Proskauer

Dodd-Frank: What's on the Radar Through Year-end

August 29, 2011

Although the Dodd-Frank Act was enacted just over one year ago on July 21, 2010, only a small percentage of the rules contemplated by the Act are effective today, so clients should remain on alert for a continuing roll-out of new rules through 2013. This alert highlights what to expect through this year-end. Banks, investment funds, securities firms and publicly listed companies outside the financial sector all will be affected.

Corporate Governance, Disclosure and Executive Compensation

Rule Adoptions Expected

- *Conflict Minerals/Natural Resources.* In an area that is expected to impact a wide variety of companies with rigorous new requirements, the SEC expects to adopt specialized disclosure provisions relating to conflict minerals, coal or other mine safety, and payments by resources extraction issuers to foreign or U.S. government entities in the early fall of this year.

We highlight conflict minerals disclosure because it is poised to impact many companies and industries outside of the natural resource business that would not expect to be affected. A commercial bank, for instance, has stated that it expects to fall within the scope of the new rules because it issues credit cards that include covered elements. The disclosure provisions relating to conflict minerals are proposed to require public companies to disclose annually whether any conflict minerals that are "necessary to the functionality or production of a product" manufactured by the company originated in the Democratic Republic of Congo or an adjoining country (the "DRC countries"). The Act defines conflict minerals as columbite-tantalite (coltan), cassiterite, gold, wolframite or their derivatives, or any other mineral or its derivative determined by the U.S. Secretary of State to be financing conflict in the DRC countries. Companies will be required to provide their initial conflict minerals disclosure after their first full fiscal year following the promulgation of the SEC's final rules. While the SEC is already a few months late in the adoption of the final rules, it must adopt the final rules by year-end in order to be applicable for the 2012 reporting period.

- *Investment Manager Say on Pay*. The SEC has proposed and intends to adopt rules regarding disclosure by institutional investment managers of votes on executive compensation at least annually. Earlier this year the SEC adopted rules requiring public companies to provide their shareholders with a nonbinding "say on pay" vote and disclosure about and a shareholder advisory vote on "golden parachute" arrangements in business combination transactions.
- *Compensation Committee and Adviser Requirements*. The SEC has proposed but not yet adopted rules that would require exchanges to establish listing standards that require each member of a listed issuer’s compensation committee to be "independent." The proposal issued by the SEC also would compel exchanges to amend listing standards on existing compensation consultant disclosure to require disclosure of whether:

- the issuer’s compensation committee retained or obtained the advice of a compensation consultant;
- the work of the compensation consultant has raised any conflicts of interest; and
- if there are any conflicts of interest relating to the work of a compensation consultant, the nature of any such conflict and how it is being addressed.

Rule Proposals Expected (with adoptions to follow in 2012)

- *Clawback.* Mandating new listing standardsrequiring companies to adopt and disclose a compensation clawback policy to recover any excess executive incentive-based compensation that is paid as a result of materially erroneous financial data.
- *"Pay-for-Performance" and Compensation Ratio*. Imposing new clear "pay-for-performance" disclosure showing the relationship between compensation for a company's named executive officers that was actually paid and the company's financial performance (taking into account any change in value of the stock and any dividends or distributions. The SEC will also require the disclosure of the median total annual compensation of all employees other than its chief executive officer, the total annual compensation of its chief executive officer and the ratio of such amounts. These disclosure requirements will apply to proxy and other materials filed by companies subject to the executive compensation proxy disclosure requirements.
- *Employee and Director Hedging*. Imposing disclosure requirements with respect to whether a company permits its employees or directors to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities granted as compensation or otherwise owned, directly or indirectly, by such employees and directors.

Asset-Backed Securities

In March 2001, the SEC, along with other federal regulators, issued a proposed rule on credit risk retention in securitizations. As required by Section 941 of the Act, the proposed rule would require securitizers to retain not less than 5% of the credit risk of the assets collateralizing any asset-backed securities ("ABS") issuance, unless an exemption is available. The SEC has reported that it received a number of comments on the "qualified residential mortgages" exemption included in Section 941. The comment process was extended to August 1, 2011 from June 10, 2011 and the SEC expects to adopt rules by year-end.

