneficiaries? How can a dynamic reservation system be designed, which takes into account demographic, cultural, and economic changes?

In India, the so-called "reservation policies" aroused growing frustration amongst the children in the intermediate castes (the OBC, or "Other Backward Classes," roughly 40% of the population) caught between the most disadvantaged groups and the highest castes. Since the 1980s, several Indian states extended the policy of preferential admission to these new groups (including the Muslims who were excluded from the original system). Conflicts concerning these arrangements are all the greater because the old boundaries between castes are porous and do not always match the hierarchies in income and wealth. Far from it, in fact. In 2011, the federal government finally resolved to clarify these complex relationships by organizing a socio-economic census of the castes (the first to be carried out since 1931). The results of this census have been criticized as being unreliable and the central government also agreed on a series of measurement errors.

This reveals the importance of sound and legitimate data production systems to track demographic, economic, and cultural evolutions. In order to bypass current criticisms associated with reservation policies, one option for India could be to gradually transform these preferential admission policies into rules founded on universal social criteria, such as parental income or place of residence, along the lines of the admission mechanisms used for entry to schools or higher education institutions.

To a large extent, it could be argued that a country like India is simply endeavoring to confront the challenge of effective equality with the means available to a state based on the rule of law, in a situation where inequality of status originating in the former society and past discrimination is particularly extreme and threatens to degenerate into violent tensions at any time. However, as we have seen above, rich countries are not exempt from these issues, either—as may sometimes be thought. Indeed, rich and poor countries alike have a great deal to learn from the trials and errors of the Indian reservation system, one of the oldest nationwide affirmative action programs in the world.

Box 5.4.2

Minimum wage, fair wage, and corporate governance

Educational policies promoting social mobility and equality of opportunity are certainly key to reducing income inequality and widening access to good jobs. They remain, however, limited in their ability to provide decent incomes to all. Policy tools potentially useful for increasing workers' pay include the minimum wage, and more democratic corporate governance.

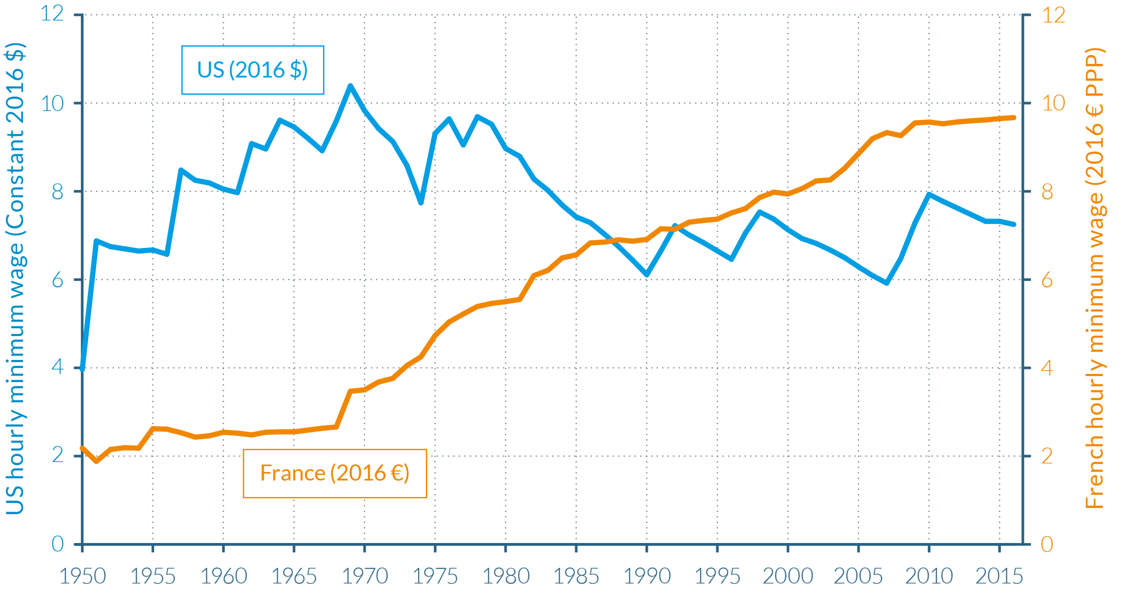
It is, in this respect, noteworthy to mention that wage inequality and employment precariousness remain of crucial importance, and have been increasing in a range of countries. According to the International Labour Organization, the share of labor in aggregate income has continued its long-run decline in the past five years, and still, 80% of workers are paid less than the average wage of the firm in which they work—a fact that skills-related characteristics fail dramatically to explain. Whether countries record high rates of average income growth or not, if individuals can only expect a declining share of it, equality-of-opportunity policies in education alone will fall short of meeting their demands.

Minimum wages and labor market regulation can be critical to tackling income inequality. **Figure 5.4.3** illustrates how regulatory policies can be tightly linked to disparities in earnings. While the real minimum wage has been steadily increasing in France since the beginning of the 1970s, in the United States it was actually higher in 1980 than it is today. Differences in income inequality dynamics between the two countries mirror this pattern, especially at the bottom of the distribution, as chapters 2.4 and 2.5 showed. Today, minimum wage workers in France earn nearly €10 per hour, almost 50% more than their counterparts in the United States, and this despite an average national income per adult in the United States that is 50% higher than in France. Minimum wages can therefore usefully help in compressing wage disparities, and notably differences in earnings between men and women, given that women are overrepresented among the low-paid in both developed and developing countries.

To reduce wage inequality and improve the overall quality of jobs would surely require deep changes in the way the power of different stakeholders is determined and organized. Some Nordic and German-speaking countries have already undergone changes in this direction by promoting "codetermination." For instance, employees' representatives hold half the seats in executive boards of major German firms, which ensures better consideration of workers' interests in companies' strategic choices or decisions over executive or workers' pay. These examples suggest that while being crucial, educational policies cannot suffice on their own to tackle the extreme inequality levels observed in certain countries.

Figure 5.4.3

Minimum wage in France and the US, 1950–2016



Source: Piketty (2014) and updates. See wir2018.wid.world for data series and notes.

Between 2000 and 2016, the hourly minimum wage rose from €7.9 to €9.7 in France, while it rose from $7.13 to $7.25 in the US. Income estimates are calculated using Purchasing Power Parity (PPP) euros for France and dollars for the US. For comparison, €1 = $1.3 = ¥4.4 at PPP. PPP accounts for differences in the cost of living between countries. Values are net of inflation.

5.5

A MESSAGE FROM THE PAST: LET GOVERNMENTS INVEST IN THE FUTURE

- The share of public wealth in national wealth has declined in most countries analyzed in this report. In many rich countries, it is now close to zero (France, Germany, Japan) or even negative (US, UK).
- Such low levels of public wealth makes tackling existing and future inequality extremely challenging given that governments do not currently possess the resources necessary for investments in education, healthcare and environmental protection.
- Selling public assets and/or undergoing prolonged periods of austerity would be barely sufficient, or even insufficient, to repay public debts. Moreover, these policies would leave governments without the means to improve equality of opportunity for their citizens.
- History indicates that there are three different ways – and generally a combination of the three – by which a reduction of large public debts can be achieved: progressive taxes on private capital, debt relief, and inflation. Given the potential difficulties in controlling the incidence and extent of inflation, a combination of the former two policies appears more appropriate.
- Reducing public debt is, however, by no means an easy task. Whilst several options exist and have been used across history, it is challenging to identify the best option(s) for each country. This is a matter for serious public debate, which must be grounded in sound economic, social and historical data and analyses

The share of public wealth in total national wealth has declined in all the countries analyzed in this report (see Part III). In Russia and China, this decline is the logical consequence of the move away from a communist system. Both countries were, however, successful to maintain relatively high levels of public capital as compared to rich countries. The current situation in rich countries stands out as an anomaly from a historical perspective.

During the postwar economic boom, public assets in European countries were considerable (approximately 100–130% of national income, thanks to their very large public sectors, the result of postwar nationalizations), and significantly higher than public debt (which was typically less than 30% of national income). In total, public capital—net of debt—was largely positive, in the range of 70–100% of national income. As a result, net public wealth made up a significant share of total national wealth between 1950 and 1980, typically around 15–25% or more.

Over the past thirty years, public debt approached 100% of national income in most industrialized economies, with the result that net public capital became almost zero. On the eve of the global financial crisis in 2008, it was already negative in Italy. The latest available data, presented in Part IV, shows that net public capital has become negative in the United States, Japan, and the United Kingdom. In France and in Germany, net public capital is just slightly higher than zero.

This situation does not mean that rich countries have become poor: it is their governments which have become poor. As discussed in Part IV, private wealth—net of debt—has risen spectacularly since the 1970s. Private wealth represented 300% of national income back then. Today it has risen to, or exceeded, 600% in most rich countries. This prosperity in private wealth is due to multiple causes: the rise in property prices (agglomeration effects in larger metropolitan areas); the aging of the population and decline in its growth (which automatically increases savings accumulated in the past in relation to current income and contributes to inflating the prices of assets); and the privatization of public assets and rise in debt (which is held in one form or another by private owners, via the banks). Also contributing to this increase were the very high returns obtained by the highest financial assets (which structurally grow faster than the size of the world economy) and the evolution in a legal system globally very favorable to private property owners (both in real estate and in intellectual property).

It is interesting to remark that countries such as China and Russia, despite large shifts in the balance of private and public capital since their transition away from Communism, have succeeded in maintaining relatively high public wealth levels. In China, public wealth is above 200% of national income, and it is close to 100% in Russia. While the ratio has sharply decreased in Russia over the past two decades, it has remained fairly constant in China. In both cases, it is still much higher than in rich countries. Governments in these countries have preserved significant means of action and control over their economies.

Large public property has obviously important consequences for the state's ability to conduct industrial, educational, or regional development policy (sometimes efficiently and sometimes less so). In contrast, negative public wealth also has potentially enormous fiscal consequences: governments with negative net public wealth typically have to pay large interest payments before they can finance public spending and welfare transfers, while those with large positive net public wealth can potentially benefit from substantial capital income, and finance more public spending than what they levy in taxes. This situation is particularly problematic in a situation of high income and wealth inequality.

What, then, are the different options for highly indebted governments? One possibility would be to sell all public assets (including all public buildings, schools, universities, hospitals, police stations, and infrastructure). In the United States, Japan, and the UK—and even more true of Italy—this would not be sufficient to repay the totality of public debt. In France and Germany, it would barely be sufficient. In all these cases, moreover, states would then have lost all (or nearly all) means of control over their education and health systems. To put it differently, social states would largely disappear, leaving governments without means to ensure equality of opportunity.

Another option would be to undergo prolonged periods of austerity, via drastic reductions in governments' expenditures. In effect, this also contributes to increasing inequality as governments would slash their redistribution programs to repay debts. In terms of both justice and efficiency, austerity and privatizations stand out as very bad measures.

Fortunately there are also other options. In history, one generally observes three different ways—and generally a combination of the three—to accelerate the reduction of a large public debt: progressive taxes on private capital; debt relief; and inflation.

First, an exceptional tax on private capital can raise substantial revenue to reduce debt. For instance, a flat tax of 15% on private capital in rich countries (about 600% of national income) would yield nearly a year's worth of national income (exactly 90% of national income) and thus allow for immediate reimbursement of all nearly outstanding public debt.

This solution is equivalent to repudiation of the public debt, except for two crucial differences. First, it is always difficult to predict the ultimate incidence of a debt repudiation (even a partial one). Bondholders are forced to accept what is called a "haircut"—meaning that the value of government bonds held by banks and creditors is reduced by 10–20% or even more. The problem is that it is very difficult to predict which actors ultimately bear the loss and, when applied at a large scale, haircuts can trigger panic among investors and a wave of bankruptcies—and potentially, the meltdown of the financial sector, which few governments are willing to experience. Second, an exceptional tax on private capital, contrary to a debt repudiation, can be adjusted to individuals' wealth levels—by using an explicitly progressive rate structure. Given the very large concentration of wealth, this is highly preferable. For instance, the top 1% of the wealth distribution typically owns around 30% of total wealth (that is, the equivalent of 180% of national income if aggregate wealth represents 600% of national income). Instead of using a flat tax of 15% on private capital, one could raise the same revenue by exempting the bottom 99% of the wealth distribution and applying an average effective tax rate of 50% on the top 1% wealth group. Alternatively, one could use an intermediate system. For instance, a progressive tax on capital that levied zero tax on capital up to 1 million euros, a 10% tax between 1 and 5 million euros, and a 25% tax above 5 million euros would raise 20% of national income in Europe—and that would be an important step toward a gradual reduction of public debt.

Interestingly, a special tax on capital was applied in France in 1945 to reduce substantial public debt. This special tax had progressive rates which ranged from 0 to 25%. Most importantly, special progressive taxes on private wealth were put in place after the Second World War in Germany, and were gradually paid by German private wealth holders between the 1950s and the 1980s.

At that time, exceptional progressive taxes on private wealth were used together with various gradual forms of debt repudiation and debt relief—an obvious second way to accelerate the reduction of a large public debt. In particular, Germany benefited from a near complete reduction of its foreign debt at the

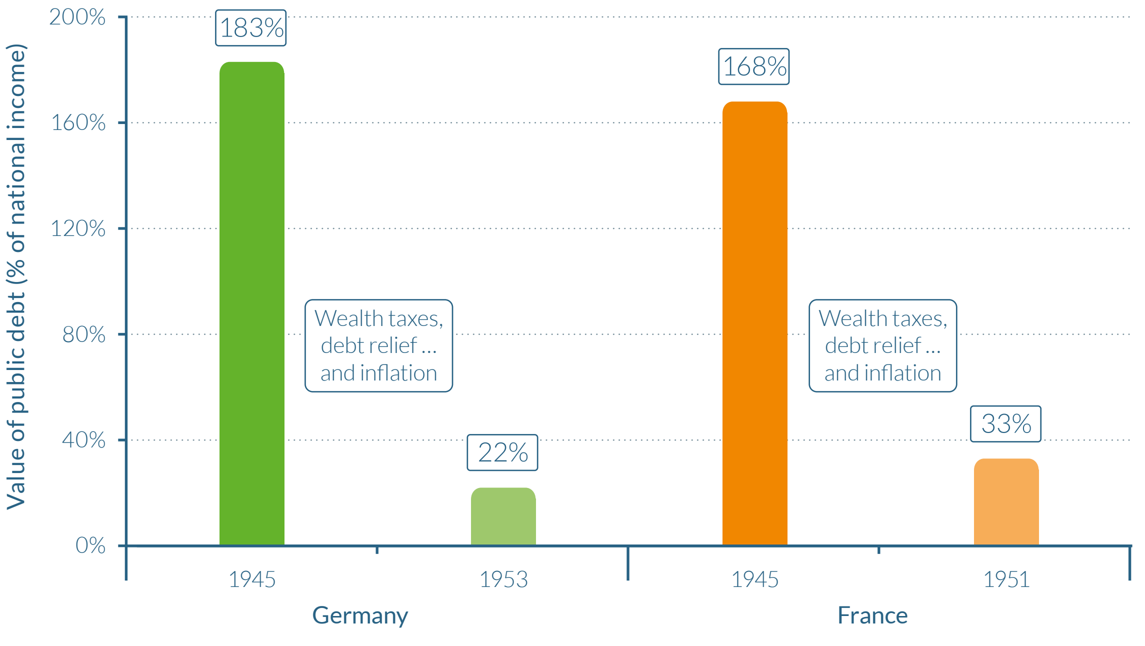
London conference in 1953. These were debts that were accumulated by Germany during the reconstruction period of 1945 to 1953. International creditors—largely governments—decided in 1953 to postpone repayment until German unification (with no indexation mechanism), and the debt was eventually entirely cancelled.[21]

In the current context, new forms of debt relief might develop in Europe, and to some extent have already started to develop (albeit too slowly, and with multiple hesitations and setbacks). Specifically, public institutions like the European Central Bank (ECB) and the European Stability Mechanism (ESM) could gradually take onto their balance sheets rising fractions of individual countries' public debts and postpone repayments until certain social, economic, and environmental objectives have been met. This would make it possible to have the advantages of debt repudiation without the financial instability coming from investor panic and bankruptcies.

Finally, the third solution used historically to accelerate the reduction of a large public debt is inflation. Historically, this mechanism played a crucial role in the reduction of most public debts. High levels of inflation were the major mechanisms used in France and Germany to bring their public debts to very low levels after the First World War, and they also played a central role in the aftermath of the Second World War, together with more sophisticated mechanisms like progressive wealth taxes and debt relief. One major problem with inflation as a policy instrument is that it is hard to control. Once it starts, policymakers may have difficulties stopping it. Inflation, moreover, is a much less precise tool than taxation in terms of incidence. In theory, it could act as a tax on those who have idle capital, and provide relief to those who are indebted by reducing the value of their debt. In practice, however, it can have less desirable effects from a fairness point of view. During high-inflation phases, large and well diversified portfolios invested on the stock market

Figure 5.5.1

Public debt in France and Germany, 1945–1953



Source: Piketty & Zucman (2014). See wir2018.wid.world for data series and notes.

In 1945, public debt in Germany was 183% of national income, and decreased to 22% in 1953.

