JULY 20, 2017

CHOICE Act 2.0 Passes the House: What Is the 'CHOICE'?

On June 8, 2017, the House of Representatives passed an amended version of H.R. 10, the Financial CHOICE Act of 2017, or CHOICE Act 2.0, which scales back or eliminates many of the post-crisis financial reforms that were promulgated by the Dodd-Frank Wall Street Reform and Consumer Protection Act including, for example, the Volcker Rule, the authority of the Financial Stability Oversight Council to designate systematically important financial institutions, and the orderly liquidation authority. In addition, CHOICE Act 2.0 proposes a number of capital market reforms directed at easing the regulatory burden on smaller issuers. The passage of CHOICE Act 2.0 represents a significant step towards financial regulatory reform that the Republican leadership has been calling for since the passage of the Dodd-Frank Act.

CHOICE Act 2.0 as passed by the House has evolved since Republican Representative Jeb Hensarling first introduced the bill in 2016 and the House Financial Services Committee passed "version 2.0" of the bill on May 4, 2017. One significant change from to version 2.0 as passed by the Committee was the omission of a provision that would have repealed the "Durbin Amendment." A highly contested provision, the Durbin Amendment limits interchange fees charged in connection with debit cards, and was removed by House Republicans in an effort to obtain the votes needed to pass the legislation through the House.

In light of the bill's many sweeping changes to the current financial regulatory landscape, the prospects of CHOICE Act 2.0 being approved in its current form by the Senate are slim. The Senate is more likely to pursue legislation that is more limited in scope than the current bill.

While CHOICE Act 2.0 covers a broad range of topics, certain core themes, aside from generally revisiting Dodd-Frank Act reforms, emerge from the bill's provisions, including: (1) dramatically curtailing financial regulatory discretion and encouraging transparency in, and oversight over, regulation and supervision; (2) reining in the ability of the Federal Reserve and others to implement the kinds of interventionist measures that were taken at the height of the financial crisis and generally chipping away at Federal Reserve independence; (3) effecting changes with an aim to facilitate smaller company capital formation; (4) repealing many of the public company disclosure requirements mandated by the Dodd-Frank Act and considered by the Republican leadership as outside the scope of the SEC's purview; (5) limiting the impact of regulation on community banks; and (6) encouraging increased coordination among regulatory agencies.

Subsequent to the House passage of CHOICE Act 2.0, the Treasury Department released the first of a series of reports entitled "A Financial System That Creates Economic Opportunities: Banks and Credit Unions," produced in response to the Presidential executive order on core principles for regulating the financial system,[1] which directs the

---

[1] For an overview of the Presidential executive order, you may wish to refer to our client publication: "An Annotated Guide to Trump's Executive Order on Financial Regulatory Reform," available at: http://www.shearman.com/en/newsinsights/publications/2017/02/guide-to-trump-order-on-financial-reg-reform

Department to examine existing financial regulation and make recommendations to the President on suggested reforms. While CHOICE Act 2.0 and the Treasury Report touch on many similar topics, there are certain notable differences, including:

- While CHOICE Act 2.0 would repeal the Volcker Rule in its entirety, the Treasury Report does not propose the elimination of the Volcker Rule. Instead, the Treasury Report recommends exempting entities with $10 billion or less in assets from the Rule's scope and suggests that regulatory agencies modify certain concepts and defined terms in order to reduce the complexity of the Volcker Rule.
- While critical of the Consumer Financial Protection Bureau, the Treasury Report, unlike CHOICE Act 2.0, would permit the CFPB to continue enforcing against covered persons for unfair, deceptive, or abusive acts or practices, while recommending that the CFPB more clearly define its interpretations of the UDAAP standard. Like CHOICE Act 2.0, the Treasury Report advocates for the elimination of the CFPB's supervisory authority, noting that this authority is duplicative of the supervisory authority of the prudential regulators, and recommends that the CFPB be funded through Congressional appropriations, thereby increasing Congressional oversight of the agency.
- A majority of the recommendations in the Treasury Report are capable of being implemented directly by the various federal financial industry regulators without Congressional action, making many of the recommendations, in theory, less difficult to institute.

Because the Treasury Report recommends reform that is more modest that those that would be enacted by CHOICE Act 2.0, and the Report's recommendations are the product of Treasury's collaborative discussions with regulators, it may be that the reforms implemented by Congress or the regulatory agencies (or both) will be more reflective of the Treasury Report's recommendations rather than CHOICE Act 2.0 provisions. Republican leaders also may choose to pursue adoption of certain financial reforms that can be tied to spending, revenues or deficit reduction through the budget reconciliation process, where changes would require only a majority vote in the Senate. The Congressional Budget Office estimates that enacting CHOICE Act 2.0 would result in a reduction of budget deficits by $33.6 billion, with the majority of such savings resulting from elimination of the orderly liquidation fund and subjecting the CFPB and other agencies to the Congressional appropriations process.

Nevertheless, the passage of CHOICE Act 2.0 represents a major first step towards financial deregulation. CHOICE Act 2.0, together with the Treasury Report, will certainly be influencing the regulatory agenda for the federal financial regulators for the months and years to come. This note highlights the key takeaways of CHOICE Act 2.0. We will continue to track the progress of CHOICE Act 2.0 as it makes its way through Congress.

Key Takeaways

Title I: Ending "Too Big to Fail"

- *Repeal of the Orderly Liquidation Authority*. CHOICE Act 2.0 would repeal the orderly liquidation authority ("OLA") created under the Dodd-Frank Act, which enables federal regulatory authorities to place a large financial company into a receivership if its failure under ordinary insolvency law would have a serious adverse impact on US financial stability. In its place, CHOICE Act 2.0 would create a new Subchapter V under Chapter 11 of the Bankruptcy Code, which is tailored to address the failure of large, complex financial institutions. Such proposed

legislation is largely consistent with prior versions of proposals seeking to adopt a specialized subchapter of the Bankruptcy Code for large, complex financial institutions.

- *FSOC Reforms*. Title I would make significant changes to the membership, structure, powers and functions of the Financial Stability Oversight Council ("FSOC"). Specifically, the FSOC's authority to designate a firm as a systemically important financial institution would be repealed, along with all designations previously made. FSOC would also no longer have the authority to designate central counterparty clearinghouses and payment systems as systemically important financial market utilities.
- *Elimination of the Office of Financial Research*. Title I would eliminate the Office of Financial Research, an independent office that was created within the Department of the Treasury by the Dodd-Frank Act.
- *Biannual Resolution Plans*. Title I would reduce the frequency of living will submissions to every 2 years and eliminate the role of the Federal Deposit Insurance Corporation ("FDIC") in the process. The Board of Governors of the Federal Reserve System (the "Federal Reserve") would be required to provide feedback to banking organizations within six months of their submissions of the living wills, and to publicly disclose its resolution plan assessment frameworks for notice and comment.
- *Reforms Stress Test Regime*. Title I would overhaul the current stress testing regime for banking organizations, including extending the Comprehensive Capital Analysis and Review ("CCAR") cycle to every two years, eliminating the Dodd-Frank Act Stress Tests ("DFAST") for banking organizations that are not bank holding companies ("BHCs") and increasing the transparency of the stress testing process.
- *Curb Emergency Assistance*. Title I would curb the federal regulatory agencies' ability to assist large financial institutions that encounter financial distress. For example, it would repeal the provisions of the Dodd-Frank Act that currently permit the FDIC and the Federal Reserve to create a widely available program to guarantee obligations of solvent financial firms and their affiliates in the event of a liquidity event and limit the use of the Exchange Stabilization Fund ("ESF").

Title II: Demanding Accountability From Wall Street

- *Increase Maximum Regulatory Penalties*. Title II would increase the maximum penalties that regulators could impose under certain federal laws, including: the Securities Act of 1933 (the "Securities Act"), the Securities Exchange Act of 1934 (the "Exchange Act"), the Investment Advisers Act of 1940 (the "Advisers Act"), the Investment Company Act of 1940 (the "'40 Act"), the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), the Home Owners' Loan Act, the Federal Deposit Insurance Act, the Federal Credit Union Act, the Federal Reserve Act, and the Bank Holding Company Act of 1956 ("BHC Act").

Title III: Demanding Accountability From Financial Regulators

- *Require Cost-Benefit Analysis*. Title III would require federal financial regulatory agencies to conduct quantitative and qualitative cost-benefit analyses when proposing new regulations. Specifically, the agencies could not propose new rulemakings without first analyzing the effectiveness of such rule and its burden on potential stakeholders, especially local entities, governments or private sectors.

- *Periodic Review of Regulators*. Within one year of enactment of CHOICE Act 2.0 and every five years thereafter, each federal financial regulatory agency[2] would be required to submit to Congress and post on their public website, a plan to modify, streamline, expand or repeal existing regulations to make its regulatory program more effective or less burdensome.
- *Congressional Approval of Major Rules*. Title III requires each "major rule" (as defined within CHOICE Act 2.0) of a federal financial regulatory agency to be approved by a joint resolution of Congress within 70 session days or legislative days of its submission to Congress before it could take effect.
- *Eliminate Chevron Deference*. Title III would eliminate the so-called Chevron doctrine of judicial deference for federal financial regulatory agencies, under which judges generally defer to an agency's reasonable statutory and regulatory interpretation where a statutory or regulatory provision contains a gap or ambiguity. CHOICE Act 2.0 would implement the repeal two years after enactment rather than immediately, as was stipulated in earlier iterations of the bill.
- *Asserting Congressional Control*. Title III would bring the FDIC, FHFA, OCC, the examination and supervision functions of the NCUA, and the non-monetary functions of the Federal Reserve into the Congressional appropriations process.
- *Requiring Coordination in Enforcement Actions*. Title III would require the federal financial regulatory agencies to implement policies and procedures to minimize duplication of efforts with other federal and state authorities when bringing administrative or judicial action against an individual or entity, and establish a "lead agency" for joint investigations, administrative actions or judicial actions.
- *Criminalizing Disclosure of Individual Information*. Title III would create a misdemeanor offense for any employee of a Federal department or agency who discloses individually identifiable information contained in confidential agency records without authorization.

Title IV: Facilitating Capital Formation for Small Businesses, Innovators and Job Creators

- "*JOBS Act 2.0*." Title IV is primarily focused on easing the regulatory hurdles of smaller companies related to raising capital and on providing a smoother transition for smaller companies that have completed an initial public offering. Title IV covers a range of areas, including raising the shareholder thresholds triggering public company status, expanding private offering exemptions, delaying the impact of certain requirements of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and expanding the availability of shelf offerings to smaller companies. Some of the key changes include:
  - Eliminating the 500 non-accredited investor threshold triggering registration under Section 12(g), leaving as the Section 12(g) registration triggers $10 million in assets and at least 2,000 holders of record. The SEC would be required to index the $10 million asset trigger for inflation every five years. In addition, the threshold that allows a

---

[2] Federal financial regulatory agencies for purposes of Title III are: the Federal Reserve, CFPB, Commodity Futures Trading Commission ("CFTC"), FDIC, Federal Housing Finance Agency ("FHFA"), Office of the Comptroller of the Currency ("OCC"), National Credit Union Administration ("NCUA") and Securities and Exchange Commission ("SEC").

company to cease reporting as a public company would be increased to fewer than 1,200 shareholders (up from 300).

- Creating a new "micro offering" exemption for offerings of less than an aggregate of $500,000 in a 12-month period, increasing the Regulation A+ offering ceiling to $75 million in a 12-month period (up from $50 million) and revamping the existing crowdfunding rules.
- Revising the definition of "general solicitation" in a private offering to exclude presentations and related advertising for events sponsored by venture capital or angel investor groups, and expanding the exemption for private resales of securities by allowing general solicitation and eliminating information requirements for sales made on accredited investor-only platforms.
- Restricting the SEC from adopting some of the investor protections it has proposed to add to certain JOBS Act private offering reforms.
- Allowing all companies, regardless of their size, that are seeking to go public to use the JOBS Act provisions to "test the waters" and make all registration statement filings with the SEC on a confidential basis, with the requirement to file publicly 15 days before the start of the roadshow.
- Delaying the Sarbanes-Oxley Act 404(b) requirement for a company to have its auditor attest and report on management's assessment of internal controls for up to 10 years for companies with revenue of less than $50 million.
- Allowing all companies with listed equity securities, regardless of public float, to conduct shelf offerings on Form S-3.
- Expanding the availability of well-known seasoned issuers ("WKSI") status, and the related offering communication rules to business development companies and closed-end funds.
- Codifying existing staff position providing an exemption from broker-dealer registration and registration for a category of broker-dealers engaged in advising companies on M&A transactions.