Additionally, the SEC intends to propose rules prohibiting material conflicts of interest in certain securitizations.

Clearing & Settlement

The SEC intends to adopt rules regarding standards for clearing agencies designated as systemically important and rules regarding the process to be used by designated clearing agencies to provide notice of proposed changes.

The proposed rules issued by the SEC would require, among other things, that clearing agencies:

- maintain certain standards with respect to risk management and operations;
- have adequate safeguards and procedures to protect the confidentiality of trading information;
- have procedures that identify and address conflicts of interest;
- require minimum governance standards for their boards of directors;
- designate a chief compliance officer; and
- disseminate pricing and valuation information if they perform central counterparty services for security-based swaps.

The SEC also proposed rules that would set out a process in which those clearing agencies that are designated as “systemically important” must submit advance notices for changes to their rules, procedures, or operations that could materially affect the nature or level of risk presented at such clearing agencies.

Derivatives

Enhanced regulation of the over-the-counter (“OTC”) derivatives marketplace has been one of the most active areas of rulemaking for the SEC. Together with the CFTC and in coordination with other federal regulators, the SEC has issued a number of proposed rules as required by Title VII of the Dodd-Frank Act. In spite of a July 16, 2011 effective date for Title VII, many of the proposed rules relating to Title VII still remain proposals and comment periods have been extended or re-opened. In order to address and alleviate any market uncertainty relating to an absence of final rules by the effective date for Title VII, the SEC and CFTC issued guidance and temporary relief from the application of certain provisions of the Dodd-Frank Act relating to OTC derivatives.

The SEC has proposed and calendared for adoption before year-end:

- rules defining key terms used in the Dodd-Frank Act with respect to products and intermediaries;

- rules regarding trade reporting, data elements, and real-time public dissemination of trade information for security-based swaps;
- rules for clearing agencies for security-based swaps;
- rules regarding the obligations of security-based swap data repositories; and
- rules relating to mandatory clearing of security-based swaps and a related end-use exception to such a requirement.

Even with the guidance and temporary rules and relief and the significant number of proposed rules, it remains a challenge to predict with certainty the exact contours of a final regulatory regime for the OTC derivatives marketplace. SEC Chairman Mary L. Schapiro noted recently that there is still much to be done to fully implement Title VII. Chairman Schapiro intends to focus the agency on:

- proposing rules regarding the registration and regulation of security-based swap dealers and major security-based swap participants;
- evaluating the international implications of Title VII and addressing the implications holistically in a single proposal; and
- working with other state and federal regulators and market participants on implementation timeframes and next steps.

After proposing all of the key rules under Title VII, the SEC intends to seek public comment on a detailed implementation plan for the various rulemakings.

Exempt Offerings

The SEC intends to adopt rules that disqualify securities offerings involving certain "felons and other 'bad actors'" from relying on the safe harbor from Securities Act registration provided by Rule 506 of Regulation D. Under the proposed rules issued by the SEC, the disqualifying events include:

- certain criminal convictions, court injunctions and restraining orders;
- certain final orders of state securities, insurance, banking, savings association or credit union regulators, federal banking agencies or the National Credit Union Administration;
- certain types of SEC disciplinary orders;
- suspension or expulsion from membership in, or from association with a member of, a securities self-regulatory organization; and

- certain other securities law-related sanctions.

Additionally, the SEC staff is preparing final recommendations for rule amendments to exclude the value of an individual's primary residence when determining if that individual's net worth exceeds the $1 million threshold required for "accredited investor" status. While Section 413(a) of the Act has been effective since the Act's enactment, the SEC's rule amendments are designed to clarify the requirements and codify them within the SEC's rules.