Box 5.5.1

The importance of standardized inequality metrics for international comparisons and collective learning

The need for sound economic data to allow civil society, researchers, businesses, and policymakers to debate and develop informed and balanced policy responses to rising economic inequality has been a dominant theme in this report.

In that regard, it is interesting to note that the United Nations agreed in 2015 to seventeen sustainable development goals (SDGs), as part of a global agenda to transform society in rich and poor countries alike. Recognizing that rising income and wealth inequality has become a universal issue, SDG Target 10 commits countries to "reduce inequalities within and among countries." To that end, the SDG framework calls on states to articulate nationally specific implementation strategies and to put in place monitoring and review processes to meet the UN goals.

This development is particularly remarkable since international organizations have until recently paid limited attention to within-country inequality issues, considering the reduction of inequalities to be a sovereign issue for each country, or positing inequalities as a necessary evil towards global improvement of wellbeing. Concerns about domestic income inequalities were politically confined in the shadow of absolute poverty considerations, until the UN's Sustainable Development Goals replaced its former Millenium Development Goals. In addition, global development goals have so far only focused on poor and emerging countries—leaving rich countries aside. We have seen, however, that both rich and poor countries face rising inequality.

In this context, the unanimous endorsement of SDG Target 10.1 by the UN member states marks an important shift. Target 10.1 aspires to "by 2030, progressively achieve and sustain income growth of the bottom 40 per cent of the population at a rate higher than the national average." This target was subject to harshly contested debates among country representatives. While China argued that within-country inequality reduction was a national prerogative, the United States contended that a standalone goal on inequality would better be achieved through economic growth. At some point, the inequality target was even removed from the SDG list. A group of countries led by Denmark, Norway, and Brazil supported its reinsertion, arguing that a specific metric should be used to precisely ensure that growth reduces inequality.[a] If anything, such debates suggest that countries are taking this new indicator seriously.

Table 5.5.1

Real income growth in emerging and rich countries, 1980–2016

		Brazil	China	France	India	Russia	USA
2015–2016	**Bottom 40%**	-7.1%	6.4%	1.7%	4.4%	-1.4%	0.6%
	Full Population	-5%	6.6%	1.4%	4.5%	-2.7%	2.2%
2000–2016	**Bottom 40%**	12%	200%	10%	50%	119%	-7%
	Full Population	1%	281%	4.7%	108%	69%	12%
1980–2016	**Bottom 40%**	–	359%	31%	107%	-21%	-3.9%
	Full Population		833%	40%	223%	52%	66%

Source: WID.world (2017). See wir2018.wid.world for data series and notes.

Between 1980 and 2016, the average pre-tax income of the Bottom 40% in China grew by 359%. In comparison, the average pre-tax income of the full adult population grew by 833%.

How do countries fare on SDG Target 10.1? WID.world data is particularly suited to address this question. **Table 5.5.1** compares target achievement of six countries over the following periods of time: 2015–2016, 2000–2016, and 1980–2016. The focus here is on pre-tax income.

In 2016–2015, only one country was able to meet the target: France. In all five other countries, the income growth of the bottom 40% was lower than the national average. These results help underscore the power of this objective: it is transformative in the sense that it cannot be automatically met. Countries will have to act if they want to fulfill their commitments. The 2000–2016 period provides another crucial insight. During this time span, Brazil, France, and Russia were able to meet the target—with very different average growth trajectories, however. This implies that success has been possible over relatively longer time spans for several countries, and suggests that meeting the target in the future is not only desirable but also feasible—even if results over the 1980–2016 period are less encouraging.

Two points are worth noting.

First, as described earlier in this report, inequality also increased at the top. Focusing on the bottom 40% alone can miss important dynamics—in part for the middle class, which may be squeezed between increases in both the bottom 40% share and the top 1% share. In particular, the top 1% can also grow significantly faster, as was the case in most countries for the periods considered. In Brazil from 2000 to 2016, the bottom 40% grew much faster (12%) than the average (1%), but the top 1% grew at 24% in the meantime. To a lesser extent, this also occurred in France over 2015–2016, with bottom 40% groups and the top 1% growing faster than average. This means that the income share held by individuals richer than the bottom 40% but poorer than the top 1% decreased. This "squeezed middle class" phenomenon obviously poses one of the most important policy challenges for the years to come and deserves very careful scrutiny.

Second, these estimates focus on pre-tax income. Pre-tax income inequality estimates take into account most cash redistribution in rich countries (see Box 2.4.1) but do not include personal income and wealth taxes. International comparisons of post-tax income inequality measures are thus also necessary to assess the full impact of fiscal policy. As discussed earlier in this report, more work lies ahead to collect, harmonize, and analyze such information. The United Nations and other international organizations have a responsibility in this regard. WID.world will remain committed to working toward such results, with all its statistical contributors willing to dedicate resources to this task, to enlighten the public democratic debate.

Bearing in mind these remarks, the SDG Target 10.1 on inequality stands out as a very useful tool for stakeholders dedicated to tackling economic inequality. To be sure, an inequality metric based on sound data cannot in itself change policy—but it is a necessary basis for doing so. The SDG framework can also lead to the establishment of a framework for collective learning on inequality reduction policies.[b] As emphasized in this report, there is large scope for learning between rich and poor countries regarding the fiscal, educational, wage, and public investments policies they employ to promote fairer development pathways.

a Chancel, L, Hough, A., Voituriez, T. (2017) "Reducing Inequalities within Countries: Assessing the Potential of the Sustainable Development Goals," 12511. Global Policy.

b Chancel et al., "Reducing Inequalities within Countries."

can earn a good return while smaller wealth holdings of the middle class and the poor held in savings accounts can be wiped out. A combination of exceptional wealth taxes and debt relief seems like a better option.

Reducing public debt is thus by no means an easy task. Several options exist and have been used across history. We certainly do not pretend that we have identified the best option for each country. This is a matter of serious public debate, which must be grounded in sound economic, social, and historical analysis and comparisons over time and countries. (See **Box 5.5.1**.) In this discussion, there is one crucial element: today, large investments are required to promote more equal access to education or to protect the environment and combat the consequences of climate change.[22] If these challenges go unaddressed they are likely to reinforce tomorrow's levels of economic inequality. Recent history has shown that in exceptional circumstances, exceptional measures were taken by societies through their governments to reinvest in the future.

NOTES

1 OECD (2017), GDP long-term forecast. doi: 10.1787/d927bc18-en. Note that the rates we use are voluntarily more optimistic than the rates assumed by the OECD to compute their total global income in 2050 for Africa, Latin America, and Asia. Assuming higher growth rates tends to reduce global inequality. Ours should be seen as a conservative approach to the rise of global inequality in the coming decades.

2 UNDESA (2017) UN Population Prospects. https://esa.un.org/unpd/wpp/. Note that we use the medium variant of the UN prospects.

3 These projections may be done at the level of regions rather than of countries, when there are not sufficiently detailed data over the 1980–2016 period.

4 Goldin, C. D., and Katz, L. F. (2009). *The Race between Education and Technology.* Harvard University Press.

5 "The Economics of Superstars," *American Economic Review*, 71 (5): 845–858, 1981.

6 Gabaix, X., and Landier, A. (2008). "Why Has CEO Pay Increased So Much?" *Quarterly Journal of Economics*, 123(1), 49–100. https://doi.org/10.1162/qjec.2008.123.1.49

7 Bloomberg (2017). Global CEO Pay Index. Bloomberg database.

8 Piketty, T., Saez, E., and Stantcheva, S. (2014). Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities. *American Economic Journal: Economic Policy.*

9 Piketty, T., Saez, E., and Stantcheva, S. (2014). *Ibid.*

10 See also Piketty, T. (2014). *Capital in the Twenty-First Century.* Harvard University Press.

11 A. Alstadsæter N. Johannesen, and G. Zucman (2017). "Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality," NBER Working Paper No. 23805.

12 Zucman, G. (2015). *The Hidden Wealth of Nations: The Scourge of Tax Havens.* University of Chicago Press and updates.

13 Zucman, Gabriel (2014). Taxing across Borders: Tracking Personal Wealth and Corporate Profits. *The Journal of Economic Perspectives*, 28(4), 121–148.

14 Chetty, R., Hendren, N., Kline, P., Saez, E., and Turner, N. (2014). "Is the United States Still a Land of Opportunity? Recent Trends in Intergenerational Mobility." *The American Economic Review*, 104(5), 141–147. And Chetty, R., Hendren, N., Kline, P., and Saez, E. (2014). "Where is the Land of Opportunity? The Geography of Intergenerational Mobility in the United States." *The Quarterly Journal of Economics*, 129(4), 1553–1623.

15 The raw correlation between upward mobility and the Gini coefficient in commuting zones is -0.58. The top 1% income share, however, is only weakly correlated with mobility (-0.19), so that upward mobility correlates more with inequality when measured by the Gini coefficient computed on the bottom 99% of the income distribution.

16 The size of the middle class is measured by the fraction of parents in a community zone who have family incomes between the twenty-fifth and seventy-fifth percentiles in the national income distribution.

17 The authors use a social capital index developed by Rupasingha and Goetz (2008) which factors in voter turnout rates, fraction of people returning census forms, and various measures of participation in community organizations.

18 Chetty, R., Friedman, J. N., Saez, E., Turner, N., and Yagan, D. (2017). *Mobility Report Cards: The Role of Colleges in Intergenerational Mobility* (No. w23618). National Bureau of Economic Research.

19 Indeed, perfect mobility would mean that there was no link between a family's income group and its child's income group. Thus, children coming from the poorest 20% families would be evenly distributed across the five quintiles, so that 4% of them (20% divided by 5) would join the top 20%.

20 Fack, G., Grenet, J., and Benhenda, A. (2014). L'impact des procédures de sectorisation et d'affectation sur la mixité sociale et scolaire dans les lycées d'Île-de-France. *Rapport de l'Institut des Politiques Publiques*, (3).

21 See for example A. Ritschl, "Does Germany Owe Greece a Debt? The European Debt Crisis in Historical Perspective", LSE, 2012.

22 See Chancel, L. and Piketty, T. (2015). Carbon and Inequality: From Kyoto to Paris. Trends in the Global Inequality of Carbon emissions (1998–2013) and Prospects for an Equitable Adaptation Fund. Paris School of Economics.

CONCLUSION

The *World Inequality Report 2018* draws from data available on the World Wealth and Income Database (WID.world), which combines historical statistical sources in a consistent and fully transparent way to fill a gap in the democratic debate regarding inequality. Our objective in this report has been to present inequality data that are consistent with macroeconomic statistics such as GDP and national income and that can be easily understood and used by the public, to help ground deliberations and decisions in facts. Our data series are fully transparent and reproducible; our computer codes, assumptions, and detailed research papers are available online so that any interested person can access and use them.

Drawing on novel inequality data published on WID.world, Part II showed that since 1980, income inequality has increased rapidly in North America and Asia, has grown moderately in Europe, and has stabilized at extremely high levels in the Middle East, sub-Saharan Africa, and Brazil. The poorest half of the global population has seen its income grow significantly thanks to high growth in Asia (particularly in China and India). Perhaps the most striking finding of this report, however, is that, at the global level, the top 0.1% income group has captured as much of the world's growth since 1980 as the bottom half of the adult population. Conversely, income growth has been sluggish or even nil for the population between the global bottom 50% and top 1%. This includes North American and European lower- and middle-income groups. The diversity of trends observed in the report suggest that global dynamics are shaped by a variety of national institutional and political contexts. There is no inevitability behind the rise of income inequality.

In Part III, we presented recent shifts in public versus private capital ownership. Understanding the dynamics of private and public capital ownership is critical to understanding the dynamics of global inequality, and particularly of wealth inequality. We documented a general rise in the ratio between net private wealth and national income in nearly all countries in recent decades. It is striking to see that this long-run finding has been largely unaffected by the 2008 financial crisis, or by the asset price bubbles experienced by countries including Japan and Spain. There have also been unusually large increases in the ratios for China and Russia, following their transitions from communist- to capitalist-oriented economies. These shifts were mirrored by the dynamics of public wealth, which has declined in most countries since the 1980s. Net public wealth (public assets minus public debts) has even become negative in recent years in the United States, Japan, and the United Kingdom, and is only slightly positive in Germany and France. This arguably limits government ability to regulate the economy, redistribute income, and mitigate rising inequality.

In Part IV, we discussed how increasing income inequality, and the large transfers of public wealth to private hands which have occurred over the past forty years, have led to a rise in wealth inequality among individuals. At the global level—represented by China, Europe, and the United States—the top 1% share of wealth increased from 28% in 1980 to 33% today, while the bottom 75% share oscillated around 10%. Large rises in top wealth shares have been experienced in

China and Russia following their transitions from communism toward capitalist economies, though the different inequality dynamics experienced between these two countries highlight different economic and political transition strategies. In the United States, wealth inequality has increased dramatically over the last thirty years and has mostly been driven by the rise of the top 0.1% wealth owners. Growing inequality of income and saving rates created a snowballing effect of rising wealth concentration. The increase in top wealth shares in France and the UK has been more moderate over the past forty years, in part due to the dampening effect of the rising housing wealth of the middle class and lower income inequality relative to the United States.

In Part V, we presented projections on the future of global income inequality, which is likely to be shaped both by convergence forces (rapid growth in emerging countries) and divergence forces (rising inequality within countries). Our benchmark projections showed that if within-country inequality continues to rise as it has since 1980, then global income inequality will rise steeply, even under fairly optimistic assumptions about growth in emerging countries. The global top 1% income share could increase from nearly 20% today to more than 24% by 2050, in which case the global bottom 50% share could fall from 10% to less than 9%. If all countries were to follow the high inequality growth trajectory followed by the United States since 1980, the global top 1% income share would rise even more. Conversely, if all countries were to follow the relatively low-inequality growth trajectory followed by Europe since 1980, the global top 1% income share would actually decrease by 2050. This finding reinforces one of our main messages: rising income inequality is not inevitable in the future. We also stressed that differences between high and low inequality growth trajectories within countries have enormous impacts on incomes of the bottom half of the global population.

The remainder of Part V was dedicated to a discussion of key policy issues that should be brought back to the center of the political agenda to tackle inequality. We certainly do not claim to have ready-made solutions to rising inequality within all countries. We believe, however, that much more can be done in the four key policy areas we highlight.

We first emphasized that progressive income taxation is a proven tool to combat rising income and wealth inequality at the top. It not only reduces posttax inequality, it also shrinks pretax inequality by discouraging top earners from capturing higher shares of growth via aggressive bargaining for higher pay. It should be noted that tax progressivity was sharply reduced in rich countries from the 1970s to the mid-2000s. Since the global financial crisis of 2008, however, the downward trend has been halted and reversed in some countries. The future use of progressive taxation remains uncertain and will depend on democratic deliberation.

Second, we argued that although tax systems are crucial mechanisms for tackling inequality, they also face obstacles—among them, tax evasion. The wealth held in tax havens is currently equivalent to more than 10% of global GDP and has increased considerably since the 1970s. The rise of tax havens makes it difficult to properly measure and tax wealth and capital income in a globalized world. Reducing financial opacity is critical to improving data on wealth and its distribution, to fostering a more informed public debate about redistribution, and to fighting tax evasion, money laundering, and the financing of terrorism. One key challenge, however, involves recording the ownership of financial assets. While land and real estate registries have existed for centuries, they miss a large fraction of the wealth held by households today, as wealth increasingly takes the form of financial securities. A global financial register recording the ownership of equities, bonds, and other financial assets would deal a severe blow to financial opacity.

Third, we discussed the importance of achieving more equal access to education and good paying jobs, if the bottom half of the population is to escape the trap of stagnating or sluggish income growth rates. Recent research shows the enormous gaps that often exist between public discourses about equal opportunity and the practical realities of unequal access to education. In the United States, for instance, out of a hundred children whose parents fall within the bottom 10% of income earners, between twenty and thirty go to college. That figure reaches ninety, however, among children whose parents fall within the top 10% of earners. On the positive side, research shows that elite colleges in the United States are able to improve openness to students from poor backgrounds without compromising their outcomes. Whether a country is rich or emerging, it might have to set transparent and verifiable objectives—while also making changes in financing and admissions systems—to equalize access to education. Democratic access to education can achieve much, but unless there are also mechanisms to provide people at the bottom of the distribution with access to good paying jobs, investments in education cannot do enough to tackle inequality. Better representation of workers in corporate governance bodies and boosts in minimum wages are important tools to achieve this.

Finally, we stressed the need for governments to invest more in the future, both to address current income and wealth inequality levels and to prevent further increases. This is particularly difficult given that governments have become poor and heavily indebted in rich countries over the past decades. Reducing public debt is by no means an easy task, but several options exist for accomplishing it (including taxation, debt relief, and inflation), all of which have been used across history. Finding the proper combination of solutions will require serious public debate, which must be grounded in sound economic, social, and historical analysis.

To conclude, we must repeat that current knowledge of global income and wealth inequality remains limited and unsatisfactory. Much more data collection work lies ahead of us to expand the geographical coverage of our inequality data, as well as to provide more systematic representations of pre- and post-tax income and wealth inequality. WID.world, the World Inequality Lab, and their partner institutions are committed to pursuing these efforts in the coming years.