Title V: Relief From Regulatory Burden for Community Financial Institutions

- "*Ability to Repay*" *Safe Harbors*. Title V makes various revisions to the regulatory framework for residential mortgage lending, including providing a safe harbor from consumers' "ability to repay" requirements that are originated by a depository institution and are maintained in the portfolio of such institution.
- *Tailoring to Community Banks*. Federal banking regulators would have increased responsibilities and accountability for all future rulemakings, as CHOICE Act 2.0 would require that regulators take into consideration certain factors, such as the necessity, appropriateness and impact of rulemakings, and tailor each rulemaking to limit the regulatory compliance impact, cost, liability risk and other burdens on institutions within their respective jurisdictions. Further, banking agencies would be required to disclose how they have complied with this requirement in each rulemaking release and submit an annual report to Congress regarding their compliance.

- *Oversight of Supervisory Functions*. An Office of Independent Examination Review would be created within the Federal Financial Institutions Examination Council ("FFIEC"), which would investigate regulators' examination practices and receive petitions from financial institutions for review of supervisory determinations.
- *Overturning Madden v. Midland Funding, LLC*. The "valid when made" doctrine would be codified, such that the interest rate applicable to a loan would remain valid after a loan is transferred if the interest rate was valid under the laws applicable to the lender at the time the loan was originated, irrespective of whether the loan's interest rate would violate a state usury law applicable to the transferee of such loan.
- *FIRREA Actions*. The Act would also limit the subpoena power of the Attorney General in investigating possible violations under FIRREA and clarifies the circumstances under which banks may be prosecuted for fraud or related financial crimes under FIRREA.

Title VI: Regulatory "Off Ramp" for Strongly Capitalized, Well-Managed Banking Organizations

- Title VI provides that qualifying banking organizations ("QBOs"), by virtue of maintaining an average leverage ratio of 10%, would become exempt from various federal laws and regulations, including: (i) all capital and liquidity requirements, (ii) all laws and regulations that would permit federal banking agencies to object to a capital distribution, including CCAR, (iii) consideration by federal banking agencies of financial stability-related factors in connection with certain events and applications (e.g., examinations and applications relating to M&A), (iv) the deposit concentration limit, (v) certain limitations on large acquisitions made by banking holding companies and financial holding companies, and (vi) certain "enhanced prudential standards" established by Section 165 of the Dodd-Frank Act (e.g., living wills, stress testing and single counterparty credit limits). Notably, few large banks would be able to satisfy the capital standards required to become QBOs today without raising more capital.

Title VII: Consumer Financial Protection Bureau

- *Reforming CFPB's Structure*. Title VII introduces a series of reforms to the Consumer Financial Protection Bureau (the "CFPB"). The CFPB would be renamed the "Consumer Law Enforcement Agency" and while it would still be led by a single Director, the President would now be able to remove the Director at will. Additionally, the President, rather than the Director, would be able to appoint the agency's Deputy Director. A Senate-confirmed inspector general would also be created for the agency.
  - The agency would no longer be funded through the Federal Reserve System and instead would receive funding through the Congressional appropriations process.
- *CFPB Limited to Enforcement*. The CFPB would be stripped of its supervisory and examination powers, but retain its enforcement authority, although such authority would be reduced. The CFPB would lose its ability to promulgate and enforce rules addressing unfair, deceptive, or abusive acts and practices by financial institutions, and the ability to limit or prohibit the use of arbitration agreements where they violate public interest. The CFPB would no longer be responsible for regulating small dollar credit, including payday and vehicle title loans. Its complaint database would no longer be made publicly available.

- *Status of Durbin Amendment*. While the bill that originally passed the Committee contained a provision that would repeal the Durbin Amendment, which limits fees charged in connection with debit cards, House Republicans removed this repeal from the bill before the full House vote.

Title VIII: Capital Markets Reform

- Title VIII of CHOICE Act 2.0 covers amendments to a wide range of areas from SEC funding and appropriations to its internal operations and functioning. It also makes specific changes to the powers, policies and procedures of the Enforcement Division, changes to the regulation of rating agencies and changes to corporate governance practices. Finally, Title VIII repeals a range of the Dodd-Frank Act rulemaking mandates and directives to conduct studies and prepare reports. Some of the key changes include:
  - Significant changes to enforcement, including limiting the SEC's ability to seek relief through administrative proceedings, mandated presentations and notifications to the SEC following Wells notices, providing for limitations on the duration of investigations and for timely notices of the closing of investigations, creating an "enforcement ombudsman" with confidential communication procedures, elimination of automatic disqualification of exemptions, and the requirement that an updated enforcement manual be published with priorities and trends.
  - Eliminating compensation for whistleblowers who were responsible for or complicit in misconduct.
  - Changing the pleading standards in connection with derivative suits against investment companies.
  - Repealing the Department of Labor's "fiduciary rule."
  - Significant changes to the shareholder proposal rules, including increasing the stock ownership thresholds necessary to submit shareholder proposals to be voted on at annual shareholders meetings, increasing the stock ownership thresholds necessary for shareholders to resubmit proposals that were voted down at prior annual meetings and allowing companies to exclude shareholder proposals submitted on behalf of shareholders.
  - Prohibiting the SEC from adopting a rule that provides that a company must use a single ballot in connection with a contested election for its board of directors.
  - Fixing the income test of the accredited investor definition at $200,000 per year (or $300,000 including spouse's income) and the net worth test to $1 million. Each test would be adjusted for inflation every five years.
  - Eliminating the Sarbanes-Oxley Act 404(b) requirement to have an auditor attest and report on management's assessment of internal controls for companies with a market cap of less than $500 million (from $75 million).
  - Repealing the conflict minerals, resource extraction and mine safety disclosure requirements.
  - Repealing the Dodd-Frank Act provisions related to pay ratio, hedging disclosures and restrictions on incentive compensation at certain financial institutions, and restricting the scope of the proposed compensation claw back rule.
  - Requiring the CFTC and SEC to review and harmonize swaps and security-based swaps rules.

Title IX: Repeal of Volcker Rule

- Title IX would repeal Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule, in its entirety.

Title X: Federal Reserve Reform and Emergency Lending Authority

- *Reforming the Monetary Function*. In an effort to increase transparency and predictability of the process of the Federal Reserve regarding monetary policy, Title X would establish a rule-based process by which the Federal Open Markets Committee ("FOMC") would set interest rates. The bill would also provide for the Comptroller General to perform an annual audit of the Federal Reserve and the Federal Reserve Banks. FOMC meetings would also be recorded, with transcripts being made publicly available. Additionally, a Centennial Monetary Commission would be established and tasked with reviewing the operation, history and impact of the Federal Reserve's monetary policy on the economy and making certain related legislative recommendations.
- *Limiting the Emergency Authority*. Title X would limit the Federal Reserve's emergency lending authority under Section 13(3) of the Federal Reserve Act by: (i) only permitting emergency lending in unusual and exigent circumstances "that pose a threat to the financial stability of the United States," (ii) adding to existing approval requirements for emergency lending, the approval of at least nine Federal Reserve Bank presidents, (iii) revising collateral requirements to, among other things, prohibit the acceptance of equity collateral, (iv) requiring regulatory certification of an institution's solvency, and (v) establishing a minimum interest rate for loans made under this authority.

Title XI: Insurance Reform

- Title XI would abolish the Federal Insurance Office and create instead, the Office of Independent Insurance Advocate within the Treasury Department, with the head of the new Office being the independent member with insurance expertise on the FSOC. The Office would not have general supervisory or regulatory authority over the business of insurance, thereby preserving the traditional state-based system of insurance regulation in the United States.

Title I: Ending "Too Big to Fail" and Bank Bailouts

Repeal of Orderly Liquidation Authority and Creation of Subchapter V

Title II of the Dodd-Frank Act created the orderly liquidation authority ("OLA"), which enables federal regulatory authorities to place a large financial company into a receivership if its failure under ordinary insolvency law would have a serious adverse impact on US financial stability. In the years following the enactment of the Dodd-Frank Act, a 'single point of entry' approach was developed which became the preferred strategy of operationalizing OLA. The approach aims to take advantage of the fact that US financial conglomerates are largely organized under a holding company structure with a top-tier parent holding company and multiple operating subsidiaries. Under this approach, upon failure of a large financial institution, the parent holding company would be put into an FDIC receivership with the institution's bank, broker dealer and other operating subsidiaries remaining open for business.

Title II also created the orderly liquidation fund ("OLF") which can be utilized during an OLA proceeding to make loans to the institution being resolved or its covered subsidiaries, acquire debt, purchase assets or guarantee them against loss, assume or guarantee obligations, and make payments.

Title I of CHOICE Act 2.0 would repeal OLA and replace it with a new subchapter under the Bankruptcy Code, to be located in Subchapter V of Chapter 11 of the Bankruptcy Code. Subchapter V, the details of which are outlined below, would be generally similar to OLA in that it is intended to facilitate the SPOE strategy that most globally systemically important banks have adopted in their resolution plans. There would be no equivalent to the OLF in the new Subchapter V.

Key provisions of Subchapter V are as follows:

- *Covered institutions*. Subchapter V applies only to "covered financial corporations," essentially defined as BHCs, as well as holding companies with total consolidated assets of $50 billion or more and with 85% of the most recent fiscal year consolidated annual gross revenues or consolidated assets derived from or related to financial activities/ownership of insured depositary institution(s).
- *Commencement*. A Subchapter V case may be commenced by the debtor (the financial institution) under penalty of perjury that it is a "covered financial corporation." The members of the Board of Directors of a covered financial institution would not be liable to shareholders, creditors, or other parties in interest for a good faith filing of a petition to commence a case, or for any reasonable action taken in good faith in connection with the filing, whether prior to or after commencement of the case. Subchapter V does not provide for an involuntary bankruptcy proceeding.
- *Regulator Involvement*. The Federal Reserve, SEC, OCC, CFTC and the FDIC may raise and may appear and be heard on any issue in any case or proceeding under Subchapter V.
- *Special transfer of property of the estate*. Subchapter V contemplates that, at the request of the trustee, and after a hearing to occur not less than 24 hours after the order for relief, the court may order a transfer of property of the estate, the assignment of executory contracts, unexpired leases, and qualified financial contracts ("QFCs") of the debtor, to a bridge company. In making the decision, the court must consider, among other things, whether: (i) the transfer is necessary to prevent serious adverse effects on financial stability in the United States, and (ii)

the transfer does not provide for the assumption of any capital structure debt (i.e., unsecured debt of the debtor, excluding claims under QFCs) or equity of the debtor.

