

Dodd-Frank Act Regulatory Update

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New Regulatory and Advisory Entities

- Stand-alone Bureau of Consumer Financial Protection
- Regulates how consumer financial products and services are provided
 - Independent rule-writing authority
 - Authority to examine and enforce regulations for banks/credit unions with assets greater than \$10 billion, and other nonbank financial companies
 - Exception for CPAs who perform customary and usual accounting activities, including the provision of accounting, tax, advisory or other services subject to regulation by state board or federal authority, and the services incidental to such customary and usual activities
- Financial Stability Oversight Council (FSOC)
 - Identify risks that pose threat to US economic stability
 - Analyze national and international proposed rules; comment on proposed rules; advise Congress

Eligibility Threshold for SEC Investment Adviser Registration

- Section 410 raises the assets under management (AUM) threshold to \$100 million
 - Currently \$25 million by statute; \$30 million by rule
 - If registering 15 or more states – ability to register with SEC
 - Will cause additional burden for state agencies to register entities with fewer assets under management. Additional recordkeeping and reporting burdens on these entities and those who serve them
 - Subject to potentially state run examinations and related rules

Proposed Rules Regarding Investment Adviser Filing

- Proposed rules require Investment Advisers that advise one or more private funds – including Commodity Pool Operators and Commodity Trading Advisors that advise one or more private funds – to file Form PF
- To assist FSOC in the discharge of its monitoring duties and to fulfill Dodd-Frank’s mandate to require public disclosure of certain information related to advisers
- Periodic (yearly, more for large funds) disclosure of non-public information regarding funds and trading strategies to assist FSOC in ascertaining systemic risk – very limited disclosure
- Identifying funds advised; detailed asset/liability information; fund performance; net assets under management; fund holdings and performance breakdown; counterparty information; and other detailed information regarding holdings, risk, etc.

Registration for Auditors of Broker-Dealers

- Previously, while auditors of nonpublic Broker-Dealers had to *register* with PCAOB, there was not much *oversight*
- Section 982 of Dodd-Frank extends oversight authority
 - Authority to require a program of inspection for auditors of BDs who are registered with the PCAOB and to set standards for audits
 - Ability to differentiate among BD classes and exempt introducing brokers when establishing such inspection programs
 - Aligns registration with inspection
 - Requires BDs to pay annual accounting support fee in proportion to BD's net capital
- Deliverables from PCAOB
 - Issue information and guidance for BD accounting firms
 - Issue proposed rules on assessment and collection of support fees
- *Related Note:* Following study under Section 913, SEC is authorized to establish a rule-made fiduciary duty for BDs similar to standard currently in place for Registered Investment Advisers

Disclosures in Asset-Backed Securitization Matters

- Securitizers must retain economic interest in portion of the credit risk by investing in securities that the assets back
 - Five percent of credit risk
 - Cannot hedge or transfer risk
- Enhanced disclosures for these securities
 - Data regarding the broker or originator
 - Compensation of broker or originator
 - Amount of risk retention
- Commissions studies related to federally-subsidized loans and FASB Standards for Transfers and Servicing and Consolidation

Executive Compensation

- Sections 951-957
- Companies must give shareholders a nonbinding vote on compensation (including “golden parachutes”)
 - SEC proxy authority
 - Imposes standards for listing on an exchange
- Auditors of public firms may need to assess management’s compliance with new procedures on executive compensation, accountability, and governance

Enhanced Whistleblower Incentives and Protection

- Sections 922-924 amend the Securities Exchange Act of 1934 to add securities whistleblower incentives and protection
 - Investor protection fund
 - Encourages individuals to report securities violations
- Auditor exception

SOX External Audit Exemption

- Sarbanes-Oxley required external audit of internal control over financial reporting for all issues
- Dodd-Frank exempts public entities whose public float is less than \$75 million and who issue debt only
- Requires SEC study to investigate further partial relief for slightly larger companies
- Requires GAO study to analyze impact of amendments

Registration of Advisers to Private Funds

- Sections 401, 403, 407, 408 & 409 add definition of “private adviser” to the Investment Advisers Act of 1940 (IAA) and eliminate the private adviser registration exemption
 - Exempts venture capitalists
 - Exempts advisers to private funds
 - Acting solely as an adviser to private funds
 - AUM less than \$150 million
 - Amends IAA to exclude “family offices” from registration as an investment adviser
 - Increased registrant numbers; increased oversight responsibilities

OTC Derivatives Regulation

- Promote greater transparency
- Moderate systemic risks
- Minimize the recurrence of operational stresses and excessive risk-taking
- Comprehensive regulation of the OTC derivatives market by the CFTC and the SEC
- Broad definition of “Swap”

Regulated Exchange Trading and Central Clearing

- Increases standardization of swap instruments
- Establishes margin and collateral requirements (unless exempted)
- Increases transparency in pricing and transactions

Potential Accounting Implications of Swap Rules

- Unclear which types of swap transactions will have to be centrally cleared and whether all centrally cleared swaps will be standardized
- Standardization is expected for exchange-traded swaps
 - Will likely cause mismatches between hedged exposures and standardized derivatives, which may increase income statement volatility
 - Today, a company can purchase a customized instrument that precisely matches debt maturity dates
 - In the future, exchanges will only carry standardized instruments
- Companies will need to decide whether to accept the additional ineffectiveness that stems from using a standardized instrument or pay potentially more for a customized swap that minimizes ineffectiveness

Potential Accounting Implications of Swap Rules

- More Difficult to Achieve Hedge Accounting Treatment
- Less likely that hedging strategies would qualify for the “shortcut” and “matched critical terms” methods currently allowed under US generally accepted accounting principles (GAAP)
- As a result, companies willing to apply hedge accounting will have to consider implementing “long haul” hedge effectiveness methods.
- Recent FASB Exposure Draft *Accounting for Financial Instruments*
- Elimination of matched critical terms and shortcut methods proposal

Potential Accounting Implications of Swap Rules

- Changes to Fair Value Measurement
- Margin taken into consideration when computing the credit valuation adjustment to fair value derivatives
- Potential impact on balance sheet presentation
- For disclosure purposes, the fair value hierarchy level may change for derivatives that will be exchange traded

Aiding and Abetting Securities Fraud

- Section 929 enhances SEC ability to prosecute securities fraud, extending liability to those who “aid and abet” securities fraud
 - New Legal standard: “knowing or reckless”
 - Former standard: “knowing”
 - Possible impact on service providers whose exposure to information might create liability under these new standards

Additional Relevant Sections

- Section 413 revises the definition of “accredited investor”
- Section 914 requires the SEC to examine whether investment advisers should be subject to additional oversight
- Section 411 amends the custody rules of the Advisers Act
- Section 919C – Commissions study by GAO; possible broader regulations on financial planning services offered by CPAs