The WID.world database is currently being expanded to increase its coverage of emerging countries in Asia (in particular, Malaysia and Indonesia), Africa (for instance, in South Africa), and Latin America (Chile and Mexico, among others).

We are also currently working towards better integration of natural capital in national wealth estimates, as the importance of environmental degradation as a dimension of inequality continues to grow.

More gender inequality data are also being integrated to WID.world and we are developing estimates of inequality at the regional (subnational) level, with the aim of further reducing the gap between individuals' perceptions of inequality and what economic statistics are able to measure. Indeed, WID.world is just one step in a long, cumulative research process.

We welcome efforts made by other institutions and researchers to take part in this collective endeavor. And we very much hope that, together with all interested actors and citizens, we will continue making progress toward financial transparency and economic democracy in the years to come.

APPENDIX

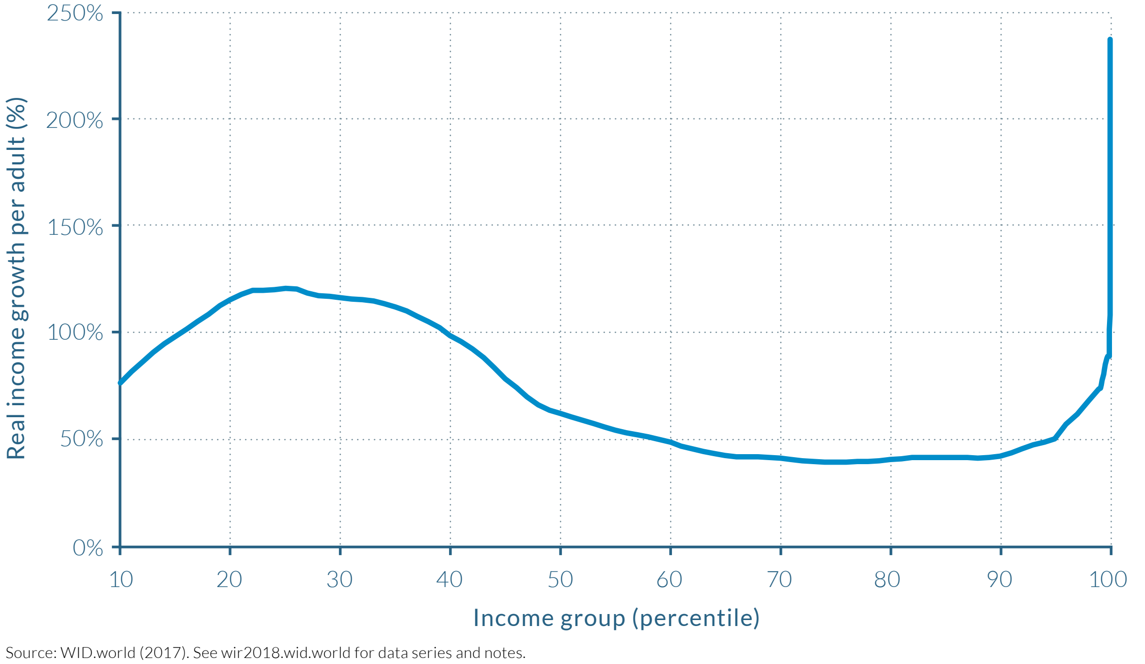
APPENDIX

- In order to improve the ease of reading of the World Inequality Report, we have not included all technical details in the main body of the text.
- However, interested readers are warmly invited to visit the Report's dedicated website (wir2018.wid.world) for methodological details on how estimations were constructed. In our efforts to be as transparent as possible, the website hosts all the methodological documents, country technical papers, raw data sources and computer codes used for the production of the series presented in the World Inequality Report.
- In particular, for detailed technical notes on each of the graphs presented in the report, users should refer to the document: "World Inequality Report 2018 Technical Notes" (WID.world Technical Notes 2017/7). This document at times redirects readers towards other working papers or scientific articles where more exhaustive information can be ascertained.
- The online publication of these documents is essential in our view to increase the level of transparency and reproducibility of global inequality data. We would encourage as many people as possible to view the site, make their own estimations, and discover ways in which our data can be improved and what alternative assumptions would be made in order to do so.
- Below is a limited selection of Appendix graphs, that we refer to earlier in the World Inequality Report. Figures A1 to A3 show alternative methods to represent our main results on global income inequality dynamics. Figure A4 focuses on income inequality dynamics in India and China and provides an example of the types of additional graphs which can be obtained on wir2018.wid.world.

In this representation of global income inequality dynamics discussed in Chapter 2.1, we scale the horizontal axis by population size, meaning that the distance between different points on the x-axis is proportional to the size of the population of the corresponding income group. (See **Box 2.1.1**)

Figure A1

Total income growth by percentile across all world regions, 1980–2016: Scaled by population



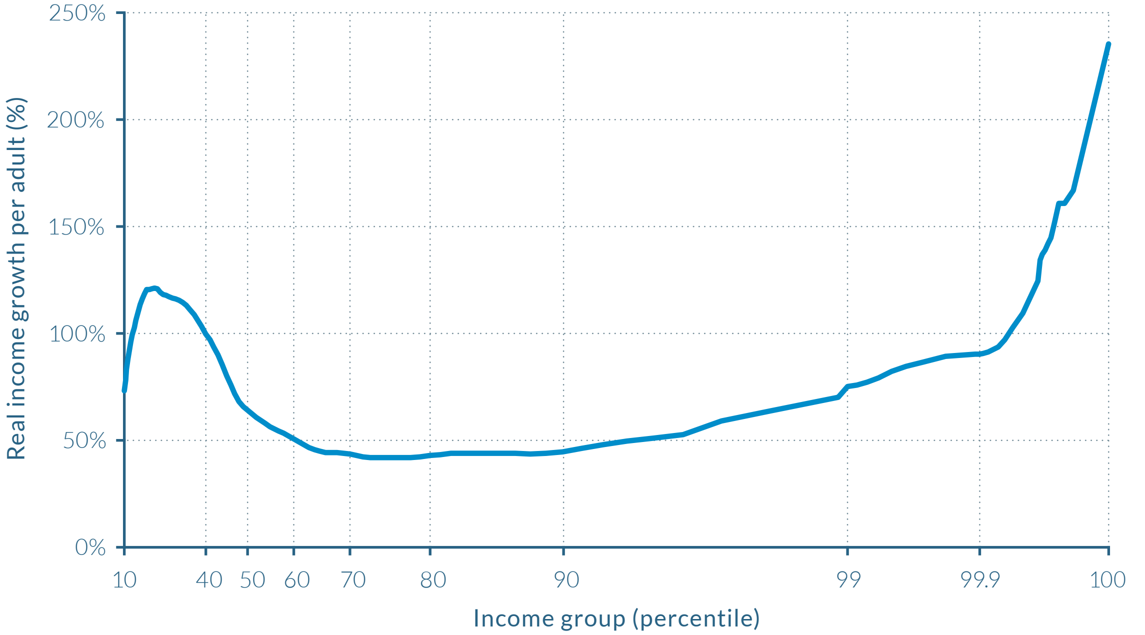
Source: WID.world (2017). See wir2018.wid.world for data series and notes.

This graph is scaled by population size, meaning that the distance between different points on the x-axis is proportional to the size of the population of the corresponding income group. The income group p0p1 (lowest percentile), for instance, occupies 1% of the size of the x-axis. On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the richest 1% of global earners), growth was 74% between 1980 and 2016. The Top 1% of income earners captured 27% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

In this representation of global income inequality dynamics discussed in Chapter 2.1, we scale the horizontal axis by the share of growth captured by income group, meaning that the distance between different points on the x-axis is proportional to the share of growth captured by the corresponding income group. (See **Box 2.1.1**)

Figure A2

Total income growth by percentile across all world regions, 1980–2016: Scaled by share of growth captured



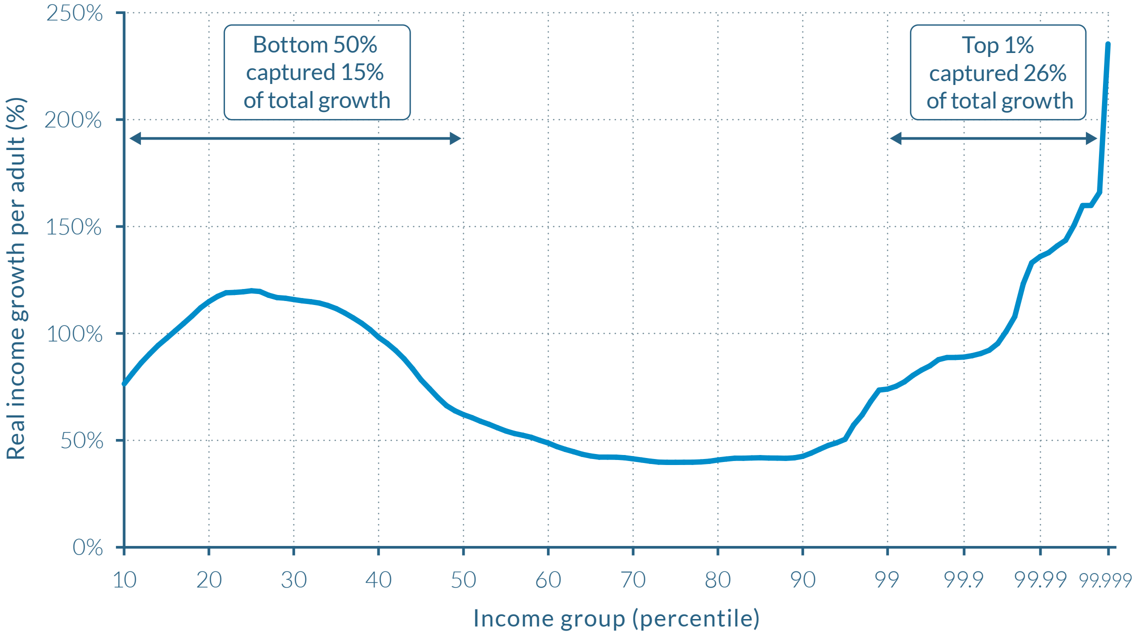
Source: WID.world (2017). See wir2018.wid.world for data series and notes.

This graph is scaled by the share of growth captured by income group, meaning that the distance between different points on the x-axis is proportional to the share of growth captured by the corresponding income group. The top 0.001% (p99.999p100), for instance, captured 3.6% of total growth. Therefore, the distance between p99.999 and p100 (the last two points of this graph) corresponds to 3.6% of the total size of the x-axis. On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the richest 1% of global earners), growth was 74% between 1980 and 2016. The Top 1% of income earners captured 27% of total growth over this period. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

In this representation of global income inequality dynamics discussed in Chapter 2.1, we adopt a combination of the scaling methods used in Figure A1 and Figure A2 so as to better visualize global inequality dynamics throughout the entire distribution. (See **Box 2.1.1**)

Figure A3

Total income growth by percentile, 1980–2016: Brazil, China, India, Europe, Middle-East, Russia, US-Canada



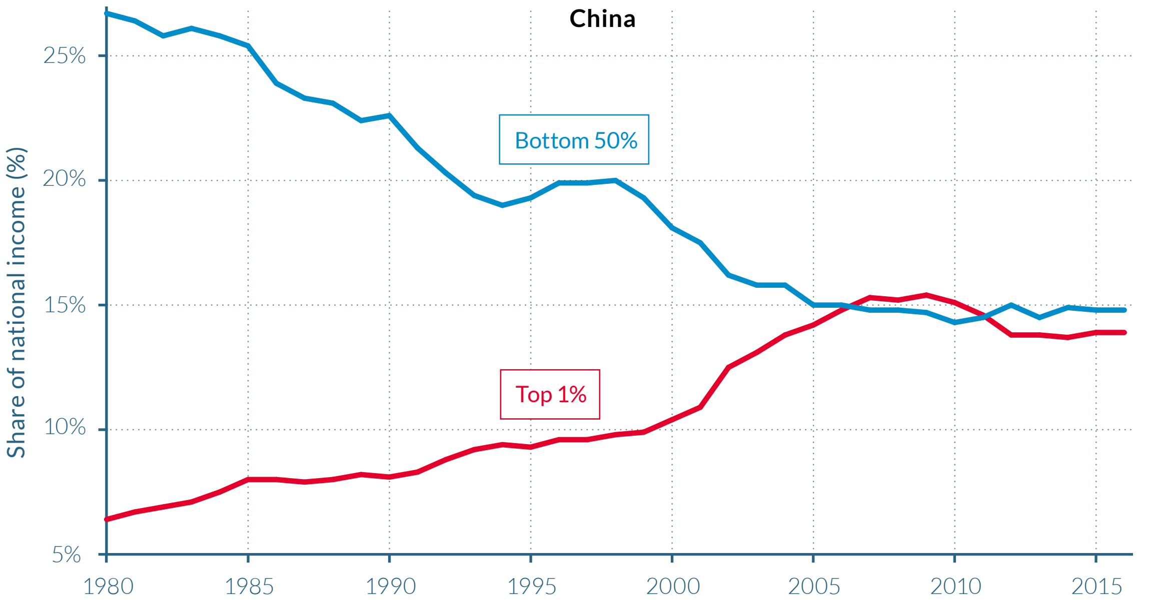
Source: WID.world (2017). See wir2018.wid.world for data series and notes.

On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level. The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size. The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016. For percentile group p99p99.1 (the poorest 10% among the richest 1% of global earners), growth was 83% between 1980 and 2016. Income estimates account for differences in the cost of living between countries. Values are net of inflation.

This graph shows the evolution of top 1% and bottom 50% income shares in India and China. It is an example of the additional graphs which can be produced online on wid.world and which are discussed in the various methodological documents referred to in the report.

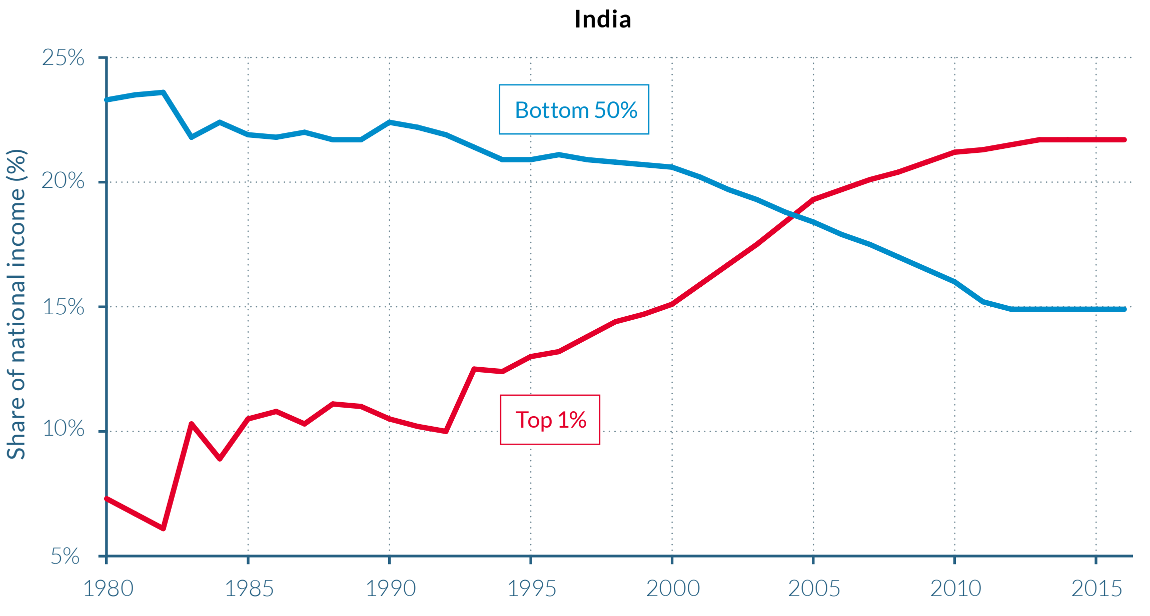
Figure A4

Top 1% vs. Bottom 50% income shares in China and India, 1980–2015



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

In 2015, the Top 1% national income share was 13.9% in China.



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WORLD INEQUALITY LAB

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PRESS RELEASE

World Bank Reforms Voting Power, Gets $86 Billion Boost

April 25, 2010

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(/en/news/press-release/2010/04/25/world-bank-reforms-voting-power-gets-86-billion-boost.print)

WASHINGTON, April 25, 2010 – The 186 countries that own the World Bank Group today endorsed boosting its capital by more than $86 billion and giving developing countries more influence, implementing historic changes to position the poverty fighting institution for the transformed world emerging from the global crisis. Along with this first general capital increase for the World Bank for more than 20 years and shift in voting power to developing countries, the Development Committee of the Board of Governors also backed the Bank's new post-crisis strategy, and a comprehensive reform package to make the Bank faster, more flexible, and more accountable.