- *Special trustee*. An order approving the transfer to the bridge institution requires the trustee to transfer all of the equity securities in the bridge company to a qualified and independent special trustee to hold in trust for the sole benefit of the estate. The special trustee would be appointed by the Bankruptcy Court and the Federal Reserve must be consulted regarding the identity of the special trustee. The special trustee would be required to file notice with the court of, among other things, material corporate actions of the bridge company (e.g., recapitalizations, material borrowings, asset sales, and issuances or sales of bridge company securities). The special trustee would be also permitted to dispose of the equity securities of the bridge company in accordance with the trust agreement. However, before any sale, the special trustee must consult with the FDIC and the Federal Reserve and disclose the results of such consultation with the court. Proceeds of the sale must be held in trust for the benefit of the estate, and ultimately, be distributed pursuant to a Chapter 11 plan, or as ordered by the court if there is a Chapter 7 conversion.
- *Temporary and supplementary automatic stay*. A bankruptcy petition under Subchapter V would operate as a temporary and supplementary stay, applicable to all entities, of the termination, acceleration, or modification of any debt, contract, lease or agreement of any kind.
- *Treatment of qualified financial contracts and affiliate contracts*. The filing of the petition would also operate as a stay on the cross-default and termination provisions of QFCs and other executor contracts and debts, and those of affiliates. Additionally, the bridge company would be required to assume all QFCs and related claims and affiliate contracts with a particular counterparty or assume none (i.e., no cherry-picking of contracts).
- *Licenses, permits and registrations*. If a request for the special transfer of property of the estate is made, any federal, state or local license, permit or registration that the debtor or an affiliate held immediately prior to the commencement of the case would not be permitted to be accelerated, terminated or modified solely on account of the insolvency of the debtor, the commencement of the case, the appointment of a trustee or a special transfer.
- *Exemption from securities laws*. A security of the bridge company would be deemed to be a security of the debtor's successor if the court approves the disclosure statement for the plan as providing adequate information.
- *Inapplicability of certain avoiding powers*. A transfer made prior to or after the commencement of the case would not be avoidable under traditional bankruptcy or non-bankruptcy law.
- *Financial stability concerns*. The Subchapter V plan would only be approved if all payable fees, costs and expenses of the special trustee had been paid or provided for and the plan was found to be unlikely to cause serious adverse effects on the financial stability of the United States. The court would be permitted to consider the effect that any decision in connection with Subchapter V may have on financial stability in the United States.
- *Judge for a case under Subchapter V*. The Chief Justice of the United States would be required to designate not fewer than 10 bankruptcy judges to hear a Subchapter V case. The judge would be randomly assigned to hear the case by the Chief Judge of the Court of Appeals for the circuit in which the case is pending.

Repeal of Obligation Guarantee Program

CHOICE Act 2.0 would repeal certain emergency stabilization provisions created by the Dodd-Frank Act, including Sections 1104, 1105 and 1106 of the Dodd-Frank Act. Section 1104 provides that, upon a determination of both the FDIC and the Federal Reserve that a liquidity event exists that warrants use of the guarantee program provided for under Section 1105 of the Dodd-Frank Act, the FDIC would be permitted to create a widely available program to guarantee obligations of solvent insured depository institutions or solvent deposit institution holding companies (and their affiliates). Section 1106 suspends the FDIC's parallel authority under section 13(c)(4)(G) of the Federal Deposit Insurance Act to establish a widely available debt guarantee program.

Repeal of Systemic Risk Determination in Resolutions

CHOICE Act 2.0 would repeal section 13(c)(4)(G) of the Federal Deposit Insurance Act which operates as a "systemic risk" exception to the "least-cost resolution" requirement. The exception allows the FDIC to take necessary actions or provide assistance to an insured depository institution if the Secretary of the Treasury (in consultation with the President) determines that: (i) the institution would have serious adverse effects on economic conditions or financial stability of the United States, and (ii) any action or assistance under that paragraph would avoid or mitigate such adverse effects.

Restrictions on Use of the Exchange Stabilization Fund

CHOICE Act 2.0 would also prevent the use of the ESF, a Department of the Treasury fund designed for foreign exchange intervention and international financial support operations, as a guarantee for nongovernmental entities. This is in response to the ESF being used as a guarantee of the Temporary Liquidity Guarantee Program for certain money market funds in September 2008. Additionally, it would prohibit the use of the ESF to prevent the insolvency of "any entity."

Reforms to FSOC

Title I of the Dodd-Frank Act created the FSOC and tasked it with identifying risks to the financial stability of the United States, promoting market discipline, and responding to emerging threats to the stability of the US financial system. The Dodd-Frank Act also authorizes the FSOC to designate certain nonbank financial companies as nonbank systemically important financial institutions ("SIFIs") if it determines that such institutions could pose a threat to the financial stability of the United States and thus subject it to enhanced supervision and regulation. CHOICE Act 2.0 would repeal FSOC's authority to designate nonbank SIFIs and repeal all designations that have been made, along with the enhanced prudential standards in respect of these designated financial institutions. CHOICE Act 2.0 would also repeal Title VIII of the Dodd-Frank Act, which authorizes the FSOC to designate central counterparty clearinghouses or CCPs and payment systems as systemically important financial market utilities, or SIFMUs. As a result, SIFMUs would no longer have access to the Federal Reserve's discount window.

While CHOICE Act 2.0 would not abolish the FSOC, it would make significant reforms to its structure and oversight. For example, CHOICE Act 2.0 would modify the FSOC's membership to include all members of multi-member agencies (i.e., the SEC, Federal Reserve, FDIC, OCC, CFTC and NCUA) with each agency collectively having one vote on the FSOC, I addition to the directors of the Consumer Law Enforcement Agency ("CLEA") and the FHFA. The members of the multi-member agencies would themselves have to vote to determine the agencies' vote at the FSOC meeting. CHOICE Act 2.0 would also create more transparency in respect of the FSOC. For

example, members of the authorization and oversight committees of the House Financial Services and Senate Banking Committees would be permitted to attend all public FSOC meetings, and the FSOC would be required to create transcripts for all non-public meetings. The FSOC would be subject to both the "Government in the Sunshine Act" and the Federal Advisory Committee Act.

CHOICE Act 2.0 would also eliminate the Office of Financial Research, an independent office that was created within the US Department of the Treasury by the Dodd-Frank Act. Finally, CHOICE Act 2.0 would authorize $4 million to be appropriated to the FSOC to carry out its duties. Its budget previously came out of the Office of Financial Research's budget.

Resolution Plans

CHOICE Act 2.0 would vest the living will process solely with the Federal Reserve and amend section 165(d) of the Dodd-Frank Act to eliminate the FDIC's role in the process. Among other changes, CHOICE Act 2.0 would:

- reduce the frequency of living will submissions to every 2 years;
- require the Federal Reserve to provide feedback on "living wills" to banking organizations within six months of their submissions of the resolution plans; and
- require the Federal Reserve to publicly disclose its resolution plan assessment framework and subject such framework to notice and comment.

CHOICE Act 2.0 also provides that any other federal banking agency that requires the submission of a resolution plan would adhere to the limitations on the resolution planning process described above which, in effect, would result in the application of these new requirements to insured depository institution resolution plans that are required to be submitted to the FDIC.

Stress Testing

CHOICE Act 2.0 would overhaul the current stress testing regime for banking organizations, including introducing a number of new provisions to reduce the burden of the stress testing exercises.

The key changes in respect of DFAST would include:

- requiring the Federal Reserve to issue regulations, after providing for notice and comment, that provide for at least three different sets of conditions under which the evaluation required by Section 165 of the Dodd-Frank Act would be conducted (baseline, adverse and severely adverse) and disclose the methodologies, including models used to estimate losses, used by the Federal Reserve;
- eliminating DFAST requirements for financial companies other than BHCs;
- removing the semi-annual submission of company run DFAST; and
- requiring the Federal Reserve to publish a summary of all stress test results.

The key changes in respect of CCAR would include:

- applying the requirements detailed above and within CHOICE Act 2.0 in respect of DFAST to the parameters and consequences applicable to CCAR;

- removing the potential for the Federal Reserve to object to a company's capital plan on the basis of qualitative deficiencies in the company's capital planning process;
- enabling a company to amend its capital plan and resubmit a new streamlined plan at any time if a company receives a quantitative objection to its plan; and
- requiring the Federal Reserve to establish and publish procedures for responding to inquiries from companies subject to CCAR, including establishing the timeframe in which such responses would be made, and making such procedures publicly available.

Miscellaneous Provisions

- *Notice and hearing requirements*. Notice and hearing requirements of Section 3(b)(1) of the BHC Act would only be permitted to be waived in the event that a company is becoming a BHC in order to acquire a bank that is critically undercapitalized.
- *Concentration limits*. CHOICE Act 2.0 would amend the BHC Act to remove concentration limits for financial companies but would retain all such limits for banking organizations.
- *Operational risk capital requirements*. CHOICE Act 2.0 would prohibit federal bank regulators from establishing an operational risk capital requirement for banking organizations, unless such requirement, among other things: (i) is based on risks posed by a banking organization's current activities and businesses, (ii) is appropriately sensitive to the risks posed by such current activities and businesses, and (iii) permits adjustments based on qualifying operational risk mitigants.

Title II: Demanding Accountability From Wall Street

CHOICE Act 2.0 increases the existing maximum penalties under the Securities Act, the Exchange Act, the Advisers Act and the '40 Act. It also creates new penalty limits for certain egregious violations (those involving fraud, deceit, manipulation, reckless disregard of a regulatory requirement and result in, or create the risk of, substantial losses to others, or substantial pecuniary gains to the wrongdoer) at the greater of: (i) $300,000 for a natural person or $1,450,000 for any other person; (ii) three times the gross amount any pecuniary gain; or (iii) the amount of losses incurred by victims. Additionally, the legislation creates a new maximum penalty limit of three times the otherwise applicable limit for recidivists, defined as those convicted of securities fraud or other SEC actions within the preceding 5-year period. Section 211 of the Act would codify the SEC's authority to bring an action for violation of a federal injunction or an order obtained by the SEC, which typically occurs after a party enters into a settlement and stipulates that it will not violate the securities laws going forward. If that entity violates the securities laws again, this provision would arm the regulator with an additional mechanism to enforce the original agreement or order and prosecute that second violation. Previously, Section 211 provided regulators with the ability to bring actions to enforce agreements and orders under Section 211 with respect to cease and desist orders only.

Nearly across the board, CHOICE Act 2.0 would double the maximum penalties for violations by registered public accounting firms and associated persons of: (i) the Sarbanes-Oxley Act, (ii) the rules of the Public Company Accounting Oversight Board (the "PCAOB"), or (iii) securities laws relating to the preparation and issuance of audit reports and other auditor obligations and liabilities. An exception is with respect to the penalty for intentional/knowing conduct by entities other than "natural persons," where the legislation increases the maximum civil penalty from $15 million to $22 million.

CHOICE Act 2.0 would also amend the Exchange Act to increase the maximum civil penalty for "controlling person" liability in the context of insider trading from $1 million to $2.5 million. The Exchange Act would maintain the limitation that the penalty may not exceed "the greater of $2.5 million, or three times the amount of the profit gained or loss avoided as a result of such controlled person's violation."

Under Section 214 of CHOICE Act 2.0, the maximum civil monetary penalties available under Section 32 of the Exchange Act, which relate to willful violations of any of the Act's provisions or its rules and regulations, would be increased. The maximum penalty for violations by an individual would be increased from $5 million to $7 million.

CHOICE Act 2.0 would also increase fines and penalties under Section 30A of the Exchange Act, associated with issuers who attempt to bribe foreign officials. The maximum fine for any issuer who violates this provision would be doubled from $2 million to $4 million. The maximum civil penalty for an issuer associated with such violation would rise from $100,000 to $250,000, while the maximum penalty against culpable agents of that issuer spikes from $10,000 to $50,000.

CHOICE Act 2.0 would also revise Sections 308(a) of the Sarbanes-Oxley Act and 21F(a) of the Exchange Act pertaining to the use of "monetary sanctions" for the relief of victims. Section 308(a), which provides for the use of funds for the benefit of victims, would apply to any monies, including penalties, disgorgement, and interest "required" to be paid as the result of a violation of the securities laws or settlement of an action and any monies deposited into a disgorgement fund pursuant to Section 308(b).

The term "victim" would be given the same meaning as the term "crime victim" under Title 18 of the United States Code, namely, "a person directly or proximately harmed by as a result of the commission of a Federal offense."