Market Oversight

In January 2011, as required by the Dodd-Frank Act, the Financial Stability Oversight Council (the "FSOC") issued a study of and recommendations regarding the implementation of Section 619 of the Act, commonly referred to as the Volcker Rule. The Volcker Rule generally prohibits banking entities, which benefit from federal insurance on customer deposits or access to the discount window, from engaging in proprietary trading and from investing in or sponsoring hedge funds and private equity funds. The SEC is now consulting and coordinating with federal banking agencies and the CFTC in drafting proposed rules to implement the Volcker Rule. The SEC currently anticipates that that this proposal will be issued prior to year-end.

Additionally, the SEC intends to finalize rules regarding due diligence for the delivery of dividends, interest and other valuable property to missing securities holders.

Municipal Advisors

Prior to year-end, the SEC intends to adopt final rules creating a new process by which municipal advisors must register with the SEC. The SEC adopted interim rules last September and proposed the permanent rule last December. The term "municipal advisor" includes any person that undertakes a solicitation of a municipal entity (including state entities). This means that placement agents soliciting investments from state and local pension plans are required to register as municipal advisors.

Oversight of Investment Advisers & Broker-Dealers

The SEC recently adopted final rules for advisers to private investment funds. These rules eliminated the so-called "private adviser exemption" under Section 203(b)(3) of the Advisers Act, which exempted any investment adviser from registration if the adviser had less than 15 clients, was not an adviser to a registered investment company, and did not hold itself out to the public as an investment adviser. Most advisers to private funds historically have relied on this exemption and thus will be required to register with the SEC unless it meets one of the following new exemptions for:

- advisers solely to venture capital funds;
- advisers solely to private funds with less than $150 million in assets under management in the United States; and
- certain foreign advisers without a place of business in the United States and with only a de minimis amount of business in the United States.

Clients should refer to our client alert, *SEC Adopts Final Rules for Advisers to Private Investment Funds and Amendments to Form ADV*, dated July 11, 2011, for a more detailed discussion of the new rules and exemptions.

The SEC, along with the CFTC, issued proposed rules, in January 2011, which would require hedge fund advisers and other private fund advisers to report systemic risk information on a new form – Form PF. The new form requires the nonpublic reporting of information about private funds managed by advisers for the purpose of systemic risk assessment by the FSOC. These new rules follow a “suite of rulemaking” amending the Investment Advisers Act of 1940 (the “Advisers Act”), a number of which have already gone into effect.

Pursuant to Section 418 of the Act, the SEC has issued an order to adjust the threshold for a "qualified client" under the Advisers Act. Rule 205–3 under the Advisers Act exempts an investment adviser from the prohibition against charging a client performance fees in certain circumstances, including when the client is a "qualified client." The SEC order will be effective as of September 19, 2011.

The SEC also has indicated that it intends to propose rules, as may be appropriate, based on a study required by Section 913 of the Dodd-Frank Act, on the obligations of brokers, dealers and investment advisers and, particularly, on the potential application of fiduciary duty standards to brokers. These rule proposals are expected by year-end. The study reviewed the broker-dealer and investment adviser industries and the regulatory framework applicable to each. The study recommends, among other things, that the SEC:

1. implement a uniform fiduciary standard for broker-dealer and investment advisers when providing personalized investment advice about securities to retail customers that would be no less stringent than the standard that currently applies to registered investment advisers under the Investment Advisers Act; and
2. consider harmonization of broker-dealer and investment adviser regulation where harmonization appears likely to add meaningful investor protection.

Related Client Alerts

Proskauer's Dodd-Frank Task Force has authored numerous client alerts that provide additional detail and analysis on critical aspects of the Act. These include:

Corporate Governance

- *The Impact of Financial Reform on Executive Compensation*, dated July 19, 2010

Derivatives

- *CFTC Action to Defer Effective Date for Swaps Regulation,* dated June 16, 2011
- *Rule Proposal Regarding Margin and Capital Requirements for Uncleared Swaps*, dated June 3, 2011
- *SEC/CFTC and Treasury Derivatives Proposals Under Dodd-Frank,* dated June 1, 2011
- *SEC Proposes New Rules for Defining Security-Based Swap Execution Facilities,* dated February 4, 2011
- *SEC Proposes New Rules for Documentation of Over-the-Counter Derivatives Transactions*, dated January 21, 2011