"We are grateful to our shareholding countries for this strong vote of confidence," said World Bank Group President **Robert B. Zoellick.** *"This extra capital can be deployed to create jobs and protect the most vulnerable through investments in infrastructure, small and medium sized enterprises, and safety nets. The change in voting-power helps us better reflect the realities of a new multi-polar global economy where developing countries are now key global players. In a period when multilateral agreements between developed and developing countries have proved elusive, this accord is all the more significant."*

The four main components of the package are:

Financial resources:

- An increase of $86.2 billion in capital for the International Bank for Reconstruction and Development (IBRD), the arm that lends to developing countries, from a general capital increase and a selective capital increase linked to the change in voting-powers; this includes $5.1 billion in paid-in capital.
- A $200 million increase in the capital of the IFC, the World Bank Group's private sector arm, as part of an increase in shares for developing and transition countries. IFC will also, subject to board approval, consider raising additional capital through issuing a hybrid bond to shareholding countries and through retaining earnings.

Voting Power:

- A 3.13 percentage point increase in the voting power of Developing and Transition countries (DTCs) at IBRD, bringing them to 47.19 percent -- a total shift to DTCs of 4.59 percentage points since 2008. This increase fulfills the Development Committee commitment in Istanbul in October 2009 to generate a significant increase of at least 3 percentage points in DTC voting power.

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- The IBRD 2010 realignment will result from a selective capital increase of $27.8 billion, including paid-in capital of $1.6 billion.
  · An increase in the voting power of Developing and Transition Countries at IFC to 39.48 percent -- a total shift to DTCs of 6.07 percentage points.
- The IFC 2010 realignment will result from a selective capital increase of $200 million and increase in the basic votes for all members.
- An agreement to review IBRD and IFC shareholdings every five years with a commitment to equitable voting power between developed countries and DTCs over time.

Post-Crisis Strategy:
The Bank is sharpening its strategic focus where it can add most value, emphasizing: 1) Targeting the poor and vulnerable, especially in Sub-Saharan Africa; 2) Creating opportunities for growth with a special focus on agriculture and infrastructure; 3) Promoting global collective action on issues from climate change and trade to agriculture, food security, energy, water and health; 4) Strengthening governance and anti-corruption efforts; and, 5) Preparing for crises.

Operational Reforms:
The Bank's series of reforms represent the most comprehensive reform agenda undertaken by the institution. These include:

- A new Access to Information Policy, inspired by the Indian and U.S. freedom of information acts, which makes the Bank a world leader among multilateral institutions on information disclosure.
- The Bank's Open Data Initiative, launched last week, puts the World Bank at the forefront of giving free and easy access to information on developing countries.
- Investment lending reform that will improve the focus on results, increase speed and delivery, and strengthened risk management.
- Strengthened governance and anti-corruption efforts that will provide more resources for prevention and coordinated sanctions to fight corruption -- including the new cross-debarment agreement announced this month with multilateral development banks.

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Transparency at the IMF

Transparency in economic policy and the availability of reliable data on economic and financial developments are critical for sound decision-making and for the smooth functioning of an economy. The IMF has policies in place to ensure that meaningful and accurate information—both about its own role in the global economy and the economies of its member countries—is provided in real time to its global audiences.

Transparency helps economies function better and makes them less vulnerable to crises. **Greater openness on the part of member countries** encourages more widespread public discussion and examination of policies, enhances the accountability of policymakers and the credibility of policies, and facilitates efficient and orderly functioning of financial markets. **Greater openness and clarity by the IMF** about its own policies and the advice it provides to its member countries contributes to a better understanding of the IMF's own role and operations, building traction for the Fund's policy advice and making it easier to hold the institution accountable. Outside scrutiny should also support the quality of surveillance and IMF-supported programs.

The IMF's approach to transparency is based on the overarching principle that it will strive to disclose documents and information on a timely basis unless strong and specific reasons argue against such disclosure. The principle respects the voluntary nature of publication of documents that pertain to member countries.

Publication of country documents prepared for consideration by the IMF Executive Board ("Board documents") is typically "**voluntary but presumed**," meaning that, while voluntary, the publication of these documents is encouraged. An even **stronger presumption** applies to publication of documents relating to the use of Fund resources, though their publication is voluntary**.** A member's consent to publication of a Board document is typically obtained on a non-objection basis. The publication of policy papers is presumed but it is subject to Board approval, while the publication of multi-country documents requires consent either from the Board or the involved members depending on the type of document involved.

The IMF's efforts to improve the understanding of its operations and engage more broadly with the public has been pursued along four broad lines: (i) transparency of surveillance and IMF-supported programs, (ii) transparency of its financial operations; (iii) external and internal review and evaluation; and (iv) external communications.

Transparency of surveillance and IMF-supported programs

- In recent years, the IMF's surveillance has become increasingly transparent. In 2016, 96 percent of member countries published a press release, providing the IMF Executive Board's assessment of the member's macroeconomic and financial situation, and 96 percent of members published the IMF country report.

- In 2016, 100 percent of member countries that used an IMF program published the reports, and 100 percent published their letters of intent, memoranda on economic and financial policies, and technical memoranda of understanding.

Financial and operational information about the IMF

- Members' Financial Data—timely information for every member country on its financial position with the IMF—is posted on the IMF's website.

- IMF Financial Activities (updated weekly), quarterly data on Financial Transactions, and monthly data on Financial Resources and Liquidity are posted on the IMF website.

- Other information posted about the IMF includes the Codes of Conduct for IMF staff and Executive Directors, recruitment policies, and procurement guidelines.

Internal and external evaluations of IMF practices

- IMF staff regularly conducts reviews of policies and procedures to improve the IMF's effectiveness. Recent reviews include the role of trade in the IMF's work, how to improve IMF surveillance, the effectiveness of the Financial Sector Assessment Program, and evenhandedness of IMF surveillance.

- An Independent Evaluation Office (IEO), established in July 2001, provides objective and independent evaluations of IMF policies and operations. The Office operates independently of IMF management and at arm's length from the IMF's Executive Board. The IEO's reports and work program are publicly available. Recent IEO reviews have examined the IMF's response to the financial crisis and the quality of IMF economic forecasts. Reviews are typically open and inclusive and often draw on contributions from IMF member countries, donor agencies, international organizations, and civil society organizations.

External communications

- Each year the IMF receives roughly 28,000 general queries via email and phone and about 1,060 inquiries addressed specifically to the Managing Director of the IMF. The IMF's Communications Department responds to these inquiries.

- Each month, the Fund's external website receives about 6 million page views,1.2 million visitors, and around 319,000 report downloads.

- A Civil Society Policy Forum, organized jointly with the World Bank, runs in parallel with the Annual and Spring Meetings of the IMF and World Bank, covering a wide range of topics, including many organized by civil society organizations themselves.

- IMF staff and management hold regular meetings, seminars, and consultations with civil society and other stakeholders at Fund headquarters and worldwide on specific policy or country issues. Invitations are extended by the IMF to contribute to reviews of its policies, by attending seminars or by providing comments to papers posted on its external website.

FINANCIAL STABILITY BOARD

June 2012

Charter of the Financial Stability Board[1]

Having regard to:

(1) the initial mandate given to the Financial Stability Forum by the Finance Ministers and Central Bank Governors of the Group of Seven (20 February 1999);

(2) the broadened mandate given by the Heads of State and Government of the Group of Twenty (London Summit, 2 April 2009, "*Declaration on Strengthening the Financial System*");

(3) the call of the Heads of State and Government of the Group of Twenty to re-establish the Financial Stability Board "with a stronger institutional basis and enhanced capacity" (London Summit, 2 April 2009, "*Declaration on Strengthening the Financial System*");

(4) the Financial Stability Board Charter of 25 September 2009 and the endorsement by the Heads of State and Government of the Group of Twenty of the institutional strengthening of the FSB through its Charter (Pittsburgh Summit, 25 September 2009);

(5) the affirmation by the Heads of State and Government of the Group of Twenty of the FSB's role in coordinating at the international level the work of national financial authorities and international standard setting bodies in developing and promoting the implementation of effective regulatory, supervisory and other financial sector policies in the interest of global financial stability (Seoul Summit Leaders' Declaration, 12 November 2010); and

(6) the call of the Heads of State and Government of the Group of Twenty to strengthen FSB's capacity, resources and governance through establishment of the FSB on an enduring organisational basis (Cannes Summit, 4 November 2011, Cannes Summit Final Declaration);

Recognising the need to promote financial stability by developing strong regulatory, supervisory and other financial-sector policies, and fostering a level playing field through coherent policy implementation across sectors and jurisdictions;

We, the Members of the Financial Stability Board hereby amend and restate the original Charter of 25 September 2009 in the following manner:

---

[1] This Charter, as amended and restated, was endorsed by the Heads of State and Government of the Group of Twenty at their Los Cabos Summit on 19 June 2012.

I. General provisions

Article 1. Objectives of the Financial Stability Board

The Financial Stability Board (FSB) is established to coordinate at the international level the work of national financial authorities and international standard setting bodies (SSBs) in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. In collaboration with the international financial institutions, the FSB will address vulnerabilities affecting financial systems in the interest of global financial stability.

Article 2. Mandate and tasks of the FSB

(1) As part of its mandate, the FSB will:

(a) assess vulnerabilities affecting the global financial system and identify and review on a timely and ongoing basis within a macroprudential perspective, the regulatory, supervisory and related actions needed to address them, and their outcomes;

(b) promote coordination and information exchange among authorities responsible for financial stability;

(c) monitor and advise on market developments and their implications for regulatory policy;

(d) advise on and monitor best practice in meeting regulatory standards;

(e) undertake joint strategic reviews of and coordinate the policy development work of the international standard setting bodies to ensure their work is timely, coordinated, focused on priorities and addressing gaps;

(f) set guidelines for and support the establishment of supervisory colleges;

(g) support contingency planning for cross-border crisis management, particularly with respect to systemically important firms;

(h) collaborate with the International Monetary Fund (IMF) to conduct Early Warning Exercises;

(i) promote member jurisdictions' implementation of agreed commitments, standards and policy recommendations through monitoring of implementation, peer review and disclosure; and

(j) undertake any other tasks agreed by its Members in the course of its activities and within the framework of this Charter.

(2) The FSB will promote and help coordinate the alignment of the activities of the SSBs to address any overlaps or gaps and clarify demarcations in light of changes in national and regional regulatory structures relating to prudential and systemic risk, market integrity and investor and consumer protection, infrastructure, as well as accounting and auditing.

(3) The FSB should, as needed to address regulatory gaps that pose risk to financial stability, develop or coordinate development of standards and principles, in collaboration with the SSBs and others, as warranted, in areas which do not fall within the functional domain of another international standard setting body, or on issues that have cross-sectoral implications.

Article 3. Consultation

(1) In the development of the FSB's medium- and long-term strategic plans, principles, standards and guidance, the FSB should consult widely amongst its Members and with other stakeholders including private sector and non-member authorities. This process shall include engaging with the FSB Regional Consultative Groups and include an outreach to countries not included in the Regional Consultative Groups.

(2) The FSB should have a structured process for public consultation on policy proposals.

Article 4. Accountability and transparency

The FSB will discharge its accountability, beyond its members, through publication of reports and, in particular, through periodical reporting of progress in its work to the Finance Ministers and Central Bank Governors of the Group of Twenty, and to Heads of State and Governments of the Group of Twenty.

II. Members

Article 5. Members

(1) The following are eligible to be a Member:

- (a) Authorities from jurisdictions responsible for maintaining financial stability, such as ministries of finance, central banks, and supervisory and regulatory authorities;
- (b) International financial institutions; and
- (c) International standard setting, regulatory, supervisory and central bank bodies.

(2) The eligibility of Members will be reviewed periodically by the Plenary in the light of the FSB objectives.

(3) Current Members of the FSB are listed in Annex A.

Article 6. Commitments of Members

(1) Member jurisdictions commit to:

- (a) pursue the maintenance of financial stability;
- (b) maintain the openness and transparency of the financial sector;

(c) implement international financial standards; and

(d) undergo periodic peer reviews, using among other evidence IMF/World Bank public Financial Sector Assessment Program reports

(e) take part in implementation monitoring of agreed commitments, standards and policy recommendations.

(2) The FSB will periodically report on the degree of adherence by the Members to these commitments and the evaluation process.

(3) In support of the mandate and tasks laid down in Article 2 (1) (e), the standard setting bodies will report to the FSB on their work without prejudice to their existing reporting arrangements or their independence. This process should not undermine the independence of the standard setting process but strengthen support for strong standard setting by providing a broader accountability framework.

(4) The international financial institutions participate as Members in the FSB in accordance with their respective legal frameworks and policies.

III. Organisation

Article 7. Structure

The organisational structure of the FSB consists of the following:

(1) the Plenary;

(2) the Steering Committee;

(3) Standing Committees;

(4) Working Groups

(5) the Regional Consultative Groups;

(6) the Chair; and

(7) the Secretariat.

Article 8. Appointment processes

Appointment processes should be open and transparent for all positions within the FSB.

The Plenary

Article 9. Responsibilities of the Plenary

(1) The Plenary is the sole decision-making body of the FSB for all matters governed by this Charter.

(2) Decisions by the Plenary shall be taken by consensus.

(3) The Plenary:

(a) decides on the manner in which the Plenary conducts its affairs;

(b) approves the work programme and the budget of the FSB;

(c) adopts reports, principles, standards, recommendations and guidance developed by the FSB;

(d) decides on Membership of the FSB;

(e) appoints the Chair;

(f) appoints the chairs of the Standing Committees and the Secretary General at the proposal of the FSB Chair;

(g) establishes Standing Committees and working groups, as necessary, and gives them their mandates;

(h) endorses the mandates of the working groups set up by the FSB Steering and Standing Committees;

(i) decides on any amendments to this Charter; and

(j) decides on any other matter governing the business and affairs of the FSB.

Article 10. Representation and attendance

(1) Representation at the Plenary shall be at the level of central bank governor or immediate deputy; head or immediate deputy of the main supervisory/regulatory agency; and deputy finance minister or deputy head of finance ministry.

Plenary representatives also include the chairs of the main SSBs and committees of central bank experts, and high-level representatives of the IMF, the World Bank, the Bank for International Settlements (BIS) and the Organisation for Economic Co-operation and Development.

(2) All Members shall be entitled to attend the Plenary Meetings. The Chair shall preside over the Plenary Meetings.

(3) The Chair can extend, after consultation with Members, ad-hoc invitations to representatives of non-FSB Members to attend the whole or part of the Plenary Meetings. In the context of specific sessions of the Plenary, the Chair can also invite, after consultation with Members, representatives of the private sector.

Article 11. Seat assignments

The number of seats in the Plenary assigned to Member jurisdictions reflects the size of the national economy, financial market activity and national financial stability arrangements of the corresponding Member jurisdiction.

The seat assignments shall be periodically reviewed in accordance with the above criteria.

Steering Committee

Article 12. Responsibilities of the Steering Committee

(1) The Steering Committee shall provide operational guidance between the Plenary meetings to carry forward the directions of the FSB and prepare the Plenary Meetings in order to allow the Plenary to efficiently fulfil its mandate.

(2) The Steering Committee may establish working groups as needed which may include representatives of non-FSB members.

(3) The duties of the Steering Committee include the following:

- (a) monitor and guide the progress of FSB's ongoing work;
- (b) promote coordination across and commission work from the Standing Committees and other working groups;
- (c) ensure effective information flow to all Members;
- (d) coordinate and conduct, jointly with the relevant SSBs, reviews of the policy development work of the international SSBs, including with regard to regulatory gaps that pose risk to financial stability.
- (e) prepare options for decision of the Plenary; and
- (f) take forward, after consultation and consistent with the directions of the Plenary, any other work necessary for the FSB to fulfil its mandate.

Article 13. Composition and appointment

(1) The composition of the Steering Committee is decided by the Plenary at the proposal of the Chair in a manner that ensures maximum effectiveness in taking forward the FSB's work while having regard to balanced representation in terms of geographic regions and institutional functions.

(2) The composition of the Steering Committee shall be reviewed periodically in accordance with the criteria set out in the previous section.

Standing Committees

Article 14. Standing Committee on Assessment of Vulnerabilities (SCAV)

The SCAV's functions are to:

(1) monitor and assess vulnerabilities affecting the global financial system and propose to the Plenary actions needed to address them

(2) monitor and advise on market and systemic developments, and their implications for regulatory policy; and

(3) provide input for the Early Warning Exercise conducted in collaboration with the IMF.

Article 15. Standing Committee on Supervisory and Regulatory Cooperation (SCSRC)

The SCSRC's functions are to:

(1) address key financial stability issues relating to the development of supervisory and regulatory policy, identify relative priorities, and seek to ensure that the different policy initiatives fit together into a coherent whole;

(2) assist in managing the coordination issues that arise among supervisors and regulators on issues that have cross-sector implications and raise any need for policy development required to close regulatory gaps that pose risk to financial stability ;

(3) set guidelines for and oversee the establishment and effective functioning of supervisory colleges; and

(4) advise on and monitor best practice in meeting regulatory standards with a view to ensure consistency, cooperation and a level playing field across jurisdictions.

Article 16. Standing Committee on Standards Implementation (SCSI)

The SCSI's functions are to:

(1) ensure comprehensive and rigorous implementation monitoring of international financial standards, agreed G20 and FSB commitments, recommendations and other initiatives in consultation and coordination with other relevant bodies, through mechanisms such as the Coordination Framework for Implementation Monitoring (CFIM);

(2) undertake peer reviews amongst its members;

(3) report to the Plenary on members' commitments and progress in implementing international financial standards, agreed G20 and FSB commitments, recommendations and other initiatives; and

(4) encourage global adherence to prudential regulatory and supervisory standards, such as through the FSB's Framework for Strengthening Adherence to International Standards.