Under Section 216 of CHOICE Act 2.0, the Government Accountability Office ("GAO") would be required, within two years of the statute's enactment, to submit a report to Congress regarding the "use by the SEC of the authority to impose or obtain civil money penalties for violations of securities laws" from June 1, 2010 to the date of enactment of CHOICE Act 2.0. The report must address the following topics:

- the types of violations for which civil monetary penalties were obtained;
- the types of persons on whom civil monetary penalties were imposed;
- the number and dollar amount of civil monetary penalties imposed, broken down by: (i) penalties imposed in administrative actions versus judicial actions, (ii) penalties obtained from issuers as compared to other persons, and (iii) penalties retained by the SEC versus those deposited with the US Treasury; and
- for those penalties imposed on issuers, whether the violations resulted in economic benefit to those issuers, and the impact of the penalties on the issuers' shareholders.

CHOICE Act 2.0 would also increase the maximum amount of civil and criminal penalties that the federal banking regulators can impose from $1,000,000 to $1,500,000 under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Home Owners' Loan Act, Federal Deposit Insurance Act, Federal Credit Union Act, Federal Reserve Act, Bank Holding Company Act, as well as various other provisions throughout Titles 18 and 31 of the United States Code.

Title III: Demanding Accountability From Financial Regulators and Devolving Power Away From Washington

Cost-Benefit Analyses

CHOICE Act 2.0 would require the Federal Reserve, CLEA, NCUA, CFTC, FDIC, FHFA, OCC, and the SEC (collectively, the "Agencies") to conduct quantitative and qualitative cost-benefit analyses when proposing new regulations. Specifically, the Agencies would not be permitted to issue a notice of proposed rulemaking without including in such notice an analysis that includes, among other factors: (i) the need and objective of the regulation and the nature and significance of the market failure, regulatory failure or other problem that necessitates regulatory action, (ii) why private, state, local or tribal authorities cannot adequately address the problem, (iii) a quantitative and qualitative assessment of direct and indirect costs and benefits of the regulation as compared to having no regulation (and a justification if benefits do not outweigh the costs); (v) alternatives to the regulation, and (vi) an assessment of whether the regulation is inconsistent, incompatible or duplicative of existing regulations.

Moreover, the Agencies would not be permitted to issue a notice of final rulemaking unless they have: (i) issued a notice of proposed rulemaking which contains the analysis described above, (ii) included regulatory impact metrics selected by the chief economists to be used in preparing the report, (iii) included data and comments provided by commenters in their analysis, (iv) provided a 90-day comment period or noted why they are not able to provide for 90 days, and (v) determined that the quantified costs are outweighed by the benefits. The Agencies would be required to make all information related to their analyses available on their public website, while preserving the confidentiality of nonpublic information.

CHOICE Act 2.0 would establish a Chief Economists Council comprised of the chief economists of each Agency that would meet quarterly and provide an annual report to Congress that covers, among other topics: (i) the benefits and costs of regulations adopted by the Agencies in the past 12 months, (ii) regulatory actions planned for the next 12 months, (iii) the cumulative effect of regulations on economic activity, innovation, international competitiveness of regulated entities and net job creation (excluding jobs created to comply with regulations), and (iv) recommendations for legislative or regulatory action to enhance the efficiency or effectiveness of financial regulation in the United States.

Within one year after enactment, and every five years thereafter, CHOICE Act 2.0 would require each Agency to submit to Congress and post on its public website, a plan to modify, streamline, expand or repeal existing regulations to make their regulatory program more effective or less burdensome. Two years after submitting the plan, each Agency would be required to submit a progress report to Congress which it would be required to post on its website.

CHOICE Act 2.0 would also provide a cause of action for any person adversely affected or aggrieved by a final rule to challenge the Agency's adherence to this process in the Court of Appeals for the District of Columbia Circuit within one year of the rule's publication in the Federal Register.

Congressional Review of Rulemaking

In a striking deviation from current practice, and one that could shut down rulemaking in many areas, CHOICE Act 2.0 would require each "major rule" of an Agency to be approved by a joint resolution of Congress within 70 session

days or legislative days of its submission to Congress. If a joint resolution is not passed in that timeframe, the rule would be deemed not approved.

A "major rule" is defined as any rule that the Office of Information and Regulatory Affairs finds has resulted in or would likely result in: (i) an annual effect on the economy of $100 million or more, (ii) a major increase in costs or prices for consumers, individual industries, federal, state, or local government agencies or geographic regions, or (iii) significant adverse effects on competition, employment, investment, productivity, innovation, or the ability of US enterprises to compete with foreign-based enterprises in domestic and export markets. Notwithstanding any Congressional action or inaction, the President would be able to cause a rule to take effect for a 90-day period if he were to make the determination in an executive order that the rule is necessary: (i) because of an imminent threat to health, safety, or emergency, (ii) for the enforcement of criminal laws, (iii) for national security, or (iv) if it was issued pursuant to statute implementing an international trade agreement.

For each "non-major rule" (i.e., any rule that is not a "major rule,") Congress would be empowered to pass a joint resolution of disapproval. However, if Congress did not act within 60 days, the rule would become effective.

Judicial Review of Agency Actions

CHOICE Act 2.0 would eliminate the so-called Chevron doctrine of judicial deference for the Agencies, under which judges would generally defer to a regulatory agency's reasonable statutory and regulatory interpretations where a provision contains a gap or ambiguity. Under CHOICE Act 2.0, in reviewing any challenge to an action by an Agency, a court would be empowered to determine the meaning of terms, and provide de novo review of all relevant questions of law, including interpreting statutory and constitutional provisions and rules made by an Agency. The effectiveness of this section would be delayed for two years from the date of the enactment of CHOICE Act 2.0. This would not however apply to rules that concern monetary policy proposed or implemented by the Federal Reserve or the FOMC.

Leadership of FDIC

The leadership of the FDIC would be restructured so that the Comptroller of the OCC and the Director of the CFPB would no longer be members on the Board of the FDIC. All five members of the FDIC Board would be required to be appointed by the President and confirmed by the Senate.

Congressional Oversight of Appropriations

CHOICE Act 2.0 would bring the FDIC, FHFA, OCC, the examination and supervision functions of the NCUA and non-monetary functions of the Federal Reserve into the Congressional appropriations process. With respect to the FDIC, the Act would exempt the FDIC's Deposit Insurance Fund from the Congressional appropriations process. The Act would require these agencies to adopt or allocate assessments and fees to cover the amount appropriated by Congress. If enacted, this would apply to all expenses paid and fees collected on or after October 1, 2017.

International Processes

CHOICE Act 2.0 would require the Federal Reserve, FDIC, Treasury, OCC and CFTC to notify the public before participating in the processes of international standard-setting, such as at the Financial Stability Board, the Basel Committee on Banking Supervision or other similar organizations. Members or employees of such agencies involved in the international standard-setting process would be required to seek public comment on the scope of

the process prior to participation, and issue a report on the topics covered during the process, as well as detailing any new or revised rulemakings or policy changes that the agency believes should be implemented as a result of the process.

Unfunded Mandates Reform

CHOICE Act 2.0 would apply the Unfunded Mandates Reform Act of 1995 to the Agencies, thereby requiring each Agency to prepare a written statement if its rulemaking would result in an annual effect on State, local or tribal governments or the private sector of $100 million or more. Such written statement should provide: (i) how the regulation can avoid undue influence, (ii) estimates of future costs of the mandate, (iii) any disproportionate budgetary effects upon particular regions, state, local, tribal, other community types or particular segments of private sector, and (iv) describe consultations with local governments and their comments, concerns or evaluations. Each Agency would also be required to develop a process to allow for the input of State, local and tribal governments in the development of regulatory proposals containing significant federal mandates. The Act would also allow courts to compel compliance with these provisions and if an Agency failed to comply, a court could invalidate the relevant Agency regulation.

Enforcement Coordination

CHOICE Act 2.0 would require that each Agency implement policies and procedures to: (i) minimize duplication of efforts with other federal and state authorities when bringing administrative or judicial action against an individual or entity, (ii) establish when joint investigations, administrative actions or judicial actions or coordination of law enforcement activities are necessary and in the public interest, and (iii) in the course of a joint investigation, administrative action or judicial action, establish a "lead agency" to avoid duplication of efforts and unnecessary burdens and to ensure consistent enforcement.

Penalties for Unauthorized Disclosures

CHOICE Act 2.0 would make it a misdemeanor offense for any employee of a Federal department or agency to disclose individually identifiable information contained in confidential agency records without authorization. The Act also makes it a misdemeanor for any person to request or receive such information knowingly, willfully or under false pretenses.

Stop Settlement Slush Funds

CHOICE Act 2.0 would forbid the Agencies, as well as the Department of Housing and Urban Development, the Department of Justice, and the Rural Housing Service of the Department of Agriculture, from agreeing to any settlement to which such Agencies or departments are a party that provides for payments to any person who is not a victim of the alleged wrongdoing.

Title IV: Unleashing Opportunities for Small Businesses, Innovators, and Job Creators by Facilitating Capital Formation

Title IV of CHOICE Act 2.0 primarily alleviates certain current restrictions on issuers of securities from accessing the capital markets. In several cases, exemptions to current registration, disclosure or regulatory requirements would be implemented or expanded. Key changes include:

M&A Brokers

Exempting from broker-dealer registration certain M&A brokers intermediating the sales of "eligible privately-held companies," which generally refers to small- and mid-sized privately-owned companies with pre-tax earnings less than $25 million or gross revenues less than $250 million. This provision codifies the exemption from the broker-dealer registration requirement for M&A brokers originally set forth in SEC no-action letter issued on February 4, 2013. The SEC no-action letter exempted M&A brokers from the registration requirement regardless of the size of company.[3]

Triggering for Public Company Registration and Deregistration

Expanding a registration exemption under Section 12(g) of the Exchange Act by eliminating the provision that requires a private company to register its securities under Section 12(g) of the Exchange Act if it has a class of equity security that is held of record by at least 500 persons who are not accredited investors, while maintaining the $10 million total asset test, which would be indexed to inflation on a five-year cycle, and the 2,000 person record holder trigger. The amendment would also permit companies to deregister when they have 1,200 shareholders, increased from 300 holders.

New Micro Offering Exemption

New exemption from federal and state registration requirements introduced for "micro offerings," which are offerings of less than an aggregate amount of $500,000 in a 12-month period and sold to no more than 35 purchasers each having a substantial pre-existing relationship with an officer or director of the issuer or is an existing 10% shareholder.

Revamped Crowdfunding Exemption

Replacing the existing crowdfunding rules issued by the SEC in 2015 completely with a new exemption providing significant additional flexibility, including: (i) no apparent caps or limits on aggregate offering amounts or investment limits; (ii) no financial statement or specific disclosure requirements; (iii) no investor financial qualifications, permitting crowdfunding offerings without use of an intermediary; and (iv) no requirement for intermediaries to be registered as broker dealers. Additionally, crowdfunding investors would be excluded from the Section 12(g) calculation. The SEC is required to implement the necessary rules to effect these amendments within six months of the enactment of the bill.

---

[3] For more information regarding the SEC no-action letter, you may wish to refer to our client publication "SEC Offers Relief to M&A Brokers," available at: http://www.shearman.com/~/media/files/newsinsights/publications/2014/02/secoffersrelieftomabrokersfiafr022114.pdf.

Relief From the Sarbanes-Oxley Act 404(b) Requirement for Low Revenue IPO Companies

The exemption provided to a new public company from having its auditor attest and report on management's assessment of internal controls would be extended for companies that lose emerging growth company status after five years if their average gross revenue over the preceding three years was less than $50 million, until the earlier of their average gross revenue exceeding $50 million or ten years from its initial public offering.

Expansion of the 4(1½) Exemption for Private Resales

The existing exemption for certain non-issuer private resales, which was adopted as part of the FAST Act, would be expanded to remove information requirements and to permit general solicitation, so long as all sales are made through a platform that is only available to accredited investors.

Relief From XBRL Filing Requirements

Emerging growth companies and companies with total annual gross revenues of less than $250 million would be exempted from XBRL filing requirements. The XBRL exemption would need to be made effective within 60 days of the enactment of the bill. Further, the SEC would be required to conduct various cost-benefit analyses in connection with these exemptions and report such findings to Congress.