Market Oversight

- *Federal Reserve Issues Final Rule for Compliance with Volcker Rule under Dodd-Frank*, dated February 14, 2011

Municipal Securities

- *Filing Deadline for Municipal Advisor Registration is October 1, 2010*, dated September 28, 2010

Oversight of Investment Advisers & Broker-Dealers

- *SEC Adopts Final Rules for Advisers to Private Investment Funds and Amendments to Form ADV*, dated July 11, 2011
- *SEC Release Final Rule Exempting Family Offices*, dated June 29, 2011

For a full list of related client alerts and articles please visit our Dodd-Frank Task Force Press Room.

Summary of Upcoming SEC Rulemaking Activity

August – December 2011

Expected Rule Proposals	Expected Rule Adoptions
Asset-backed Securities	
§621: Propose rules prohibiting material conflicts of interests between certain parties involved in asset-backed securities and investors in the transaction	**§941:** Adopt rules (jointly with others) regarding risk retention by securitizers of asset-backed securities, and implementing the exemption of qualified residential mortgages from this prohibition
Clearing & Settlement	

	§805: Adopt rules regarding standards for clearing agencies designated as systemically important **§806:** Adopt rules regarding the process to be used by designated clearing agencies to provide notice of proposed changes
Corporate Governance & Disclosure	
§§953 and 955: Propose rules regarding disclosure of pay-for-performance, pay ratios, and hedging by employees and directors **§954:** Propose rules regarding recovery of executive compensation	**§951:** Adopt rules regarding disclosure by institutional investment managers of votes on executive compensation **§952:** Adopt exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence; adopt disclosure rules regarding compensation consultant conflicts **§1502:** Adopt rules regarding disclosure related to “conflict minerals” **§1503:** Adopt rules regarding disclosure of mine safety information **§1504:** Adopt rules regarding disclosure by resource extraction issuers
Derivatives	

§764: Propose rules regarding the registration and regulation of security-based swap dealers and major security-based swap participants	**§712:** Adopt rules, jointly with the CFTC, defining key terms used in the Act with respect to products **§712:** Adopt rules, jointly with the CFTC, defining key terms used in the Act with respect to intermediaries **§§763 and 766:** Adopt rules on trade reporting, data elements, and real-time public reporting for security-based swaps **§763:** Adopt rules for clearing agencies for security-based swaps **§763:** Adopt rules regarding the registration and regulation of security-based swap data repositories **§763:** Adopt rules regarding mandatory clearing of security-based swaps **§763:** Adopt rules regarding the end-user exception to mandatory clearing of security-based swaps
Exempt Offerings	
	§413: Adopt rules to revise the "accredited investor" standard **§926:** Adopt rules disqualifying the offer or sale of securities in certain exempt offerings by certain felons and others similarly situated

Market Oversight	
§619: Propose rules to implement prohibition on proprietary trading by banking institutions and certain relationships with hedge funds and private equity funds	**§929W:** Adopt revisions to rules regarding due diligence for the delivery of dividends, interest and other valuable property to missing securities holders
Municipal Securities	
	§975: Adopt permanent rules for the registration of municipal advisors
Oversight of Investment Advisers & Brokers-Dealers	
§913: Propose rules as may be appropriate, based on §913 study conducted on the obligations of brokers, dealers and investment advisers	**§§404 and 406:** Adopt rules (jointly with the CFTC for dual-registered investment advisers) to implement reporting obligations on investment advisers related to the assessment of systemic risk **§418:** Adopt rules to adjust the threshold for "qualified client" **§619:** Adopt rules to implement prohibition on proprietary trading by banking institutions and certain relationships with hedge funds and private equity funds

All section references included in the chart are to the Dodd-Frank Act unless otherwise indicated. Source: http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml.

Related Professionals

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