Article 17. Standing Committee on Budget and Resources (SCBR)

The SCBR's functions are to:

(1) provide the Plenary with assessments of the resource needs of the Secretariat taking into account the current mandate, the work programme and emerging demands;

(2) review a medium-term budget and resource framework as well as annual resource budget for the FSB Secretariat, with due regard to cost control, for approval by the Plenary;

(3) identify, evaluate and recommend to the Plenary options for independent raising of resources by the FSB, over the medium term, to supplement the funding received from the BIS;

(4) ensure, through appropriate arrangements, necessary transparency in the matters of financial governance of the FSB so as to be able to withstand public scrutiny.

Article 18. Chairs and composition

(1) The chairs of the Standing Committees are selected from and appointed by the Plenary at the Chair's recommendation for terms of two years renewable once. They report to the Plenary on their work programs.

(2) Membership in Standing Committees is decided by the Plenary on the proposal of FSB Chair, drawn up in consultation with the chair of the Standing Committee with due regard to the effectiveness, balanced representation and the mandate of the respective Standing Committee. Membership is normally drawn from the designated representatives on the Plenary.

(3) A Member authority can, in consultation with the Chair, decide whether its representation in a Standing Committee is through another authority or agency of the Member jurisdiction that is not a designated FSB Member.

(4) The chairs of Standing Committees can extend ad-hoc invitations to non-members to attend the whole or part of their meetings.

Article 19. Setting up of working groups

Standing Committees may establish working groups as needed which may include representatives of non-FSB members.

Regional Consultative Groups (RCGs)

Article 20. Regional Consultative Groups

(1) The FSB Regional Consultative Groups provide a structured mechanism for:

- (a) interaction of FSB members with non-members regarding the various FSB initiatives underway and planned;
- (b) promoting implementation within the region of international financial policy initiatives; and
- (c) the regional group members to share amongst themselves and with the FSB their views on vulnerabilities affecting the financial system, on FSB initiatives and on other measures that could be taken to promote financial stability.

(2) The current Regional Consultative Groups are listed in Annex B.

Chair

Article 21. Appointment and Responsibilities

(1) The Chair is selected from representatives on the Plenary and appointed by the Plenary for a term of three years renewable once.

(2) The Chair should have recognised expertise and standing in the international financial policy arena

(3) The Chair convenes and chairs the meetings of the Plenary and of the Steering Committee. The Chair oversees the Secretariat.

(4) The Chair is the principal spokesperson for the FSB and represents the FSB externally. The Chair should be informed of all significant matters that concern the FSB.

(5) More generally, the Chair will take all decisions and act as necessary to achieve the objectives of the FSB in accordance with the directions given by the Plenary.

(6) The Chair, in the discharge of the functions as the Chair, shall owe duty entirely to the FSB and the FSB membership and to no other authorities or institutions.

Secretariat

Article 22. Secretariat

(1) The Secretariat shall be directed by the Secretary General.

(2) The Secretary General shall be appointed by the Plenary at the proposal of the Chair for a term of five years renewable.

(3) The Secretary General shall be under the responsibility, and shall act in accordance with the instructions, of the Chair. The Chair shall be responsible for providing general direction to the Secretary General, in accordance with any directions given by the Plenary.

(4) Secretariat staff shall be selected by the Secretary General following an appropriate recruitment and evaluation process.

(5) In appointing the Secretariat staff, the Secretary General shall, subject to the importance of securing the highest standards of efficiency and of technical competence and expertise in financial stability and regulatory policy areas, pay due regard to the importance of a balanced composition in terms of geographic regions and institutional functions, and of retaining institutional memory by having an adequate proportion of staff on open-ended contracts.

(6) The Secretary General and the Secretariat staff in the discharge of their functions should owe their duty entirely to the FSB and to no other authorities or institutions.

(7) The main responsibilities of the Secretariat include the following:

(a) to support the activities of the FSB, including its Committees, Regional Consultative Groups and working groups;

(b) to facilitate cooperation amongst the Members and between the FSB and other institutions;

(c) to ensure efficient communication to Members and others;

(d) to manage efficiently the financial, material and human resources allocated to the FSB (including the selection of staff who may be seconded by Members);

(e) to maintain the records, administer the website and deal with the correspondence of the FSB; and

(f) to carry out all other functions that are assigned by the Chair or the Plenary.

(8) The Secretariat shall be located in Basel at the BIS.

IV. Final provisions

Article 23. Legal Effect

This Charter is not intended to create any legal rights or obligations.

Article 24. Effective date

This Charter shall come into effect on 19 June 2012.

Annex A

List of FSB Members

(as amended on 26 March 2015)

A. Member Jurisdictions

Argentina

- Ministry of Finance
- Central Bank of Argentina

Australia

- Department of the Treasury
- Reserve Bank of Australia

Brazil

- Ministry of Finance
- Central Bank of Brazil
- Securities and Exchange Commission of Brazil

Canada

- Department of Finance
- Bank of Canada
- Office of the Superintendent of Financial Institutions (OSFI)

China

- Ministry of Finance
- People's Bank of China
- China Banking Regulatory Commission

France

- Ministry of Economy and Finance
- Bank of France
- Autorité des Marchés Financiers (AMF)

Germany

- Ministry of Finance
- Deutsche Bundesbank
- Bundesanstalt für Finanzdienstleistungsaufsicht (Bafin)

Hong Kong SAR

- Hong Kong Monetary Authority

India

- Ministry of Finance
- Reserve Bank of India
- Securities and Exchange Board of India

Indonesia

- Ministry of Finance
- Bank Indonesia

Italy

- Ministry of the Economy and Finance
- Bank of Italy
- Commissione Nazionale per le Società e la Borsa (CONSOB)

Japan

- Ministry of Finance
- Bank of Japan
- Financial Services Agency

Korea

- Bank of Korea
- Financial Services Commission

Mexico

- Ministry of Finance and Public Credit
- Bank of Mexico

Netherlands

- Ministry of Finance
- Netherlands Bank

Russia

- Ministry of Finance
- Central Bank of the Russian Federation

Saudi Arabia

- Ministry of Finance

- Saudi Arabian Monetary Agency

Singapore

- Monetary Authority of Singapore

South Africa

- Ministry of Finance
- South African Reserve Bank

Spain

- Ministry of Economy and Competitiveness
- Bank of Spain

Switzerland

- Swiss Federal Department of Finance
- Swiss National Bank

Turkey

- Undersecretariat of the Treasury
- Central Bank of the Republic of Turkey

United Kingdom

- HM Treasury
- Bank of England
- Financial Conduct Authority

United States

- Department of the Treasury
- Board of Governors of the Federal Reserve System
- Securities and Exchange Commission

European Union

- European Central Bank
- European Commission

B. International Financial Institutions

- Bank for International Settlements (BIS)
- International Monetary Fund (IMF)
- Organisation for Economic Co-operation and Development (OECD)
- World Bank

C. International Standard-Setting, Regulatory, Supervisory and Central Bank Bodies

- Basel Committee on Banking Supervision (BCBS)
- Committee on Payments and Market Infrastructures (CPMI)
- Committee on the Global Financial System (CGFS)
- International Accounting Standards Board (IASB)
- International Association of Insurance Supervisors (IAIS)
- International Organization of Securities Commissions (IOSCO)

Annex B

List of the FSB Regional Consultative Groups

(1) FSB Regional Consultative Group for the Americas

(2) FSB Regional Consultative Group for Asia

(3) FSB Regional Consultative Group for the Commonwealth of Independent States

(4) FSB Regional Consultative Group for Europe

(5) FSB Regional Consultative Group for the Middle East and North Africa

(6) FSB Regional Consultative Group for the Sub-Saharan Africa

FINANCIAL
STABILITY
BOARD

FSB Procedural Guidelines

1 February 2013

(as amended on 21 July 2016)

Table of Contents

FSB Procedural Guidelines

Preamble

The following Procedural Guidelines (PGL) provide guidance to the Secretariat and Members to improve transparency and consistency of practice in the operational activities of the FSB under its Charter.[1] The PGL represent good practices for internal administrative purposes. They were adopted by the Plenary at its meeting on 28 January 2013 and amended on 21 July 2016.

A. Plenary Meetings

A.1 Scheduling of meetings

1. The Plenary should meet in person at least twice in a calendar year. One meeting of the Plenary per year should be held at the domicile of the FSB in Basel, Switzerland.
2. Well before the end of the year, the Plenary should develop and agree a work programme and a calendar for its meetings and tele-/video-conferences for the following year. The Secretary General should **confirm the dates** of the meetings and tele-/video-conferences as early as possible and at least **40 calendar days** ahead of the meeting date and at least **seven calendar days** ahead of the date of the tele-/video-conference.
3. The FSB Chair may decide to hold additional meetings or tele-/video-conferences if urgently needed.
4. In scheduling meetings and deciding on venues, best efforts should be made to take into account other relevant international meetings and to distribute the travel burden, including by an appropriate rotation of meeting locations.
5. The Plenary meetings and tele-/video-conferences that discuss documents to be delivered to the G20 should be held at least seven calendar days ahead of the relevant meetings of the G20 Finance Ministers and Central Bank Governors or G20 Leaders' Summit.

A.2 Agenda and meeting documents

6. The FSB Chair should draw up the provisional agenda for each meeting of the Plenary.
7. The Secretary General should **communicate the provisional agenda** for Plenary meetings and tele-/video-conferences to Member representatives as early as possible and at least **14 calendar days** in advance for meetings and at least **seven calendar days** in advance for conference calls.
8. Member representatives should have the right to propose an item for inclusion in the agenda. The FSB Chair will decide on such proposals.

[1] The PGL do not apply to Regional Consultative Groups (RCGs), which are governed by their Plenary-approved *Operational Framework* and the RCG-specific *Operational Procedures* as adopted by each RCG.

9. The **final meeting agenda and related documents** should be communicated to Member representatives by the Secretary General or the Secretariat at least **10 calendar days** in advance, and for conference calls, at least **4 calendar days** in advance, except for urgent issues for which the circulation period could be shorter. If the agenda for a conference call is long and/or complex and thus, it, in effect, replaces a meeting, the deadlines for sending the final agenda and documents to Member representatives should be the same as for a meeting.

10. The agenda should set out clearly the purpose of the discussion, name the invited lead speakers and identify documents that are to be discussed and decided upon by the Plenary, and/or to be published after the meeting.

11. Unless the FSB Chair decides otherwise, where the documents for adoption or decision are not sent according to this timeframe, the related agenda item will stand automatically postponed for the next meeting or conference call, or, if the circumstances so demand in the view of the Secretariat, be decided by written procedure.

12. The non-FSB member co-chairs of the RCGs, if invited to and attending the Plenary meetings, should receive all the Plenary documents at the same time as the Member representatives.

13. The list of documents for dispatch should specify the documents that will be shared with the RCGs **within 14 days** following the Plenary meeting, as required under the *Operational Framework of the FSB Regional Consultative Groups*. The documents for dispatch will also invite comments, if any, from Member representatives regarding the sharing of such documents with the RCGs. Objections to sharing a document with the RCGs should be conveyed to the Secretariat before the Plenary meeting to enable discussion on the objections at the meeting, and action accordingly.

A.3 Meeting summary and action points

14. The FSB Secretariat should prepare a draft summary of each meeting and conference call, containing decisions and conclusions reached as well as action points agreed and, if so requested by Member representative(s), summarising any specific minority points of view expressed by Member representative(s).

15. The **draft summaries** should be distributed to Member representatives as soon as possible but no later than **10 calendar days** after the meeting or conference call. Summaries should be reviewed or **commented upon** by Member representatives in writing **within 10 calendar days** of circulation.

16. The **final summary** should be circulated to Member representatives no later than **30 calendar days** after the meeting or conference calls and posted on e-FSB.

A.4 Written procedure

17. Members' comments on a document may be obtained through written procedure, as opposed to in-person meetings or tele-/video-conferences. Written procedure (i.e., circulation of documents to Members by the Secretariat for obtaining their written comments) should be adopted whenever judged appropriate by the Secretary General

based upon the efficient working of the FSB, if necessary, in consultation with the Member representatives.

18. Any Member representative should be able to request the discussion of a paper submitted for written procedure, if he / she deems it necessary, by notifying the Secretariat of this view prior to the deadline established by the Secretariat for sending comments. On receiving such a request from a Member representative, the Secretary General should consult the Member representative making the request, and thereafter, if necessary, consult the FSB Chair for a decision on the request.

19. The **comment period** should be no less than **10 calendar days** after circulation of documents by the Secretariat, except in case of final revisions or fatal flaw reviews, or in exceptional circumstances by decision of the FSB Chair. Fatal-flaw reviews, following a written procedure, may have a shorter comment period.

20. Requests for additional time to comment should be made to the Secretary General or the Secretariat staff concerned before the comment period has elapsed, specifying the additional time needed. If the extension is granted, the Secretary General or the Secretariat staff concerned should provide written confirmation of the additional time given.

21. In case Member representatives have not sent comments under written procedure within the time provided, or have not requested an extension of time, it will be assumed that they had no comments to offer.

22. Comments received after the deadline or after the additional time given will not be considered unless the Secretary General decides the comments can be accommodated without significant disruption to the workflow.

23. A Member representative that was unable to send comments in time would not be precluded from providing comments in subsequent meetings or conference calls if the same issue were to be on the agenda.

24. Comments received under written procedure should be made available to all Member representatives by the Secretariat either in aggregated or disaggregated form, clearly identifying where they came from.

25. If it does not appear possible to resolve Member representatives' fatal-flaw comments through written procedure, the Secretary General may propose to the Chair to convene a conference call or a meeting.

A.5 Seating arrangements

26. Where two or three authorities from the same jurisdiction are Members of the FSB and all participate in the Plenary meeting, the representative of one of these authorities should be seated at the back. The same should apply to IFIs and SSBs with two seats. Member representatives sitting at the back should have the rights of the table. Representation at the table can be changed during a meeting according to the topic discussed.

26a. It was agreed at the Tokyo Plenary meeting in March 2016 that the European Central Bank would be granted a second seat at the Plenary table to be occupied by ECB

Banking Supervision. To accommodate this special case, the member authorities from France, Germany and Italy will give up in rotation one of their two seats at the table so that at all times the three countries in total have five seats at the table and four seats at the back.

A.6 Substitute representatives of Members

27. A designated Member representative unable to attend a Plenary meeting could be substituted, for that meeting, by his or her immediate deputy. Such a substitute should have the same rights in the meeting as the designated Member representative.

A.7 Substitution of the Chair

28. The Plenary may ask a Member representative or the Secretary General to chair a part of the meeting where the Chair recuses himself/herself from that part of the meeting due to a potential or actual conflict of interest.

B. Meetings of the Steering Committee and Standing Committees

29. The Steering Committee and Standing Committees should apply the procedures of the Plenary in their respective contexts, except the timelines for circulation of documents which could be shorter than for the Plenary. In respect of the Steering Committee, the circulation timelines should be no less than half the time specified for the Plenary documents.

30. The Steering Committee should meet at least four times a calendar year and as convened by the Chair, normally well in advance of Plenary meetings.

31. Committee chairs should, to the extent possible, seek to use teleconferencing and video conferencing wherever appropriate as a substitute for meetings.

32. There should be no substitution of designated Member representatives at meetings of the Steering Committee without prior approval of the FSB Chair.

C. Establishment of Committees and Working Groups

C.1 Standing Committees

33. Standing Committees are intended as permanent bodies. The functions of the existing Standing Committees are set out in the FSB Charter.

34. Should any new Standing Committee be established, its mandate should be proposed by the FSB Chair and endorsed by the Plenary.

35. The Standing Committees should report regularly on their work to the Plenary. The reporting should include, as appropriate, oral or written reports by the chair of the Standing Committee. Written reports as well as any other reports submitted to the Plenary should be reviewed and approved by the Standing Committee through written procedure.

36. The work programme of the Standing Committees should be approved by the Plenary.

The Standing Committees should adapt their work plans to the meeting schedule of the Plenary.

37. The Plenary may decide to wind up a Standing Committee if it is satisfied that the Committee has served its purpose and its continued existence is no longer necessary.

C.2 Working Groups

38. Working Groups should apply the procedures for the Plenary in their own contexts, wherever appropriate and reasonable, except the timelines for circulation of documents, which could be shorter than for the Plenary.

39. As a general principle, these should be temporary groups, with a pre-defined term, which could be extended by the Plenary as necessary.

40. Mandates of Working Groups should be specified by the body that established them and if that is not the Plenary, also endorsed by the Plenary.

41. Mandates should be laid down in writing, specifying the objectives and tasks of the Working Group, the projected duration of its work, and its reporting chain.

42. For carrying out the Working Group's mandate, temporary work streams, with a specific mandate, reporting chain and term, may be established, upon a proposal of its chair or any of its members.

43. Working Groups should adapt their work plan to the meeting schedule of the body they report to. Where the work is conducted in conjunction with one or more standard setting bodies, the work plan should also take due account of the meeting schedule and work plan of the standard setting bodies.