Issuances of Securities to Employees Under Rule 701

Directing the SEC to increase the threshold on the exemption under Rule 701 that requires companies to provide more comprehensive disclosures in connection with the issuance of securities to their employees pursuant to employee benefit plans from $5 million sold in a 12-month period to $20 million. The SEC is required to implement the necessary rules to effect these amendments within 60 days of the enactment of the bill.

Business Development Companies and Closed End Funds

Removing certain limits on investments made by business development companies ("BDCs") as the term is defined under the '40 Act. Central to the definition of a BDC under the '40 Act is that they are limited in the type of companies they are permitted to invest in. CHOICE Act 2.0 expands the definition of "eligible portfolio company" to include certain financial companies. The legislation also removes limits placed by Section 12 of the '40 Act for BDCs investing in investment advisers.

Lowering asset coverage requirements for BDCs from 200% to 150%%, if those BDCs disclose certain financials in a Form 8-K. This has the effect of a BDC being able to lever a greater amount of its assets.

CHOICE Act 2.0 also directs the SEC to revise rules to permit BDCs to file offering materials and proxy statements under the rules applicable to other non-investment company issuers and allows BDCs to qualify as WKSIs. Being a WKSI offers significant advantages for offering securities under the Securities Act, such as automatic shelf registration (not subject to the SEC review process)and significantly lower registration fees for shares (only pay on take down and can register an unlimited number of securities).

The legislation also permits BDCs to use Form S-3 for registering securities that otherwise meet the criteria for registering such securities under Form S-3, as well as the applicable proxy rules.

Additionally, similar to the expansion for BDCs, the SEC would be directed to permit closed-end funds to make use of a number of the securities offering and offering communication rules that are currently unavailable to closed-end funds including permitting treatment of closed-end funds as WKSIs.

The SEC would be required to implement necessary rules within one year, but BDCs and closed-end funds can take advantage of the provisions after the one year period, whether or not the implementing rules are adopted.

JOBS Act Benefits Extended to All IPO Companies

Extending the JOBS Act provisions to allow any issuer, not just emerging growth companies, to engage in "testing the waters" communications with potential investors before filing an initial public offering ("IPO") registration statement and to allow any company to submit an IPO registration statement for SEC review on a confidential basis. A company would be required to make its first public filing with the SEC of its IPO 15 days before the roadshow, reduced from 21 days.[4]

Shelf Offerings for Smaller Companies

Directing the SEC to expand S-3 eligibility to allow issuers that do not meet the $75 million minimum public float requirement to register securities under Form S-3 if they have at least one class of common equity securities listed on a national securities exchange. Also, CHOICE Act 2.0 directs the SEC to broaden the eligibility for limited primary offerings by eliminating the requirement to have a class of common equity securities listed on a national securities exchange. These amendments are to take effect within 60 days of enactment of the bill.

Regulation A+

Increasing the maximum allowable offering amount for Regulation A+ offerings from up to $50 million to $75 million, with indexing for inflation every two years.

Preempting State Securities Laws

Extending state securities registration preemption to all securities listed on a national stock exchange that has listing standards approved by SEC.

Mandating Registration and Standards for Proxy Advisory Firms

Requiring proxy advisory firms to register with and be subject to regulation by the SEC, with requirements related to adequacy of internal resources, disclosure of conflicts of interest and recommendation methodologies. Additionally, includes an annual report requirement detailing shareholder proposals reviewed, the staff used to prepare recommendations and any conflicts related to such recommendations. SEC would be required to implement necessary rules within six months, which must be effective within one year.

---

[4] On June 29, 2017, the SEC's Division of Corporation Finance announced that, beginning on July 10, 2017, it will permit confidential submissions of draft registration statements for all IPOs, including by issuers that do not qualify as emerging growth companies under the JOBS Act. For more information, you may wish to refer to our client publication "SEC to Permit Confidential of Draft Registration Statements for All IPOs and Spin-Offs, Including by Non-EGCs," available at: http://www.shearman.com/en/newsinsights/publications/2017/06/confidential-submission-of-draft-registration

Venture Exchanges

Creating venture exchanges that would list the securities of smaller companies and exempt such exchanges from compliance with certain regulations applicable to national securities exchanges including using decimal pricing.

Qualifying Venture Capital Funds

Adding a new exemption for certain venture capital funds under section 3(c)(1) of the '40 Act, which exempts certain entities from being an investment company. Venture capital funds with less than $50 million in aggregate capital contributions and uncalled committed capital (adjusted annually to reflect inflation) may have up to 500 beneficial owners, rather than being limited to 100 beneficial owners as previously applied for 3(c)(1) offerings.

Safe Harbor for Investment Fund Research

Providing relief to producers or distributors of research covering mutual funds and ETFs (and other covered funds) who participate in the offering of the covered mutual funds and ETFs under the Securities Act by expanding upon the safe harbor provided in Rule 139 of the Securities Act. The current rule requires a registrant to meet the requirements of Form S-3 or F-3 and: (i) meet the minimum float provision (greater than $75 million in market capitalization), (ii) have filed all required periodic reports during the preceding 12 months, and (iii) not be a blank check company, shell company or issuer of penny stock. In addition, to qualify the person that publishes or distributes such research reports must be doing so in the regular course of its business and the report itself may not be initiating or reestablishing such coverage.

CHOICE Act 2.0 Adds Research Reports About "Covered Investment Funds" (i.e. Mutual Funds or ETFS) to the Safe Harbor and Makes it More Flexible Because it:

- prohibits the SEC from substantially conditioning the safe harbor upon whether such publication or distribution of the research report represents the initiation or re-initiation of the coverage on the fund or its securities by the broker or dealer;
- prohibits the SEC from requiring the fund to have been a registered investment company prior to the distribution or publication of the report;
- prohibits the SEC from requiring the fund to be subject to the reporting requirements of section 13 or 15(d) of the Exchange Act prior to the distribution or publication of the report;
- prohibits the SEC from imposing an increase to the minimum float standards that apply to covered funds past those set out in Rule 139;
- requires the SEC to prevent self-regulatory organizations from maintaining or enforcing any rules that would undermine the ability of their members to rely on this section (e.g., prohibiting a member from publishing a covered investment fund research report solely because such member is participating in the offering); and
- exempts the fund research report from the filing requirements under section 24(b) of the Investment Company Act and the rules and regulations thereunder if subject to similar standards set by a self-regulatory organizations.

The antifraud and anti-manipulation provisions of the Federal securities laws and rules still apply to the publishers and distributors of research reports on such funds, which means those seeking to rely on the safe harbor should carefully consider their procedures and practices with respect to the management of conflicts of interest. Self-

regulatory organizations may also examine or supervise a member's practice to comply with Federal securities laws or self-regulatory organization rules. Pursuant to Section 421(d), the safe harbor becomes effective 120-days after the enactment of CHOICE Act 2.0 even if the SEC has not adopted the revisions and may be relied on until the SEC does adopt implementing regulations.

Senior Citizen Protections

Granting immunity for certain individuals, and their employer institutions, who disclose the possible financial exploitation of senior citizens.

Section 31 Fees

SEC would be required to return or offset any overpayments of Section 31 fees to FINRA and national securities exchanges; and promptly issue a statement responding to each recommendation made as part of the Annual Small Business Forum held by the SEC, including the actions the SEC intends to take in response to each recommendation.

Revisions to Regulation D

Several of the proposals in CHOICE Act 2.0 are aimed at streamlining the process for Rule 506(c) offerings. Rule 506(c) of Regulation D was adopted pursuant to the JOBS Act to allow for general solicitation in certain private offering to accredited investors, but the SEC had subsequently proposed rules that would have added substantial restrictions on such an offering. Several of those proposed rules would have extended to other categories of Regulation D offerings as well. CHOICE Act 2.0 seeks to restrict the ability of the SEC to adopt rules related to many of its proposals. Key provisions are:

- issuers offering or selling securities in reliance on Rule 506 must file a single Form D for each new offering of securities, and the SEC can require this filing no earlier than 15 days after the first sale. This restricts the ability of the SEC to adopt a rule that it had proposed to require a "pre-marketing" Form D filing, and potentially also obviates the need for annual or other Form D updates.
- availability of Rule 506 exemption shall not be conditioned on the issuer filing the Form D or any similar report. Proposed SEC rules had introduced a penalty of being temporarily disqualified from Rule 506 reliance if a previous offering did not comply with Form D filing requirements.
- issuers are not required to submit written general solicitation materials to the SEC for a Rule 506(c) offering (other than as requested by the SEC in connection with certain disciplinary proceedings). The SEC's proposed rules had required the filing of such materials with the SEC.
- Form D filings shall be made available to the securities commission of each state and territory.
- SEC shall not extend the requirements contained in Rule 156 (investment company sales literature) to private funds.
- Rule 501(a) must provide that a person who is a "knowledgeable employee" of a private fund or such fund's investment adviser, shall be an accredited investor for purposes of a Rule 506 offering of such private fund.

The SEC would be required to implement necessary rules within 45 days of enactment of the bill, which is an unusually short period of time for SEC rulemaking.

Additional Clarification on General Solicitation

Directing the SEC to revise the definition of general solicitation to exclude certain types of presentations and related communications made at events sponsored by venture or angel investor groups, trade or governmental organizations, educational institutions or non-profits. These events must not provide investment advice or recommendations or charge for attendance and advertisements should not reference specific securities offerings. The SEC is required to implement the necessary rules to effect these amendments within six months of the enactment of the bill.

Title V: Regulatory Relief for Main Street and Community Financial Institutions

Mortgage Lending

CHOICE Act 2.0 would provide certain regulatory relief to mortgage lenders by revising the current regulatory framework governing residential mortgage loans. Among these, the bill would provide a safe harbor from consumer "ability to pay" requirements in respect of residential mortgage loans for those loans that are originated by a depository institution and then held in portfolio on the depository institution's balance sheet. By retaining the risk of a loan for its term, the Committee's comprehensive summary notes that a depository institution would have "a powerful incentive to conduct sound underwriting to determine whether the borrower has the ability to repay the loan."

A safe harbor from escrow requirements for creditors having less than $10 billion in consolidated assets would also be created. Additionally, CHOICE Act 2.0 would make certain other modifications to the Truth in Lending Act, including modifying the definition of "mortgage originator" to broaden the exemption from the definition for retailers of manufactured or modular homes, and increasing the APR and dollar amount thresholds for certain transactions to be treated as "high-cost mortgages."

Additional Administrative Changes and Regulatory Relief

CHOICE Act 2.0 would place increased obligations on federal banking agencies regarding all of their future rulemakings. The bill would require that, for all future rulemakings of the OCC, Federal Reserve, FDIC, CFPB and NCUA, such agencies: (i) take into consideration certain factors, including the necessity, appropriateness and impact of applying such rulemaking to covered institutions, (ii) tailor the rulemakings to limit regulatory compliance impact, cost, liability risk and other burdens, (iii) consider the impact of the rulemakings, and (iv) disclose in each rulemaking how the foregoing considerations were applied. The agencies would also be required to submit a report annually to Congress explaining the specific actions taken to comply with this requirement.

CHOICE Act 2.0 also includes a provision that is intended to restrict initiatives similar to the Department of Justice's "Operation Chokepoint" in 2013. The bill would prohibit federal banking agencies from formally or informally requesting or ordering a depository institution to terminate a specific customer account or group of customer accounts or otherwise restrict or discourage the depository institution from entering into or maintaining a banking relationship with such person(s) unless the applicable agency has a material reason, beyond "reputational risk," for doing so. The bill provides examples of "material reasons," including where customers pose a threat to national security or are involved in terrorist financing. Each banking agency would also be required to report annually on all requests for termination of customer accounts.

Well capitalized depository institutions would be permitted to submit a short-form call report for the first and third quarters of each year, rather than submit a full report of condition for every quarter.

An Office of Independent Examination Review would be established within FFIEC, which would be charged with receiving and investigating complaints made by financial institutions regarding examinations, examination practices and reports, and reviewing examination policies and procedures. Financial institutions would also be able to petition the newly established office for review of material supervisory determinations contained in final examination reports, and subsequently petition for judicial review of the Office's decision. Certain revisions to

examination procedures are also contemplated by the legislation, including certain standards regarding when a commercial loan may be placed in non-accrual status.

The bill would also increase the asset threshold for institutions to which the Federal Reserve's *Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors* would apply, from $1 billion to $10 billion.

Federal savings associations would be able to elect to be treated as "covered savings associations," having the same rights and privileges as national banks, other than for certain specified purposes, such as governance, change of control, conversion, winding-up, and other purposes determined by the OCC.

The bill would also eliminate requirements for financial institutions to collect certain information regarding credit applications in respect of women-owned, minority-owned and small businesses.

Also included in Title V is an expression of the sense of Congress that consumer reporting agencies should use multi-factor authentication procedures when providing consumers with the information contained in the file about the consumer, as well as a mandate requiring the Secretary of the Treasury to issue a report to Congress on efforts to ensure that legitimate financial transactions along the southern border move globally and freely.

"Valid When Made" Doctrine

CHOICE Act 2.0 would include in each of the Federal Deposit Insurance Act, Home Owners' Loan Act and Federal Credit Union Act, a provision stating that when a loan is valid with respect to its interest rate at the time it is made, that loan shall remain valid irrespective of whether the loan is sold, assigned or transferred to a third party even where state usury laws applicable to the transferee may prohibit the interest rate that was applicable to the loan at the time it was originally made. By codifying the "valid when made" doctrine, this provision of CHOICE Act 2.0 would overturn the Second Circuit's holding to the contrary in *Madden v. Midland Funding*, *LLC*.

FIRREA

Section 951 of the FIRREA currently provides for civil penalties for violations of certain code sections that "affect" federally insured financial institutions. The relevant conduct includes, but is not limited to, violations of 18 U.S.C. 1341 ("Fraud and Swindles") and 18 U.S.C. 1343 ("Fraud by Wire, Audio or Television") and conspiracy to violate such sections. CHOICE Act 2.0 would strike the requirement that such conduct "affect a federally insured institution," and replace it with the requirement that such conduct be "against a federally insured financial institution or by a federally insured financial institution against an unaffiliated third person." This revision clarifies the circumstances under which banks involved in misconduct may be prosecuted. Certain federal courts have indicated that activity by a federally insured financial institution may be considered to be "affecting a financial institution" regardless of third party effects simply because an action taken by a financial institution affects that same institution. The revised language makes clear when such liability would exist.

The bill also would reduce the subpoena power of the Attorney General under Section 951 of FIRREA. Currently, FIRREA provides the Attorney General with subpoena power to require the attendance of witnesses and the production of documents or materials that the Attorney General deems relevant to an investigation. Under CHOICE Act 2.0, the Attorney General retains the power to summon witnesses and compel the production of relevant documents, but to do so must: (i) seek a court order, offering "specific and articulable facts" showing "reasonable

grounds to believe that the information or testimony sought is relevant and material for conducting an investigation," or (ii) either personally, or through no lower than the Deputy Attorney General, issue and sign a subpoena for those materials, which must also be based on "specific and articulable facts" showing "reasonable grounds" to believe that the material sought would be relevant for the investigation. These more exacting standards may limit the investigative powers of federal prosecutors and establish an additional layer of scrutiny into prospective investigations.

Title VI: Regulatory Relief for Strongly Capitalized, Well-Managed Banking Organizations

Regulatory Off-Ramp

CHOICE Act 2.0 would permit banking organizations that elect to be treated as QBOs to comply with a revised prudential supervisory regime, exempting such organizations from many of the laws and regulations with which they must currently comply. A banking organization would be eligible to make a QBO election if, at the time of election, its average leverage ratio for the last four calendar quarters is at least 10%. The leverage ratio calculation would be made using a ratio of tangible equity to leverage exposure, with the definition of leverage exposure for most banking organizations being the definition used for purposes of the US implementation of the Basel III supplementary leverage ratio.

Banking organizations that elect to be treated as QBOs would be exempt from various federal requirements that the Comprehensive Summary of CHOICE Act 2.0 deems "overly burdensome and highly intrusive," as follows:

- All federal capital and liquidity requirements or standards, including the liquidity coverage ratio;
- All laws and regulations that permit federal banking agencies to prevent a banking organization from making capital distributions to its shareholders, such as CCAR;
- Any requirement that a federal banking agency take into consideration the systemic risk posed by the banking organization (e.g., in connection with mergers and acquisitions (subject to the maintenance of a pro-forma leverage ratio of 10%), examinations and engaging in non-banking activities);
- Restrictions on mergers and acquisitions, including:
  - approval requirement for mergers and acquisitions resulting in total deposit liabilities in excess of 10% of all deposit liabilities of US insured depository institutions;
  - approval requirement for acquisitions where a BHC with total consolidated assets of $50 billion or more acquires a company (other than an insured depository institution) with total consolidated assets of $10 billion or more; and
  - approval requirement for financial holding company acquisitions of companies with total consolidated assets in excess of $10 billion; and
- Certain "enhanced prudential standards" implemented under Section 165 of the Dodd-Frank Act:
  - resolution plans;
  - single counterparty credit limits;
  - risk committee requirements;
  - short-term debt limits;
  - stress testing; and
  - debt-to-equity leverage ratio limits.

A QBO would also be deemed to be "well capitalized" for purposes of certain provisions of the Federal Deposit Insurance Act and the Federal Credit Union Act.

The legislation specifies that a banking organization's QBO designation would be terminated: (i) immediately, where its quarterly leverage ratio falls below 6%, and (ii) after a one-year remediation period, where the organization's quarterly leverage ratio falls below 10% and does not increase to at least 10% during the following year.

A banking organization that loses its QBO status may not make another QBO election until its leverage ratio exceeds 10% for 8 consecutive quarters.

The Federal Reserve, FDIC and OCC would each be required to conduct a study, including public hearings, and submit a report to Congress with respect to methods for designing a requirement that banking organizations issue contingent capital using a market-based conversion trigger.

Further, the GAO would be required to conduct a study and report its findings to Congress regarding whether current prompt corrective action rules should be modified such that the trigger for supervisory corrective action would be based on a non-performing asset coverage ratio rather than Basel-based capital ratios.

Title VII: Empowering Americans to Achieve Financial Independence

CHOICE Act 2.0 makes significant structural and mission changes to the CFPB. As a result of the changes contemplated by the legislation, the agency would primarily function as a regulatory and limited enforcement agency, with its supervisory and examination powers being repealed.

Structural Changes

CHOICE Act 2.0 would rename the CFPB the "Consumer Law Enforcement Agency." The CFPB is presently an agency established within the Federal Reserve System and it receives its funding through the Federal Reserve. CHOICE Act 2.0 would instead require that funding of the agency be effected through the Congressional appropriations process.

Further, the President would be able to remove the Director of the CFPB at-will and also appoint the Deputy Director of the CFPB. The Deputy Director is currently appointed by the Director, and the Director may presently only be terminated by the President for cause.

A Senate-confirmed inspector general would also be established for the CFPB.

Changes to Authority

CHOICE Act 2.0 would strip the CFPB of its supervisory and examination authority over entities presently under its jurisdiction. The CFPB would retain enforcement authority, however, over non-depository institutions within its jurisdiction and depository institutions and credit unions with total assets of more than $10 billion. Additionally, the legislation would revoke the CFPB's authority to regulate certain small-dollar credit, such as payday loans and vehicle title loans. However, the CFPB would retain its rulemaking authority with respect to various consumer protection laws, such as the Truth In Lending Act, the Real Estate Settlement Procedures Act and the Truth in Savings Act.

With respect to enforcement, the legislation would remove in its entirety the CFPB's responsibility for ensuring that, with respect to consumer financial products and services, "consumers are protected from unfair, deceptive, or abusive acts and practices." The bill specifically deletes the rulemaking and enforcement provisions concerning such acts or practices and removes the Consumer Financial Protection Act's prohibition against engaging in, or assisting in, unfair, deceptive, or abusive act(s) or practices(s). The bill does, however, maintain the CFPB's authority to protect consumers from discrimination.

Separately, CHOICE Act 2.0 would remove the power of the CFPB to enforce rules under the Federal Trade Commission Act with respect to unfair, deceptive, or abusive acts or practices. It would also delete a provision of the Federal Trade Commission Act that encourages cooperation between the Federal Trade Commission ("FTC") and the CFPB to avoid duplication or conflict of rules with respect to the offering or provision of consumer financial products or services. The bill preserves the power of Federal banking regulators to prevent "unfair or deceptive acts or practices in or affecting commerce," though not abusive acts or practices, by depository institutions through the promulgation of regulations. Under CHOICE Act 2.0, such regulations must be "substantially similar" to those promulgated by the FTC, unless: (i) the banking regulator determines that the acts or practices are not unfair or deceptive, or (ii) the Federal Reserve determines that implementation of similar regulations would "seriously conflict with essential monetary and payments systems policies of such Board."

Further, the CFPB's civil penalty fund would be required to establish segregated accounts in respect of different classes of victims of the violations for which funds are collected, and payments to victims would be required to be made within two years after victims are identified, with remaining amounts being transmitted to the Treasury's general fund. The bill also would revoke the authority of the CFPB to prohibit or impose conditions or limitations on the use of an arbitration agreement, where the prohibition or imposition is found to be in the public interest.

Where the CFPB brings administrative proceedings where a penalty or a cease-and-desist order may be issued at the conclusion of the proceeding, the subject of such proceedings would be permitted to terminate the proceeding within 20 days such that the CFPB would be required to bring a civil action in court against such party. Additionally, a statutory meet-and-confer requirement would be implemented, requiring recipients of civil investigative demands to meet and confer with the CFPB within 30 days. Currently, recipients have only 10 days to meet and confer. Additionally, parties would be able to petition, in any United States "judicial district in which such person resides, is found, or transacts business," to set aside or modify civil investigative demands within 45 days after receiving service. Currently, petitions are required to be submitted within 20 days. CHOICE Act 2.0 would also eliminate the requirement that a court give deference to CFPB interpretations of consumer financial law.

The agency would also have a dual mandate going forward. In addition to its current consumer mandate, the agency would also be tasked with strengthening consumer participation in markets, without government interference or subsidies, in order to increase competition and enhance consumer choice.

Among other reforms, the Director of CFPB would be required to, subject to payment of a fee, issue advisory opinions in response to public inquiries regarding conformance with consumer financial law. Further, CFPB employees would be placed on the General Schedule pay scale, similar to employees of other federal agencies. Additionally, the CFPB's complaint database would no longer be made available to the public.

Durbin Amendment

While Title VII of the version of CHOICE Act 2.0 that initially passed the Committee contained a repeal of the Dodd-Frank Act-established "Durbin Amendment," which places limitations on certain fees charged in respect of debit cards, the provision repealing the Durbin Amendment was removed before the full House vote.

Title VIII: Capital Markets Improvements

Title VIII of CHOICE Act 2.0 makes changes to the SEC's organization, funding and enforcement powers in addition to amending certain rules applicable to ratings agencies and shareholder proposals and proxy rules. It also repeals, amends or eliminates several provisions in the Dodd-Frank Act mandating rulemaking, studies and reports by the SEC.

SEC Funding

The bill sets appropriation authorization amounts for the SEC through fiscal year 2022, requires the SEC to report on unobligated appropriations, restricts the SEC's use of funds for a new headquarters and abolishes the SEC's reserve fund, which has generally been used to fund technology modernization investments. The bill would also require that transaction and other fees collected by the SEC be transferred to the Department of the Treasury.

SEC Organization, Structure and Operation

The bill would make several changes to the SEC's current organization and reporting structure, including requiring the SEC to implement the recommendations in the 2011 report from Boston Consulting Group[5] and shifting the Offices of Credit Ratings and Municipal Securities to report to the Director of the Division of Trading and Markets rather than the Chair of the SEC.

The bill would also require that the ombudsman associated with the Office of the Investor Advocate be appointed by the SEC and would revise the responsibilities of the Investor Advocate to prohibit the Investor Advocate from taking a position on legislation pending before Congress, unless it is legislation proposed by the Investor Advocate. It would also require the Investor Advocate to consult with the Advocate for Small Business Capital Formation on recommendations.