44. Working Groups should report regularly on their work to the Plenary. Reporting should include, as appropriate, oral or written reports by the chair of the Working Group. Written reports should be reviewed and approved by the Working Group. The final report of the Working Group should go through written procedure before being adopted by the Working Group.

D. Selection and Appointment Processes

D.1 General

45. Selection processes for the positions of chairs and the Secretary General should be open and transparent, and should be completed before the expiry of the term of the existing incumbent(s). The FSB Chair or, in case of selection of the FSB Chair, the Nomination Committee (NC) should explain the process and outcome of the process to the Plenary.

46. The FSB Secretariat should inform Member representatives about all positions falling vacant within a reasonable period in advance, but no later than one month ahead of anticipated vacancies. Members should be invited to nominate candidates who meet the specified criteria of professional expertise and background.

47. From the nominations received, priority should be given to selecting individuals who are well qualified and competent for the position vis-à-vis the FSB's cross-sectoral and

cross-institutional functional domain. Geographical and institutional diversification may also be taken into account when deciding on appointment of chairs or the composition of FSB Committees and Working Groups.

D.2 FSB Chair

48. For the selection of the FSB Chair, the Plenary should constitute a temporary NC, composed of up to seven Member representatives (including its chair) having regard to balanced geographical and institutional representation, no later than two months before the expiry of the Chair's term. The composition of the NC should be proposed to the Plenary by the FSB Secretary General after consultation with Member representatives.

49. Members may nominate candidates for the FSB Chair, in response to the Secretariat's notification, to the NC, up to the pre-announced deadline. The NC should consult Member representatives about the nominated candidates. The FSB Chair should be appointed by the Plenary following a proposal of the NC.

D.3 Standing Committee chairs

50. After consultation with Member representatives, the FSB Chair should propose Standing Committee chairs to the Plenary from the nominations received from Members in response to the Secretariat's notification.

51. An individual should not chair simultaneously more than one Standing Committee or Working Group. The chair of a Standing Committee should not chair a Working Group established by that committee.

D.4 Working Group chairs

52. Chairs of Working Groups should be appointed by the Plenary at the recommendation of the chair of the body constituting the Working Group, in consultation with that body. Working Group chairs should normally be drawn from Member representatives on the Plenary. However, other officials of Members, officials of other authorities in Members' jurisdictions, or staff of the FSB Secretariat could also be appointed as chairs of Working Groups. In all cases, it should be ensured that the chairs of Working Groups have recognised deep expertise in the required area.

53. If the term of a Working Group extends beyond two years, its chair could be re-appointed once.

E. Composition of Committees and Working Groups

E.1 General Principles governing the composition of Committees[2]

54. The following general principles should guide the composition of the committees:

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[2] Extracted from the FSB Chair's letter to Members of 19 July 2009.

a) All Members should be involved in some Committee – the Steering Committee and/or a Standing Committee – but not all Members can be involved in all Committees.

b) Balanced geographic and institutional representation should be ensured.

c) To ensure effectiveness of the Committees' work, the size of each Standing Committee should not be greater than 20-25 members.

E.2 Steering Committee

55. The composition of the Steering Committee should be reviewed at an interval of two years and its members should be eligible for reappointment.[3]

56. Members should be invited to participate in the Steering Committee according to their field of expertise.

E.3 Standing Committee

57. Members nominated for the Standing Committees should normally[4] be drawn from designated representatives on the Plenary. The composition of Standing Committees should be reviewed at an interval of two years and its members should be eligible for reappointment.

58. Member representatives should be invited to participate in the Standing Committees according to their field of expertise.

58a. Standing Committee representation and participation should be governed by the following principles:

a) In order to ensure consistency of participation, each member of a Standing Committee should designate an immediate deputy as his/her standing alternate who would attend meetings/conference calls in his/her absence. This alternate should be able to speak for his/her member organisation on policy matters. In exceptional circumstances, with the agreement of the Standing Committee chair, the standing alternate could be a suitable direct report who is not an immediate deputy to the Standing Committee member.

b) When neither the member nor the standing alternate can attend a meeting or call, another representative may attend the meeting/call in order that the member can be informed of the discussion. This person would be expected not to speak

c) If, for whatever reasons, neither the member nor standing alternate is able to attend three consecutive Committee meetings/calls, then that Member authority would lose its Standing Committee seat. The Member could request the seat again for consideration during the next review of the composition of the Standing Committees.

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[3] The latest review was undertaken in January 2012 (cf. PLEN/2012/06).

[4] As noted in Article 18(3) of the FSB Charter, a Member authority can, in consultation with the Chair, decide whether its representation in a Standing Committee is through another authority or agency of the Member jurisdiction that is not a designated FSB Member. In such cases, the representative should be at a level similar to a Plenary member.

E.4 Working Groups

59. The composition of Working Groups should be decided by the chairs of the Working Groups in consultation with the chair of the body constituting the Working Group.

60. In deciding on the membership of Working Groups, the respective chairs should consider nominations received by the Secretariat, with due regard to the effectiveness, balanced representation and mandate of the Working Group.

61. The membership should normally be drawn from Members. The membership could also be drawn from other authorities of Members' jurisdictions or from non-FSB Members, having regard to their expertise and the mandate of the Working Group.

F. Staffing of Secretariat

62. The composition of the FSB Secretariat should reflect the diversity of FSB's membership in terms of institutional functions and geographic regions.

63. Appointments should be given to well qualified, competent and highly motivated individuals, having due regard to the highest standards of efficiency and FSB's cross-sectoral and cross-institutional nature.

64. Secretariat positions should be a suitable mix of open-ended and fixed-term positions as well as short-term secondments from Members.

65. Member representatives should be informed about vacancies in the Secretariat, including that of the Secretary General, and be invited to nominate suitable candidates for the positions. Vacancies may also be advertised publicly.

66. The vacancy notice should contain a description of the primary responsibilities and eligibility criteria for the position, including expected professional expertise, educational background and practical experience required of the candidates, also indicating an appropriate response time.

G. Distribution of Documents

67. The agenda and meeting documents should be distributed by e-mail and simultaneously posted on the secure e-FSB website. Sensitive documents should be posted on e-FSB, with notification sent by e-mail.

68. The documents should contain a document number, based on a document numbering system adopted by the Secretariat, to uniquely identify all documents sent to the Plenary, Committees and Working Groups.

69. The timelines for circulation of documents are tabulated in the Annex.

H. Confidentiality

H.1 Data and information sharing

70. All non-public data and information shared by Members within the FSB should be treated with due confidentiality and not be disclosed to third parties, except in cases where its disclosure is compelled by law or necessitated under respective legal frameworks applicable to Members, or referred to in any publication or external research without prior written consent of the parties providing the data or information.

71. Members and their staff, and Secretariat staff,[5] should exercise all due care and caution and take all reasonable measures to prevent access to information and data by unauthorised persons and prevent any accidental loss or disclosure of such information and data.

72. Discussions in the FSB Plenary, Steering Committee, Standing Committees and Working Groups are on a confidential basis. It is the duty of the Member representatives to protect the confidentiality of discussions and the views of individual members.

H.2 Access to documents

73. The documents of the Plenary and Committees should be made accessible to Member representatives through a secure e-FSB website, unless decided otherwise in case of specific documents.

74. The members of each Committee and Working Group have individual access to a dedicated and secure e-FSB sub-page for that Committee or Working Group where all documents pertaining to that Committee or Working Group should be posted.

75. The members of the RCGs have individual access to a dedicated and secure e-FSB sub-page for the RCGs and also to the dedicated sub-page of their respective RCGs.

76. The staff of the Secretariat should have individual access to all e-FSB sub-pages, except those which are made accessible only to the staff governed by a subject-specific confidentiality agreement(s) signed by them.

77. The e-FSB website should include information on upcoming meetings and conference calls, current work streams, and memberships of committees and working groups, and Secretariat contact information.

78. Plenary documents will be shared with RCGs, as described in paragraphs 12 and 13.

H.3 Public disclosure

79. Members should identify in documents to be published, any confidential or market sensitive information that they request should not be published and inform the Secretariat accordingly. The Secretariat should take due care that such information as agreed by the Plenary is removed from the documents before their publication.

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[5] The duty of confidentiality of Secretariat staff with respect to all non-public information, be it oral or written, or stored using electronic media, are governed by the BIS Code of Conduct which forms part of the general employment conditions.

80. The Secretariat should prepare press releases on Plenary meetings and separate press statements on important policy decisions for Plenary approval. Whenever possible, the draft press releases on policy decisions placed for Plenary approval should be circulated to the Plenary ahead of the meeting.

81. Meeting summaries and the associated list of action points should not be published.

I. Public Consultations

82. The Plenary may decide to conduct a public consultation in order to seek input from interested parties and the public on specific issues or policy proposals. The following process should be adopted for public consultation:

a) An invitation to provide written comments and/or a dedicated press release inviting written comments should be published on the FSB website.

b) Invitation should specify the consultation period, which should, other than in exceptional circumstances, be **no less than 30 days** and state that responses received will be published on the FSB website unless requested otherwise by the respondents.

c) The responses received should be published on the FSB's website within **not later than 15 calendar days** from the close of the consultation period.

83. The FSB may also convene roundtables, hearings and other events to gather input from various stakeholders.

J. Audited financial statements

84. The annual audited financial statements of the FSB should be circulated to the Plenary for approval no less than 30 days ahead of the Plenary meeting at which the statements are to be approved.

Annex: Plenary timeframes

No.	Action	Time period
1.	Issuance of notification[6]	
(a)	for meetings	At least **40 calendar days** ahead of the meeting date
(b)	for conference calls	At least **7 calendar days** ahead of the conference call date
2.	Circulation of provisional agenda	
(a)	for meetings	At least **14 calendar days** ahead of the meeting date
(b)	for conference calls	At least **7 calendar days** ahead of the conference call date
3.	Circulation of final agenda and documents	
(a)	for meetings	At least **10 calendar days** ahead of the meeting date, except for urgent issues for which the circulation period could be shorter
(b)	for conference calls	At least **4 calendar days** ahead of the conference call date, except for urgent issues for which the circulation period could be shorter
4.	Circulation of draft summaries of meetings/conference calls	No later than **10 calendar days** after the meeting/conference call
5.	Commenting on summaries	Within **10 calendar days** of circulation
6.	Circulation of final summaries of meetings/conference calls	No later than **30 calendar days** after the meeting/conference call
7.	Commenting on other documents	No less than **10 calendar days** after circulation of documents, except for fatal-flaw reviews

Note: The timeframes for circulation of Steering Committee documents should be no less than half the time specified above for the Plenary documents (cf. PGL 29, page 4).

[6] Cf. PGL 3.

INTERNATIONAL MONETARY FUND

January 2018

KEY TRENDS IN IMPLEMENTING THE FUND'S TRANSPARENCY POLICY

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The Report prepared by IMF staff and completed on December 6, 2017 has been released.

The staff report was issued to the Executive Board for information. The report was prepared by IMF staff. The views expressed in this paper are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Electronic copies of IMF Policy Papers
are available to the public from
http://www.imf.org/external/pp/ppindex.aspx

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

December 6, 2017

KEY TRENDS IN IMPLEMENTING THE FUND'S TRANSPARENCY POLICY

Approved By
Martin Mühleisen

Prepared by Strategy, Policy, and Review Department

CONTENTS

List of Abbreviations

AML-CFT	Anti-Money Laundering and Combating the Financing of Terrorism
DSA	Debt Sustainability Analysis
EFF	Extended Fund Facility
EPA	Ex-Post Assessment
EPE	Ex-Post Evaluation
FATF	Financial Action Task Force
FCL	Flexible Credit Line
FSRB	FATF-Style Regional Bodies
FSSA	Financial System Stability Assessment
HIPC	Heavily Indebted Poor Countries
LOI	Letter of Intent
MEFP	Memorandum on Economic and Financial Policy
PIN	Public Information Notice
PLL	Precautionary and Liquidity Line
PPM	Post-Program Monitoring
PRS	Poverty Reduction Strategy
PSI	Policy Support Instrument
ROSC	Report on Observance of Standards and Codes
SBA	Stand-By Arrangement
SCF	Standby Credit Facility
SMP	Staff-Monitored Program
TMU	Technical Memorandum of Understanding
UFR	Use of Fund Resources

At the time of the 2005 *Review of the Fund's Transparency Policy*, the Executive Board requested regular updates on trends in implementing the transparency policy. The tables in this report provide an overview of recent developments, reflecting information on documents considered by the Board in 2014 and updating the previous annual report on *Key Trends*. Deeper analysis of these trends is undertaken in the context of periodic reviews of the Fund's Transparency Policy.

Table 1. Trends in Publication Rates (2014–16) 1/2/

Type of Report	2014 Reports discussed	2014 Published (percent)	2015 Reports discussed	2015 Published (percent)	2016 Reports discussed	2016 Published (percent)
All Documents	984	93	922	92	913	92
Staff Reports	220	93	217	94	201	96
Article IV, UFR, or Combined	193	93	188	94	186	96
Stand-alone Article IV 3/	112	92	113	92	115	95
Article IV combined with UFR, PPM, SMP, EPA, PSI	20	90	14	100	17	94
Stand-alone UFR	61	97	61	95	54	100
Stand-alone PPM, SMP, EPA, EPE, PSI	22	95	27	93	15	93
Joint Staff Advisory Note	5	60	1	100	0	n/a
HIPC Country Papers	0	n/a	1	100	0	n/a
Selected Issues/Statistical Annexes	78	90	84	90	93	89
FSSAs	10	70	9	78	12	92
ROSCs 4/	32	72	20	90	25	80
Article IV Press Releases	108	92	102	98	120	96
UFR and PSI Chairman's statements	92	99	80	95	53	100
Authorities' statements 5/	151	99	149	95	165	100
Country Policy Intention Documents	218	96	182	91	170	100
LOIs/MEFPs 6/	134	97	118	93	114	100
TMUs 6/	74	99	56	93	56	100
PRS documents	10	70	8	50	0	n/a
All Policy Papers	75	84	79	80	74	78
Policy Papers that are presumed to be published 7/	66	95	68	93	62	94

1/ Refers to documents considered by the IMF Executive Board during the calendar year, and published within six months of the end of the calendar year; e.g. the publication rate for 2016 refers to documents discussed by the Board in 2016 and published by June 30, 2017.

2/ Data include documents issued for the Board's consideration in a meeting or on a lapse-of-time basis. SMPs, which are for information only, are also included.

3/ Includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

4/ Includes initial ROSC assessments and reassessments produced by the IMF, as well as the World Bank and, in the case of AML/CFT ROSCs, by FATF and FATF-style regional bodies (FSRB), issued on a stand-alone basis or in FSSAs. Does not include assessments under detailed standards assessments.

5/ Does not include authorities' statements that are included in ROSCs. Includes Executive Directors' Statements and "right of reply" documents.

6/ Includes LOIs/MEFPs and TMUs issued in the context of SMPs and PSIs.

7/ The presumption of publication does not apply to certain papers dealing with administrative matters, for instance internal audits and papers on personnel and human resource issues.

Table 2. Trends in Publication Rates of Article IV and UFR Staff Reports (2014–16)[1/]

(By economic and regional characteristics)

	2014		2015		2016	
Reports by group [2/]	Reports discussed	Published (percent)	Reports discussed	Published (percent)	Reports discussed	Published (percent)
Article IV, UFR and combined staff reports [3/]	193	93	188	94	186	96
Advanced markets	39	100	30	100	34	100
Emerging markets	88	91	81	94	91	92
Developing countries	66	92	77	91	61	100
Emerging market and developing countries [3/]	154	92	158	92	152	95
Africa	46	98	51	96	44	100
Asia	26	92	28	93	28	96
Central and Eastern Europe	13	100	15	100	17	100
CIS and Mongolia	13	92	13	77	10	90
Middle East	20	95	20	90	14	86
Western Hemisphere	36	78	31	90	39	92

1/ Refers to documents considered by the IMF Executive Board during the calendar year, and published within six months of the end of the calendar year; e.g. the publication rate for 2016 refers to the documents discussed by the Board in 2016 and published by June 30, 2017.

2/ Based on *World Economic Outlook* definitions, including the new definition of Low-Income Developing Countries established in 2014 (http://www.imf.org/external/np/pp/eng/2014/060314.pdf).