Similarly, the bill would restructure the operation of the Investor Advisory Committee to work and consult with the Small Business Capital Formation Advisory Committee. The Investor Advisory Committee would also be required to include a member of the Small Business Capital Formation Advisory Committee on the committee.

The bill would also limit the length of the self-regulatory organization created pilot programs to five years, unless the SEC adopts a rule to extend it.

CHOICE Act 2.0 would also require the SEC to provide notice and comment required under the Administrative Procedures Act for any SEC statement, guidance, interpretive rules, or general policy statements that are voted on by the SEC Commissioners These types of the statements and guidance are not usually voted on by the SEC Commissioners.

Enforcement

CHOICE Act 2.0 also amends the SEC's enforcement powers, organization, policies and procedures. With regard to enforcement actions themselves, the bill prohibits any person from being subject to an enforcement action for a violation of securities laws if that person has not received adequate notice of the violated rule, law, or regulation. If the SEC has provided notice and comment for any SEC-voted statement or guidance in accordance with Section 553 of the Administrative Procedure Act, then adequate notice has been provided. In addition, the bill would provide

---

[5] A copy of this report is available at: https://www.sec.gov/news/studies/2011/967study.pdf.

that any person in receipt of a Wells notice indicating that SEC staff has recommended that an enforcement action should be brought against the aforementioned person to have the opportunity to make an in-person presentation to the SEC regarding the recommendation and be represented by counsel at such presentation, which SEC Commissioners may attend. Each SEC Commissioner shall receive a written report from SEC staff on such presentation prior to voting whether to bring the action.

The SEC would also be required to create an advisory committee to analyze and report on its enforcement policies and practices that would culminate with a series of recommendations to the SEC. The SEC would appoint an enforcement ombudsman to deal with problems that persons subject to investigations or administrative proceedings by the SEC may have with the staff or the SEC and who would create procedures for confidential communications.

In addition, the bill would require the SEC to approve and publish within one year an updated enforcement manual and to produce an updated enforcement report highlighting, among other things, past enforcement actions and future enforcement priorities. The manual would include policies and procedures of the SEC to ensure transparency.

The bill would also limit the SEC's enforcement powers and options, such as by:

- permitting persons subject to an administrative proceeding brought by the SEC, which may result in a cease and desist order or monetary penalty, to request termination of such proceeding. In such case, the SEC would be permitted to bring a civil action against that person for the same remedy;
- requiring the SEC to establish by clear and convincing evidence that a person has violated the relevant provision(s) of the securities laws in an administrative proceeding;
- eliminating the SEC's ability to issue an order in an administrative proceeding that bars persons from serving as officers or directors of an issuer;
- requiring all civil money penalties imposed on an issuer to contain an analysis by the Division of Economic and Risk Analysis concerning whether the alleged violation resulted in a direct economic benefit to the issuer, and whether the penalty would harm the issuer's shareholders;
- limiting the duration and requiring SEC approval for renewal of omnibus orders of investigation by the SEC;
- eliminating compensation for whistleblowers where the whistleblower is responsible or complicit in the securities law violation;
- eliminating automatic disqualifications of persons who previously violated securities laws, violated certain SEC rules or regulations or respective antifraud provisions, were convicted of a felony or misdemeanor, were the subject of any judicial or administrative judgment, or were suspended or barred from a registered national securities exchange from utilizing an exemption or registration provision, engaging in an activity, or qualifying for similar treatment under a provision of the securities laws or SEC rules; and

- requiring the complaint in shareholder derivative suits brought on behalf of a registered investment company be pled with particularity and would set the burden of proof for proving a breach of fiduciary duty at "clear and convincing evidence."

Process for Closing Investigations

Within 180 days after enactment of the bill, the SEC would establish a process for closing investigations in a timely manner. The process would be designed to ensure that the SEC makes a determination whether to institute a proceeding, and if not, to inform the person or entity subject to the investigation that the matter has been closed.

The SEC must:

- Make a determination whether or not to institute an administrative or judicial action in the matter or refer it to the Attorney General.
- If such matter is not pursued, the SEC must inform the affected person(s) that the investigation is closed.
- The bill permits the SEC to reopen an investigation if the SEC obtains new evidence and subject to the applicable statute of limitations.

Intellectual Property (e.g., for Algorithmic Traders)

The bill would prohibit the SEC from requiring a person to produce or furnish source code, including algorithmic trading source code or similar intellectual property, without first issuing a subpoena by limiting the SEC's authority to request such information under section 8 of the Securities Act and section 23 of the Exchange Act for a person, under section 31 of the '40 Act for an investment company and/or under section 204 of the Advisers Act for an adviser.

Limitations on Say on Pay

The Dodd-Frank Act requires each issuer to provide its shareholders with a non-binding resolution approving the compensation of executives as disclosed pursuant to Item 402 of Regulation S-K. The vote must occur at least once every three years. In addition, once every six years the shareholders are to be provided with a non-binding resolution to determine whether the aforementioned say-on-pay vote is to occur every one, two or three years. CHOICE Act 2.0 would only require the say-on-pay vote in those years in which there had been a material change to the compensation of executives from the previous year.

Restrictions on the Shareholder Proposal Process

Significant amendments to the rules related to the submission of shareholder proposals would also be made, including:

- allowing a company to exclude previously submitted shareholder proposals from its proxy materials where the shareholder proposal received less than 6% of the vote if proposed once within last five calendar years, less than 15% of the vote on its last submission if proposed twice within the last five calendar years, and less than 30% of the vote on its last submission if proposed three times within the preceding 5 calendar years, up from 3%, 6%, and 10%, respectively.

- increasing the minimum ownership requirements for shareholders to submit a shareholder proposal to 1% ownership of voting securities held for three years, which increases the existing requirement of $2,000 of voting securities held for one year; and
- permitting an issuer to exclude a shareholder proposal submitted by a person as a proxy, representative or on behalf of a shareholder.

These amendments would make it extremely difficult for shareholders to meet the requirements to submit shareholder proposals.

No Universal Ballot Rule

SEC is prohibited from adopting a rule, which it has proposed, that provides that a company must use a single ballot in connection with a contested election for its board of directors.

Ratings Agencies

CHOICE Act 2.0 would amend certain rules relating to nationally recognized statistical rating organizations (“NRSROs”):

- eliminate certain disclosure required by credit agencies describing the data and assumptions used in the determination of their published ratings;
- eliminate the requirement for NRSROs to receive an attestation on internal controls from its CEO;
- extend the look back period for conflicts with former employees of NRSROs to a one-year period prior to the departure of the employee rather than the one-year period preceding the date the credit rating action was taken;
- limits such conflicts to no longer apply to all underwriters, but rather just the lead underwriter; and
- permits an employee of an NRSRO that participates in sales and marketing to provide material information to a person determining the actual credit ratings.

Relief Fom the Sarbanes-Oxley Act 404(b) Requirement

The bill would eliminate the Sarbanes-Oxley Act requirement for an auditor attestation and the report on management’s assessment of internal controls for companies with total market capitalization of less than $500 million or smaller banks with total market capitalization of less than $1 billion. The current threshold is $75 million.

PCAOB Changes

Additionally, the bill would implement certain changes affecting the PCAOB including making the PCAOB provide any information to Congressional committees as they may request, abolish the Investor Advisory Group and eliminate the use of funds collected from monetary penalties to fund merit scholarships.

Markets Structure – Consolidated Audit Trail

The bill would also prohibit the SEC from approving the consolidated audit trail national market system plan unless the operator of the consolidated audit trail plan has developed internal risk control mechanisms for the storage of market data and related academic research. The SEC has already approved the plan for the consolidated audit trail.

Department of Labor Fiduciary Rule

CHOICE Act 2.0 would repeal the Department of Labor's "fiduciary rule." The rule, which became applicable on June 9, 2017, subjects, for the first time, many of the investment and asset management recommendations from broker-dealers, banks and other financial organizations to retail retirement clients to ERISA's fiduciary standards and remedies.[6] Pursuant to a subsequent final rule published by the Department of Labor on May 22, 2017, full compliance with certain exemptions to the rule are scheduled to take effect in 2018.[7]

In addition to repealing the rule, CHOICE Act 2.0 would amend Section 913(g)(1) of the Dodd-Frank Act, which authorized, but did not require, the SEC to establish a uniform standard of care for broker-dealers and investment advisers. As amended by CHOICE Act 2.0, Section 913 of the Dodd-Frank Act would require the SEC, prior to promulgating such a rule, to report to Congress on whether:

- retail customers are being harmed because broker-dealers are held to a different standard of conduct than investment advisers;
- alternative remedies would reduce any confusion and harm to retail investors due to the different standards of conduct;
- adoption of a uniform fiduciary standard would adversely impact the commissions of broker-dealers or the availability of certain financial products and transactions; and
- the adoption of a uniform fiduciary standard would adversely impact retail investors' access to personalized and cost-effective investment advice or recommendations.

Accredited Investor Definition Modified

CHOICE Act 2.0 would amend the definition of accredited investor to match the tests of Regulation D by adjusting the income test to $200,000 per year (or $300,000 including spouse's income) and the net worth test to $1 million. These tests would be adjusted for inflation every five years. This amendment limits the SEC's ability to further modify these concepts through rule making. Furthermore, CHOICE Act 2.0 also expands the definition of accredited investor to include natural persons that are registered brokers, investment advisers and certain knowledgeable parties that have specific knowledge or experience relevant to a particular investment.

Recovery of Erroneously Awarded Compensation Policy

The Dodd-Frank Act requires the national securities exchanges and associations to prohibit the listing of any issuer that does not develop and implement a policy mandating that, in the event the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement,

---

[6] The fiduciary rule can be found at: http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28806. For a complete overview of the rule, you may wish to refer to our client publication: "The US Department of Labor's Final 'Fiduciary' Rule Incorporates Concessions to Financial Service Industry but Still Poses Key Challenges," available at: http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/04/The-US-Department-of-Labor-Final-Fiduciary-Rule-Incorporates-Concessions-to-Financial-Service-Industry-CGE-041416.pdf.

[7] For a discussion of the current status of the exemptions, and the DOL's approach to enforcement in the short-term, you may wish to refer to our client publication: "DOL Announces No Further Delay to Implementation of the 'Fiduciary Rule,'" available at: http://www.shearman.com/en/newsinsights/publications/2017/05/dol-no-delay-implementation-fiduciary-rule.

the issuer is to recover incentive-based compensation received by any current or former executive officer in the three-year period preceding the restatement that is in excess of what would have been paid under the restatement.[8] CHOICE Act 2.0 would limit the executive officers affected by the rule to those that had control or authority over the financial reporting that resulted in the accounting restatement.

Dodd-Frank Act Amendments and Repeals

The bill would repeal the following the Dodd-Frank Act rulemaking mandates directed to the SEC:

- the pay ratio disclosure rule (the rule requiring issuers to disclose the ratio between CEO pay and that of the median annual compensation of all employees);[9]
- the employee and director hedging disclosure rule;
- the authorization of the SEC to adopt proxy access rules;
- conflict minerals disclosure rule;
- resources extraction disclosure rule;
- mine safety disclosure rule;
- the interagency rulemaking to restrict incentive compensation at certain financial institutions; and
- the authorization to adopt rules related to CEO/Chairman split disclosures.

In addition, the bill would repeal, among others: (i) mandates to conduct various studies, (ii) the authority of the SEC to restrict mandatory pre-dispute arbitration, (iii) rules requiring disclosure by investment advisers on short sales, (iv) certain enforcement and penalty provisions relating to violations of securities laws by credit rating agencies, (v) the SEC's authority to require a national securities association registered under the Exchange Act to establish and account for a reasonable annual accounting support fee to adequately fund the annual budget of the Governmental Accounting Standards Board, and (vi) the SEC's rulemaking authority relating to the loan or borrowing of securities if such rule or regulation is appropriate in the public interest or for the protection of investors.