3/ Includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

Table 3. Trends in Publication Lags (2014-16)[1/ 2/]

(By type of reports, and by economic and regional characteristics)

Reports by type and group [3/]	2014				2015				2016			
	Number published	Average lag 4/	percent with lag > 1 month	percent with lag > 2 month	Number published	Average lag 4/	percent with lag > 1 month	percent with lag > 2 month	Number published	Average lag [4/]	percent with lag > 1 month	percent with lag > 2 month
Article IV, UFR and Combined staff reports	180	23	17	8	176	20	17	3	179	16	11	6
Article IV	103	18	17	8	104	23	17	5	109	19	13	6
Combined	18	31	33	11	14	23	29	7	16	12	6	0
UFR	59	21	14	7	58	14	14	0	54	16	9	7
Advanced markets	39	9	0	0	30	5	0	0	34	6	0	0
Emerging markets	80	25	21	9	76	19	21	4	84	16	13	8
Developing countries	61	24	20	8	70	25	20	4	61	17	15	5
Emerging market and developing countries	141	22	18	4	147	22	21	5	145	18	14	8
Africa	45	27	24	11	49	19	20	2	44	15	9	2
Asia	24	20	13	0	26	17	12	0	27	12	15	4
Central and Eastern Europe	13	15	0	0	16	9	6	0	17	10	0	0
CIS and Mongolia	12	26	17	2	10	31	40	10	9	24	11	11
Middle East	19	23	21	2	18	25	17	6	12	26	25	17
Western Hemisphere	28	21	32	9	28	29	32	11	36	23	22	14
Selected other documents												
FSSAs	7	30	29	14	7	58	57	14	11	25	27	9
Selected Issues/Statistical Annexes	70	18	21	7	76	23	18	9	83	16	12	4
Article IV Press Releases	99	18	16	8	100	12	4	1	115	9	3	0
UFR and PSI Chairman's statements	91	19	13	8	76	5	4	1	53	0	0	0
Country Policy Intention Documents [5/]	210	21	6	3	166	2	11	0	170	14	7	6
Policy papers [6/]	63	24	1	1	63	23	2	1	58	20	2	1

1/ Refers to documents considered by the IMF Executive Board during the calendar year, and published within six months of the end of the calendar year; e.g. the publication rate for 2016 refers to the documents discussed by the Board in 2016 and published by June 30, 2017.

2/ Data include documents issued for the Board's consideration in a meeting or on a lapse-of-time basis. It also includes SMPs, which are for information only.

3/ Based on World Economic Outlook definitions, including the new definition of Low-Income Developing Countries established in 2014 (http://www.imf.org/external/np/pp/eng/2014/060314.pdf). Also includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

4/ Number of calendar days.

5/ Includes LOIs/MEFPs/TMUs issued in the context of SMPs and PSIs.

6/ Only includes policy papers for which publication is presumed.

Table 4a. Deletions in Article IV and UFR Staff Reports (2014–16) [1/ 2/]

(Percent of all published reports, unless otherwise indicated)

	2014				2015				2016			
Reports by group [3/]	Number published	With deletions	With deletions on exch. rate issues	With deletions on fin. sector issues	Number published	With deletions	With deletions on exch. rate issues	With deletions on fin. sector issues	Number published	With deletions	With deletions on exch. rate issues	With deletions on fin. sector issues
All Article IV and UFR reports	180	19	6	7	176	11	4	7	179	12	4	7
Advanced markets	39	23	0	8	30	13	3	10	34	12	3	12
EU	26	12	0	4	18	11	0	11	22	18	5	18
Other Europe	3	0	0	0	4	50	25	25	4	0	0	0
ROW	10	60	0	20	7	0	0	0	7	0	0	0
Emerging markets	80	26	11	11	76	16	7	11	84	19	6	10
Developing countries	61	8	2	0	70	4	1	3	61	2	2	0
Emerging market and developing countries	141	18	7	6	147	10	4	7	145	12	4	6
Africa	45	9	0	2	49	2	0	2	44	2	0	2
Asia	24	21	4	0	26	8	4	8	27	7	7	0
Central and Eastern Europe	13	15	0	0	16	6	0	6	17	12	0	12
CIS and Mongolia	12	58	42	33	10	30	10	20	9	22	22	11
Middle East	19	16	5	0	18	11	11	6	12	33	17	8
Western Hemisphere	28	32	11	14	28	21	7	11	36	17	3	8

1/ Refers to documents considered by the Board during the calendar year, and published within six months of the end of the calendar year; e.g. the publication rate for 2016 refers to the documents discussed by the Board in 2016 and published by June 30, 2017.

2/ Because a single report can have deletions falling into multiple categories, e.g., exchange rate, financial sector and/or other areas, there is no fixed relationship between the second column and the third and fourth column under each year.

3/ Based on World Economic Outlook definitions. Also includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

Table 4b. Deletions in 2016[1/]

(Percent of all deletions requested by income group and region, unless otherwise indicated)

Reports by group [2/]	Number of deletion requests [3/]	Approved	*Of which*: Partially rejected[4/]	Rejected	Rejected, but subsequently approved by management	Reason deletion requests were rejected[5/6/]: Information is already in the public domain	Information is sufficiently general not to trigger market disruption in near term	Inclusion of information in Staff report does not impede ability to implement new policy	Other
All Article IV, UFR and combined reports	66	70	27	30	0	8	12	3	8
Advanced markets	14	64	14	36	0	14	14	0	7
EU	12	75	17	25	0	0	17	0	8
Other Europe	1	0	0	100	0	100	0	0	0
ROW	1	0	0	100	0	0	0	0	0
Emerging markets	50	72	30	28	0	6	10	4	8
Developing countries	2	50	50	50	0	0	50	0	0
Emerging market and developing countries									
Africa	1	100	100	0	0	0	0	0	0
Asia	3	67	67	33	0	0	0	0	33
Central and Eastern Europe	4	50	25	50	0	50	0	0	0
CIS and Mongolia	6	67	50	33	0	0	0	0	33
Middle East	22	82	23	18	0	0	9	9	0
Western Hemisphere	16	63	25	38	0	6	25	0	6
Countries with fixed or crawling pegs or bands	36	69	31	31	0	6	17	6	3
Countries with other exchange rate regimes	24	63	29	38	0	13	8	0	17

1/ Figures refer to deletions made to staff reports for Article IV consultations and use of Fund resources that went before the Board from January 1, 2016 to December 31, 2016.

2/ Based on *World Economic Outlook* definitions. Also includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

3/ This aggregate includes deletion requests received by country desks and reviewed by SPR; it does not include requests received and rejected by country teams that were not forwarded to SPR for review. Each deletion is counted separately, implying that there may be multiple deletion requests for each document.

4/ Partially rejected deletions include items where only part of the requested deletion was accepted or where the deletion was reformulated and then accepted.

5/ Deletions may be made on the basis of market sensitivity when the material is not already in the public domain, is market-relevant within the near term, and is sufficiently specific to create a clear risk of triggering a disruptive market reaction if disclosed.

6/ Deletions may be made on the basis of premature disclosure of policy intentions where material is not already in the public domain, the information consists of operational details of a policy the authorities intend to implement, and premature disclosure of the operational details would, in itself, seriously undermine the ability of the authorities to implement it.

Table 5a. Corrections in Article IV and UFR Staff Reports (2014-16)[1/ 2/]

(Percent of all published reports, unless otherwise indicated)

	2014				2015				2016			
Reports by group [3/]	Number published	With corrections	With corrections for evident ambiguity	With corrections for mischaracteriz-ation	Number published	With corrections	With corrections for evident ambiguity	With corrections for mischaracteriz-ation	Number published	With corrections	With corrections for evident ambiguity	With corrections for mischaracteriz-ation
All Article IV and UFR reports	180	74	39	23	176	76	45	18	179	78	53	18
Advanced markets	39	92	79	33	30	97	80	57	34	94	82	35
EU	26	85	73	27	18	83	89	67	22	91	77	32
Other Europe	3	100	67	67	4	100	50	25	4	100	75	50
ROW	10	100	90	40	7	100	71	57	7	100	100	29
Emerging markets	80	94	41	31	76	96	62	16	84	100	67	19
Developing countries	61	38	11	5	70	46	11	4	61	39	18	7
Emerging market and developing countries	141	70	28	20	147	72	38	10	145	74	46	14
Africa	45	44	18	9	49	57	12	4	44	57	25	5
Asia	24	58	25	29	26	69	42	8	27	70	52	19
Central and Eastern Europe	13	92	54	23	16	88	50	0	17	100	59	18
CIS and Mongolia	12	75	33	17	10	100	60	20	9	100	44	11
Middle East	19	89	21	32	18	83	50	22	12	92	67	25
Western Hemisphere	28	96	43	21	28	89	57	18	36	81	61	19

1/ Refers to documents considered by the IMF Executive Board during the calendar year, and published within six months of the end of the calendar year; e.g. the publication rate for 2016 refers to the documents discussed by the Board in 2016 and published by June 30, 2017.

2/ Because a single report can have corrections falling into multiple categories, e.g., exchange rate, financial sector and/or other areas, there is no fixed relationship between the second column and the third and fourth column under each year.

3/ Based on World Economic Outlook definitions. Also includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

Table 5b. Corrections in 2016 [1/ 2/]

(Percent of all corrections requested by income group and region, unless otherwise indicated)

Reports by group [3/]	Number of correction requests [4/]	Approved	*Of which:* Partially rejected [5/]	Rejected	Rejected, but subsequently approved by Management	Reason correction requests were rejected: Alters staff assessment	Attempts to improve presentation	Extends argument/ Introduces new information	Does not meet post-Board criteria [6/]	Other
All Article IV, UFR or combined reports	1,557	92	11	8	0	1	3	3	0	0
Advanced markets	538	94	10	6	0	0	2	4	0	0
EU	288	93	12	7	0	0	3	4	0	0
Other Europe	36	97	14	3	0	0	0	3	0	0
ROW	199	93	8	7	0	0	2	5	0	0
Emerging markets	917	91	12	9	0	1	4	3	1	0
Developing countries	102	92	10	8	0	0	4	3	0	1
Emerging market and developing countries										
Africa	141	90	11	10	0	0	5	3	2	0
Asia	228	92	10	8	0	0	4	4	0	0
Central and Eastern Europe	173	96	10	4	0	1	2	1	0	0
CIS and Mongolia	59	90	12	10	0	2	5	2	0	2
Middle East	104	90	13	10	0	3	1	3	0	3
Western Hemisphere	329	89	13	11	0	1	5	4	0	0
Countries with fixed or crawling pegs or bands	537	88	17	12	0	1	5	4	0	1
Countries with other exchange rate regimes	753	92	11	8	0	0	3	4	0	0

1/ Figures refer to corrections made to staff reports for Article IV consultations and use of Fund resources that went before the Board from January 1, 2016 to December 31, 2016.
2/ Certain corrections are subject to Staff review as per the Transparency Policy (http://www.imf.org/external/np/pp/eng/2009/102609.pdf) and the 2013 Transparency Policy Review (http://www.imf.org/external/np/pp/eng/2013/051413.pdf). As per the policy, corrections to staff reports cannot be used to improve the presentation, extend staff's or the authorities arguments, alter staff's assessment, or introduce any new information.
3/ Based on World Economic Outlook definitions. Also includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.
4/ This aggregate includes correction requests received by country desks and reviewed by SPR; it does not include requests received and rejected by country teams that were not forwarded to SPR for review. Each correction is counted separately, implying that there may be multiple correction requests for each document.
5/ Partially rejected corrections include items where the requested correction was reclassified or reformulated and then accepted.
6/ Corrections may only be made after the Board date if the correction is brought to the attention of the Board before the conclusion of the Board’s consideration of the document, or the failure to make the correction would undermine the overall value of the publication.

Table 6. Members that Published All Article IV/UFR Staff Reports in 2016 1/ 2/ 3/ 4/

Afghanistan, Islamic Republic of	Guinea	Papua New Guinea
Albania	Guinea-Bissau	Paraguay
Algeria	Guyana	Peru
Argentina	Haiti	Philippines
Armenia	Honduras	Poland
Austria	Hong Kong SAR	Portugal
Azerbaijan	Hungary	Romania
Bahamas, The	Iceland	Russia
Bangladesh	India	St. Kitts and Nevis
Barbados	Indonesia	St. Lucia
Belarus	Iraq	St. Vincent and the Grenadines
Belgium	Ireland	San Marino
Belize	Italy	São Tomé Príncipe
Bhutan	Jamaica	Saudi Arabia
Bolivia	Japan	Senegal
Bosnia and Herzegovina	Jordan	Serbia
Botswana	Kenya	Sierra Leone
Brazil	Kiribati	Singapore
Bulgaria	Korea	Slovak Republic
Burkina Faso	Kosovo	Slovenia
Cambodia	Kyrgyz Republic	Solomon Islands
Canada	Latvia	South Africa
Cabo Verde	Lebanon	Sri Lanka
CEMAC	Lesotho	Sudan
Central African Republic	Liberia	Sweden
Chad	Lithuania	Switzerland
Chile	Luxembourg	Tanzania
China	Macedonia, FYR	Thailand
Colombia	Madagascar	Timor-Leste
Comoros	Malawi	Tonga
Costa Rica	Malaysia	Trinidad And Tobago
Côte d'Ivoire	Maldives	Tunisia
Croatia	Mali	Turkey
Cyprus	Malta	Tuvalu
Czech Republic	Marshall Islands	Ukraine
Denmark	Mauritania	United Arab Emirates
Dominica	Mauritius	United Kingdom
Dominican Republic	Mexico	United States
ECCU	Moldova	Uruguay
Egypt	Montenegro	Vanuatu
El Salvador	Morocco	Vietnam
Equatorial Guinea	Namibia	WAEMU
Ethiopia	Netherlands	Zimbabwe
Euro Area	Netherlands - Curaçao	
Fiji	New Zealand	
Finland	Nicaragua	
France	Niger	
Gabon	Nigeria	
Germany	Norway	
Ghana	Pakistan	
Grenada	Palau	
Guatemala	Panama	

1/ Includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

2/ The members listed in this table had published all their Article IV and/or all their UFR staff reports considered by the Board in 2016, by June 30, 2017.

3/ Member countries who published some of their Article IV/UFR staff reports in 2016 are Ecuador and Suriname.

4/ This list does not reflect the 43 members and members' territories that did not have an Article IV or UFR document considered by the Board in 2016: Angola , Aruba, Australia, Benin, Burundi, Cameroon, Congo (Democratic Republic of) Congo (Republic of), Djibouti, Eritrea, Estonia, Gambia, Greece, Iran, Israel, Kazakhstan, Kuwait, Laos, Libya, Macao SAR, Micronesia, Mongolia, Mozambique, Myanmar, Nauru, Nepal, Qatar, Rwanda, Samoa, Seychelles, Somalia, South Sudan, Spain, Swaziland, Syria, Tajikistan, Togo, Turkmenistan, Uganda, Uzbekistan, Venezuela, Yemen, and Zambia.

Table 7(a) Members Not Publishing Article IV Reports in 2016 [1/2]

Antigua and Barbuda
Bahrain
Brunei Darussalam
Ecuador
Georgia
Oman
Suriname

1/ These member countries had Article IV documents considered by the Board in 2016 (including for discussions with currency unions in the context of Article IV consultations with their constituent members), but had not published these documents by June 30, 2017.
2/ All these countries published Press Releases except Antigua and Barbuda, Ecuador, Georgia, and Oman.

Table 7(b) Members Not Publishing All UFR Staff Reports in 2016[1/]

None

1/ These member countries had UFR staff reports considered by the Board in 2016, but had not published all of these documents by June 30, 2017.

Table 8. Longest and Shortest Publication Lags for 2016 1/ 2/ 3/

Shortest Publication Lag			Longest Publication Lag		
Board Date	Country 3/	Days	Board Date	Country 3/	Days
1/13/2016	Poland	0	2/19/2016	Dominican Republic	265
5/27/2016	Mexico	0	12/14/2016	Kyrgyz Republic	170
7/11/2016	France	1	5/23/2016	Panama	163
7/27/2016	Ireland	1	7/13/2016	ECCU	104
11/9/2016	Argentina	1	7/18/2016	Saudi Arabia	87
2/10/2016	Austria	2	11/18/2016	Haiti	80
3/21/2016	Solomon Islands	2	8/29/2016	Equatorial Guinea	79
5/2/2016	Zimbabwe	2	11/11/2016	Egypt	68
5/9/2016	Romania	2	7/8/2016	Ecuador	63
5/16/2016	Algeria	2	11/29/2016	Papua New Guinea	62
6/13/2016	Colombia	2	5/9/2016	Guyana	59
6/20/2016	Iceland	2	5/11/2016	Timor Leste	44
7/6/2016	Euro Area	2	12/12/2016	Lebanon	43
8/31/2016	Serbia	2	7/13/2016	CEMAC	42
9/7/2016	Bosnia and Herzegovina	2	5/20/2016	Trinidad and Tobago	40
9/7/2016	Kiribati	2	9/9/2016	Palau	40
11/7/2016	Moldova	2	9/21/2016	Belize	36
12/7/2016	Chile	2	12/1/2016	Senegal	34
1/11/2016	Slovak Republic	3	6/17/2016	Vietnam	31
2/5/2016	New Zealand	3	10/28/2016	Guinea	31
2/8/2016	Netherlands	3	2/19/2016	Gabon	28
6/15/2016	United Kingdom	3	3/25/2016	Turkey	28
7/25/2016	Marshall Islands	3	7/29/2016	Korea	28
9/16/2016	Jamaica	3	9/7/2016	Sudan	27
11/14/2016	Sweden	3	10/26/2016	Honduras	27
5/6/2016	San Marino	4	3/16/2016	Botswana	26
6/17/2016	Jamaica	4	7/22/2016	Chad	26
6/20/2016	Malawi	4	7/27/2016	Netherlands - Curaçao	26
7/8/2016	United States	4	12/2/2016	Guinea-Bissau	26
7/25/2016	Singapore	4	6/20/2016	Peru	25

1/ Publication refers to Article IV and UFR documents considered by the Board in 2016, and published by June 30, 2017.