The bill would further eliminate the need for the Comptroller General of the United States and the GAO to conduct certain studies to determine the cost of compliance with various regulations including the accredited investor standard, custody rule costs, the feasibility of forming a self-regulatory organization to oversee private funds and

---

[8] In July of 2015, the SEC issued a proposed rule implementing Section 954 of the Dodd-Frank Act. The proposed rule can be found at http://www.sec.gov/rules/proposed/2015/33-9861.pdf. For a complete overview of the proposed rule, you may wish to refer to our client publication: "SEC Proposed Highly Anticipated Clawback Rules," available at: http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/07/SEC-Proposes-Highly-Anticipated-Clawback-Rules-ECEB-070915.pdf.

[9] For a complete overview of the final rule on pay ratio disclosure, you may wish to refer to our client publication: "The SEC's Final Pay Ratio Rules: What You Need to Know," available at: http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/08/The-SECs-Final-Pay-Ratio-Rules-What-You-Need-to-Know-ECEB-081015.pdf.

short selling. It would also eliminate the requirement for an issuer of municipal securities to retain an advisor prior to issuing such securities.

Exemption of and Reporting by Private Equity Fund Advisers

CHOICE Act 2.0 would amend Section 203 of the Advisers Act by: (i) providing that no investment adviser shall be subject to registration/reporting requirements of the Advisers Act with respect to providing investment advice relating to a private equity fund, and (ii) requiring that within 6 months after the legislation's enactment, the SEC must issue final rules to: (A) require investment advisers to private equity funds to maintain such records and provide such reports to the SEC as the SEC determines necessary to the public interest and for the protection of investors (taking into account fund size, governance, investment strategy, risk, and other factors) and (B) define the term "private equity fund" for purposes of this new subsection of the Advisers Act.

As background, the Dodd-Frank Act greatly expanded the number of private equity fund managers required to register as investment advisers. CHOICE Act 2.0 provisions summarized above seem poised to largely reverse this requirement, but the SEC's definition of "private equity fund" and the reporting and recordkeeping that would be required of unregistered private equity fund advisers will be critical to determining the true practical impact of this section of the Act.

Streamlining of Applications for an Exemption From the Investment Company Act of 1940

Section 6(c) of the '40 Act provides the SEC with the authority to grant orders exempting applicants from the provisions of the '40 Act, if the SEC finds it is in the public interest to do so. CHOICE Act 2.0 would require the SEC, within 5 days of the receipt of an exemptive application, to either: (i) publish the exemptive application, or (ii) if the SEC determines the application is deficient, to inform the applicant of the specific reasons why it was rejected. The bill would give the SEC 45 days after publication to evaluate an application (with a 45-day extension under certain circumstances). After the 45-day period, the SEC must either: (i) approve the application, (ii) if the application would have been approved if it had included additional information, inform the applicant of what information it needs to provide, or (iii) deny the application. If SEC were to deny an application, it must provide a written explanation and provide an opportunity for a hearing if requested by the applicant. Any such hearing would be required to be held within 30 days after the denial if requested by the applicant. If the SEC failed to meet its time limits for denial of an application or holding a hearing after a denial, the application would be automatically approved.

Records and Reports of Private Funds

Section 204(b) of Advisers Act (Records and Reports of Private Funds) and section 211(e) would be amended by CHOICE Act 2.0 to: (i) delete any mention of the FSOC, and (ii) remove the ability of the SEC to require information in order to assess systemic risk (leaving "the public interest" and "the protection of investors" as the only two considerations). These changes implicitly call into question the primary rationale for Form PF, an SEC filing requirement adopted in the wake of the financial crisis ostensibly to gather information from private funds for the purpose of assessing systemic risk (i.e., with the expectation that the SEC would share Form PF information with FSOC).

Changes to Swap and Security-Based Swap Rules

CHOICE Act 2.0 has only limited direct impact on the swaps and security-based swaps markets. It makes two key amendments: First, it calls for harmonization between swaps and security-based swaps rules issued under Title VII of the Dodd-Frank Act. Specifically, it requires the CFTC and SEC to review each rule, regulation, and any other regulatory guidance issued by the agencies under Title VII. In the event there is an inconsistency between the approaches of the two agencies, the SEC and CFTC must issue new rules, regulations, or other regulatory guidance to resolve the inconsistency.

Second, CHOICE Act 2.0 generally exempts from CFTC and SEC regulation swaps and security-based swaps between majority-owned affiliates that are consolidated from an accounting perspective. However, in the event either affiliate is a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant, the transaction must still comply with the reporting, risk management, and anti-evasion requirements. The change eliminates current requirements that many inter-affiliate swaps be reported and expands existing exemptions for such swaps from clearing, margin and other requirements.

Title IX: Repeal of the Volcker Rule and Other Provisions

Title IX would repeal section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule, in its entirety. Implementing regulations issued jointly by the Federal Reserve, OCC, CFTC and SEC effectuated the statute's mandate to prohibit banking organizations from engaging in proprietary trading or forming certain relationships with hedge funds or private equity funds.

Title X: Fed Oversight Reform and Modernization

CHOICE Act 2.0 seeks to improve how the Federal Reserve communicates monetary policy by imposing on the FOMC a requirement to submit to Congress, following each of its meetings, a "directive policy rule," intended to achieve specified targets for various rates (e.g., the federal funds rate, the rate charged on reserves, and the discount window rate) based upon a formula that varies as a function of changes in inflation, gross domestic product and other macroeconomic factors. By requiring the Federal Reserve to communicate its monetary policy strategy through the directive policy rules, CHOICE Act 2.0 aims to increase transparency of the FOMC's process. The FOMC would have the ability to select the specific policy inputs for each rule and would also be able to deviate from any directive policy rule when it determines that it cannot or should not comply with such rule due to changing economic conditions.

Additionally, the FOMC would be subject to a week-long blackout period prior to each of its meetings, during which FOMC members and staff would only be permitted limited public communications with respect to macroeconomic or financial developments or monetary policy issues. Further, transcripts of all FOMC meetings would be made publicly available.

CHOICE Act 2.0 would also change the membership composition of the FOMC by expanding the committee's rotating members from five to six Federal Reserve Bank members, removing the president of the Federal Reserve Bank of New York as a permanent member.

CHOICE Act 2.0 would also require an annual audit of the Federal Reserve and Federal Reserve Banks by the Comptroller General, with a report of such audit, including legislative recommendations, required to be submitted to Congress.

A bipartisan Centennial Monetary Commission would also be established under CHOICE Act 2.0, which commission would be tasked with reviewing, among other things: (i) the history of the Federal Reserve's monetary policy since its inception and its impact on the American economy, (ii) the Federal Reserve's use of macroprudential supervision and regulation as a tool of monetary policy, (iii) the Federal Reserve's lender of last resort function, and (iv) the impact of the Federal Reserve's dual mandate on economic activity, federal debt, and actions of the Federal Reserve. The Centennial Monetary Commission would be required to prepare a report to Congress summarizing its findings and conclusions, which includes specified recommendations for monetary policy going forward.

Limitation on Section 13(3) Authority

The Federal Reserve's emergency lending authority under Section 13(3) of the Federal Reserve Act was limited by the Dodd-Frank Act. CHOICE Act 2.0 would further limit the Federal Reserve's emergency lending authority under Section 13(3) by:

- requiring that the authority could only be invoked where the "unusual and exigent circumstance" currently required for use of such authority are also those that "pose a threat to the financial stability of the United States";
- requiring that the use of the lending authority must be approved by no fewer than nine presidents of the Federal Reserve Banks, in addition to the currently required approval of five of seven Federal Reserve Board members;

- modifying the collateral requirements by prohibiting the acceptance of equity securities as collateral and requiring the Federal Reserve to issue a rulemaking that would: (i) develop a method for determining the sufficiency of requisite collateral, (ii) establish acceptable classes of collateral, (iii) develop a method for determining the haircut that would apply for purposes of calculating sufficiency of collateral and (iv) develop a method for independent appraisal of collateral;
- revising the solvency requirement to prohibit self-certification as to solvency by any recipient of emergency funds. Rather, the Federal Reserve and the applicable federal banking regulator shall make the certification; and
- requiring the Federal Reserve to implement by rulemaking, a minimum interest rate for emergency lending.

Title XI: Improving Insurance Coordination Through an Independent Advocate

CHOICE Act 2.0 would abolish the Federal Insurance Office, which was created by the Dodd-Frank Act. In its place, the bill would establish an Office of the Independent Insurance Advocate within the Treasury Department, led by a Presidential-appointee who would be confirmed by the Senate. The mission of the Office would be to act as an independent advocate on behalf of the interests of US insurance policyholders on prudential aspects of insurance, and to provide perspective on protecting their interests. The head of the Office, the Independent Insurance Advocate, would serve on the FSOC as the FSOC's independent member having insurance expertise.

The Office would have the authority to, among other things, coordinate federal efforts on prudential aspects of international insurance matters, consult with states regarding insurance matters of national importance and prudential matters of international importance, and observe all aspects of the insurance industry, including identifying issues with insurance regulation that could have systemic effects.

The Office would be restricted, however, from participating in any supervisory college and its authority may not extend to health insurance, long-term care insurance or crop insurance. Additionally, the Office would not have general supervisory or regulatory authority over the business of insurance.

SHEARMAN & STERLING LLP

CONTACTS

John J. Cannon III
New York
+1.212.848.8159
jcannon@shearman.com

Nathan J. Greene
New York
+1.212.848.4668
ngreene@shearman.com

Geoffrey B. Goldman
New York
+1.212.848.4867
geoffrey.goldman@shearman.com

Daniel H.R. Laguardia
San Francisco
+1.415.616.1114
daniel.laguardia@shearman.com

Lona Nallengara
New York
+1.212.848.8414
lona.nallengara@shearman.com

Russell D. Sacks
New York
+1.212.848.7585
rsacks@shearman.com

Reena Agrawal Sahni
New York
+1.212.848.7324
reena.sahni@shearman.com

Sylvia Favretto
Washington D.C.
+1.202.508.8176
sylvia.favretto@shearman.com

Thomas M. Majewski
New York
+1.212.848.7182
thomas.majewski@shearman.com

Ted Randolph
New York
+1.212.848.7260
ted.randolph@shearman.com

John D. Reiss
New York
+1.212.848.7669
john.reiss@shearman.com

Roger Deming
New York
+1.212.848.7296
roger.deming@shearman.com

Zahrah Z. Devji
New York
+1.212.848.5094
zahrah.devji@shearman.com

Nicholas Emguschowa
New York
+1.212.848.4620
nicholas.emguschowa@shearman.com

Jenny Ding Jordan
New York
+1.212.848.5095
jenny.jordan@shearman.com

P. Sean Kelly
New York
+1.212.848.7312
sean.kelly@shearman.com

Jennifer Scott Konko
New York
+1.212.848.4573
jennifer.konko@shearman.com

Christopher Lanzalotto
New York
+1.212.848.4082
christopher.lanzalotto@shearman.com

Caitrin McKiernan
Hong Kong
+852.2978.8048
caitrin.mckiernan@shearman.com

Kerry Murphy
New York
+1.212.848.4832
kerry.murphy@shearman.com

Naveen Pogula
New York
+1.212.848.4698
naveen.pogula@shearman.com

Catherine Sum
New York
+1.212.848.4268
catherine.sum@shearman.com

Yizhou Xu
New York
+1.212.848.7485
yizhou.xu@shearman.com

Matthew Behrens
New York
+1.212.848.7045
matthew.behrens@shearman.com

ABU DHABI | BEIJING | BRUSSELS | DUBAI | FRANKFURT | HONG KONG | LONDON | MENLO PARK | MILAN | NEW YORK
PARIS | ROME | SAN FRANCISCO | SÃO PAULO | SAUDI ARABIA* | SHANGHAI | SINGAPORE | TOKYO | TORONTO | WASHINGTON, DC

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

Copyright © 2017 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong.
*Dr. Sultan Almasoud & Partners in association with Shearman & Sterling LLP