2/ Publication lags refer to calendar days between the Board date and the publication date.

3/ Includes discussions held with members' territories and currency unions in the context of Article IV consultations with their constituent members.

Table 9 Members Requesting Explicit Consent Prior to Publication[1/]

Bahrain
Brazil
Bulgaria
Cabo Verde
Dominican Republic
Ecuador
Egypt
Guyana
Haiti
Iraq
Jordan
Kuwait
Lebanon
Maldives
Nicaragua
Oman
Panama
Qatar
Saudi Arabia
Suriname
Syria
Timor-Leste
Trinidad and Tobago
Turkmenistan
United Arab Emirates
Uzbekistan
Yemen

1/ Under the Fund's Transparency Policy, a member country's consent to publish is typically obtained on a "non-objection" basis. However, a member may "opt out" of the "non-objection" system, in which case the member's explicit consent is required prior to publication of its country and related policy intention documents. See: http://www.imf.org/external/np/pp/eng/2014/040714.pdf.

G20 Leaders' Communiqué
Brisbane Summit, 15-16 November 2014

1. Raising global growth to deliver better living standards and quality jobs for people across the world is our highest priority. We welcome stronger growth in some key economies. But the global recovery is slow, uneven and not delivering the jobs needed. The global economy is being held back by a shortfall in demand, while addressing supply constraints is key to lifting potential growth. Risks persist, including in financial markets and from geopolitical tensions. We commit to work in partnership to lift growth, boost economic resilience and strengthen global institutions.

2. We are determined to overcome these challenges and step up our efforts to achieve strong, sustainable and balanced growth, and to create jobs. We are implementing structural reforms to lift growth and private sector activity, recognising that well-functioning markets underpin prosperity. We will ensure our macroeconomic policies are appropriate to support growth, strengthen demand and promote global rebalancing. We will continue to implement fiscal strategies flexibly, taking into account near-term economic conditions, while putting debt as a share of GDP on a sustainable path. Our monetary authorities have committed to support the recovery and address deflationary pressures when needed, consistent with their mandates. We will be mindful of the global impacts of our policies and cooperate to manage spillovers. We stand ready to use all policy levers to underpin confidence and the recovery.

3. This year we set an ambitious goal to lift the G20's GDP by at least an additional two per cent by 2018. Analysis by the IMF-OECD indicates that our commitments, if fully implemented, will deliver 2.1 per cent. This will add more than US$2 trillion to the global economy and create millions of jobs. Our measures to lift investment, increase trade and competition, and boost employment, along with our macroeconomic policies, will support development and inclusive growth, and help to reduce inequality and poverty.

4. Our actions to boost growth and create quality jobs are set out in the Brisbane Action Plan and in our comprehensive growth strategies. We will monitor and hold each other to account for implementing our commitments, and actual progress towards our growth ambition, informed by analysis from international organisations. We will ensure our growth strategies continue to deliver and will review progress at our next meeting.

Acting together to lift growth and create jobs

5. Tackling global investment and infrastructure shortfalls is crucial to lifting growth, job creation and productivity. We endorse the Global Infrastructure Initiative, a multi-year work programme to lift quality public and private infrastructure investment. Our growth strategies contain major investment initiatives, including actions to strengthen public investment and improve our domestic investment and financing climate, which is essential to attract new private sector finance for investment. We have agreed on a set of voluntary leading practices to promote and prioritise quality investment, particularly in infrastructure. To help match investors with projects, we will address data gaps and improve information on project pipelines. We are working to facilitate long-term financing from institutional investors and to encourage market sources of finance, including transparent securitisation, particularly for small and medium-sized enterprises. We will continue to work with multilateral development banks, and encourage national development banks, to optimise use of their balance sheets to provide additional lending and ensure our work on infrastructure benefits low-income countries.

6. To support implementation of the Initiative, we agree to establish a Global Infrastructure Hub with a four-year mandate. The Hub will contribute to developing a knowledge-sharing platform and network between governments, the private sector, development banks and other international organisations. The Hub will foster collaboration among these groups to improve the functioning and financing of infrastructure markets.

7. To strengthen infrastructure and attract more private sector investment in developing countries, we welcome the launch of the World Bank Group's Global Infrastructure Facility, which will complement our work. We support similar initiatives by other development banks and continued cooperation amongst them.

8. Trade and competition are powerful drivers of growth, increased living standards and job creation. In today's world we don't just trade final products. We work together to make things by importing and exporting components and services. We need policies that take full advantage of global value chains and

encourage greater participation and value addition by developing countries. Our growth strategies include reforms to facilitate trade by lowering costs, streamlining customs procedures, reducing regulatory burdens and strengthening trade-enabling services. We are promoting competition, entrepreneurship and innovation, including by lowering barriers to new business entrants and investment. We reaffirm our longstanding standstill and rollback commitments to resist protectionism.

9. Our actions to increase investment, trade and competition will deliver quality jobs. But we must do more to address unemployment, raise participation and create quality jobs. We agree to the goal of reducing the gap in participation rates between men and women in our countries by 25 per cent by 2025, taking into account national circumstances, to bring more than 100 million women into the labour force, significantly increase global growth and reduce poverty and inequality.

10. We are strongly committed to reducing youth unemployment, which is unacceptably high, by acting to ensure young people are in education, training or employment. Our Employment Plans include investments in apprenticeships, education and training, and incentives for hiring young people and encouraging entrepreneurship. We remain focussed on addressing informality, as well as structural and long-term unemployment, by strengthening labour markets and having appropriate social protection systems. Improving workplace safety and health is a priority. We ask our labour and employment ministers, supported by an Employment Working Group, to report to us in 2015.

11. We are committed to poverty eradication and development, and to ensure our actions contribute to inclusive and sustainable growth in low-income and developing countries. We commit to take strong practical measures to reduce the global average cost of transferring remittances to five per cent and to enhance financial inclusion as a priority. The G20 Food Security and Nutrition Framework will strengthen growth by lifting investment in food systems, raising productivity to expand food supply, and increasing incomes and quality jobs. We support efforts in the United Nations to agree an ambitious post-2015 development agenda. The G20 will contribute by strengthening economic growth and resilience.

Building a stronger, more resilient global economy

12. Strengthening the resilience of the global economy and stability of the financial system are crucial to sustaining growth and development. We have delivered key aspects of the core commitments we made in response to the financial crisis. Our reforms to improve banks' capital and liquidity positions and to make derivatives markets safer will reduce risks in the financial system. We welcome the Financial Stability Board (FSB) proposal as set out in the Annex requiring global systemically important banks to hold additional loss absorbing capacity that would further protect taxpayers if these banks fail. Progress has been made in delivering the shadow banking framework and we endorse an updated roadmap for further work. We have agreed to measures to dampen risk channels between banks and non-banks. But critical work remains to build a stronger, more resilient financial system. The task now is to finalise remaining elements of our policy framework and fully implement agreed financial regulatory reforms, while remaining alert to new risks. We call on regulatory authorities to make further concrete progress in swiftly implementing the agreed G20 derivatives reforms. We encourage jurisdictions to defer to each other when it is justified, in line with the St Petersburg Declaration. We welcome the FSB's plans to report on the implementation and effects of these reforms, and the FSB's future priorities. We welcome the progress made to strengthen the orderliness and predictability of the sovereign debt restructuring process.

13. We are taking actions to ensure the fairness of the international tax system and to secure countries' revenue bases. Profits should be taxed where economic activities deriving the profits are performed and where value is created. We welcome the significant progress on the G20/OECD Base Erosion and Profit Shifting (BEPS) Action Plan to modernise international tax rules. We are committed to finalising this work in 2015, including transparency of taxpayer-specific rulings found to constitute harmful tax practices. We welcome progress being made on taxation of patent boxes. To prevent cross-border tax evasion, we endorse the global Common Reporting Standard for the automatic exchange of tax information (AEOI) on a reciprocal basis. We will begin to exchange information automatically with each other and with other countries by 2017 or end-2018, subject to completing necessary legislative procedures. We welcome financial centres' commitments to do the same and call on all to join us. We welcome deeper engagement of developing countries in the BEPS project to address their concerns. We will work with them to build their tax administration capacity and implement AEOI. We welcome further collaboration by our tax authorities on cross-border compliance activities.

14. We endorse the 2015-16 G20 Anti-Corruption Action Plan that will support growth and resilience. Our actions are building cooperation and networks, including to enhance mutual legal assistance, recovery of

the proceeds of corruption and denial of safe haven to corrupt officials. We commit to improve the transparency of the public and private sectors, and of beneficial ownership by implementing the G20 High-Level Principles on Beneficial Ownership Transparency.

Strengthening global institutions

15. The G20 must be at the forefront in helping to address key global economic challenges. Global economic institutions need to be effective and representative, and to reflect the changing world economy. We welcome the increased representation of emerging economies on the FSB and other actions to maintain its effectiveness. We are committed to maintaining a strong, quota-based and adequately resourced International Monetary Fund (IMF). We reaffirm our commitment in St Petersburg and in this light we are deeply disappointed with the continued delay in progressing the IMF quota and governance reforms agreed in 2010 and the 15th General Review of Quotas, including a new quota formula. The implementation of the 2010 reforms remains our highest priority for the IMF and we urge the United States to ratify them. If this does not happen by year-end, we ask the IMF to build on its existing work and stand ready with options for next steps.

16. We need a strong trading system in an open global economy to drive growth and generate jobs. To help business make best use of trade agreements, we will work to ensure our bilateral, regional and plurilateral agreements complement one another, are transparent and contribute to a stronger multilateral trading system under World Trade Organization (WTO) rules. These rules remain the backbone of the global trading system that has delivered economic prosperity. A robust and effective WTO that responds to current and future challenges is essential. We welcome the breakthrough between the United States and India that will help the full and prompt implementation of the Trade Facilitation Agreement and includes provisions on food security. We commit to implement all elements of the Bali package and to swiftly define a WTO work programme on the remaining issues of the Doha Development Agenda to get negotiations back on track. This will be important to restore trust and confidence in the multilateral trading system. We agreed to discuss ways to make the system work better when we meet next year. We will continue to provide aid-for-trade to developing countries in need of assistance.

17. Increased collaboration on energy is a priority. Global energy markets are undergoing significant transformation. Strong and resilient energy markets are critical to economic growth. Today we endorse the G20 Principles on Energy Collaboration. We ask our energy ministers to meet and report to us in 2015 on options to take this work forward. Gas is an increasingly important energy source and we will work to improve the functioning of gas markets.

18. Improving energy efficiency is a cost-effective way to help address the rising demands of sustainable growth and development, as well as energy access and security. It reduces costs for businesses and households. We have agreed an Action Plan for Voluntary Collaboration on Energy Efficiency, including new work on the efficiency and emissions performance of vehicles, particularly heavy duty vehicles; networked devices; buildings; industrial processes; and electricity generation; as well as work on financing for energy efficiency. We reaffirm our commitment to rationalise and phase out inefficient fossil fuel subsidies that encourage wasteful consumption, recognising the need to support the poor.

19. We support strong and effective action to address climate change. Consistent with the United Nations Framework Convention on Climate Change (UNFCCC) and its agreed outcomes, our actions will support sustainable development, economic growth, and certainty for business and investment. We will work together to adopt successfully a protocol, another legal instrument or an agreed outcome with legal force under the UNFCCC that is applicable to all parties at the 21st Conference of the Parties (COP21) in Paris in 2015. We encourage parties that are ready to communicate their intended nationally determined contributions well in advance of COP21 (by the first quarter of 2015 for those parties ready to do so). We reaffirm our support for mobilising finance for adaptation and mitigation, such as the Green Climate Fund.

20. We are deeply concerned with the humanitarian and economic impact of the Ebola outbreak in Guinea, Liberia and Sierra Leone. We support the urgent coordinated international response and have committed to do all we can to contain and respond to this crisis. We call on international financial institutions to assist affected countries in dealing with the economic impacts of this and other humanitarian crises, including in the Middle East.

21. We remain resolute in our commitment to lift economic growth, support job creation, promote development and build global confidence. We thank Australia for its leadership this year. We look forward to working together in 2015 under Turkey's presidency and to discussing progress at our next meeting in Antalya on 15-16 November 2015. We also look forward to meeting in China in 2016.

Annex

Agreed documents

The following documents agreed by the G20 support our communiqué:

- Brisbane Action Plan, November 2014
- G20 Note on the Global Infrastructure Initiative and Hub, November 2014
- 2014 Financial Inclusion Action Plan, November 2014
- G20 Plan to Facilitate Remittance Flows, November 2014
- G20 Food Security and Nutrition Framework, November 2014
- Development Working Group Accountability Framework, November 2014
- 2015-16 G20 Anti-Corruption Action Plan, November 2014
- G20 High-Level Principles on Beneficial Ownership Transparency, November 2014
- G20 Principles on Energy Collaboration, November 2014
- G20 Energy Efficiency Action Plan, November 2014
- The 2015 G20 Accountability Assessment Process, November 2014
- 2014 Accountability Assessment Report, November 2014

Ministerial statements

- Communiqué, Meeting of G20 Finance Ministers and Central Bank Governors, Cairns, 20-21 September 2014
- G20 Labour and Employment Ministerial Declaration, Melbourne, 10-11 September 2014, including G20 Statement on Safer and Healthier Workplaces
- Chairman's Summary, Meeting of G20 Trade Ministers, Sydney, 29 July 2014
- Communiqué, Meeting of G20 Finance Ministers and Central Bank Governors, Washington DC, 10-11 April 2014
- Communiqué, Meeting of G20 Finance Ministers and Central Bank Governors, Sydney, 22-23 February 2014

Supporting documents

We welcome the delivery of the following documents:

- G20 Members' Comprehensive Growth Strategies, November 2014
- G20 Members' Country Employment Plans, November 2014
- IMF Surveillance Note, November 2014
- Quantifying the Impact of G-20 Members' Growth Strategies, OECD/IMF report, November 2014
- Growth Strategies: G20 Emerging Market Economies – World Bank Group Assessment, November 2014
- Global Infrastructure Facility: Update for G20 Leaders, World Bank Group, November 2014
- G20/OECD Report on Effective Approaches to Support Implementation of the G20/OECD High-Level Principles on Long-Term Investment Financing by Institutional Investors, and Annex, November 2014
- Report on G20 Trade and Investment Measures, WTO, OECD, and UNCTAD, November 2014
- G20 Labour Markets: Outlook, Key Challenges and Policy Responses, OECD, ILO and World Bank Group, November 2014
- Opportunities for Economic Growth and Job Creation in Relation to Food Security and Nutrition, FAO and OECD (with inputs from ADB, IFAD, ILO, IFPRI and WTO), September 2014
- Financial Reforms: Completing the Job and Looking Ahead, Financial Stability Board Chairman's Letter to G20 Leaders, November 2014
- Adequacy of loss-absorbing capacity of global systemically important banks in resolution, Financial Stability Board, November, 2014
- Cross-Border Recognition of Resolution Action, Financial Stability Board, September 2014
- Updated G20 Roadmap towards Strengthened Oversight and Regulation of Shadow Banking in 2015, Financial Stability Board, November 2014

- Report to the G20 Brisbane Summit on the FSB's review of the structure of its representation, Financial Stability Board, November 2014
- OECD Secretary-General's Report to G20 Leaders on Tax Matters, November 2014
- International Organisations' proposal for structured dialogue process with developing countries on tax matters, November 2014

These documents are in addition to those delivered to G20 Finance Ministers and Central Bank Governors, Labour and Employment Ministers, and Trade Ministers at their meetings this year.

G20 Working Group reports

- G20 2014 Brisbane Anti-Corruption Update
- 2014 Brisbane Development Update
- G20 Energy Sustainability Working Group 2014 Co-chairs' Report
- G20 Climate Finance Study Group – Report to Ministers, 2014

Issues for further action

- The FSB proposal for an internationally agreed standard requiring global systemically important banks (G-SIBs) to hold additional loss absorbing capacity in resolution will be subject to public consultation, a rigorous quantitative impact assessment and further refinement before any final measure is agreed by the 2015 Summit. The impact analyses will include consideration of the consequences of this requirement on banks in emerging markets, G-SIBs headquartered in EMEs, and state-owned banks.

- Given the challenges litigation poses and in order to strengthen the orderliness and predictability of the sovereign debt restructuring process, we welcome the international work on strengthened collective action and pari passu clauses. We call for their inclusion in international sovereign bonds and encourage the international community and private sector to actively promote their use. We ask our Finance Ministers and Central Bank Governors to discuss the progress achieved on this and related issues.

- If the US does not ratify the 2010 IMF reforms by end-2014, we ask the IMF to discuss options for next steps shortly thereafter and we ask our Finance Ministers and Central Bank Governors to work with the IMFC to schedule a discussion on these options in their next meeting.

Acknowledgements

We thank international organisations, including the IMF, OECD, World Bank Group, WTO, ILO, FSB and UN, for their reports and recommendations, which have provided valuable inputs to G20 discussions. These can be found at http://www.g20.org/official_resources.

We thank the Business 20, Civil Society 20, Labour 20, Think 20 and Youth 20 for their important contribution to the G20's work.