



Risk Management Update May 2011

WHERE WE ARE TODAY WITH THE DODD-FRANK ACT

Most in the financial industry will remember July 21, 2010 – for that is when Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). Within its framework are requirements for regulators to set forth new industry rules and guidelines for nearly every facet within the financial industry. This includes registration of advisers to private funds, corporate governance, enactment of the whistleblower program, tighter regulations for derivatives, asset-backed securities, and much more. This risk management update highlights some of the key provisions as they stand today which may likely impact investment adviser, broker-dealer and private fund companies.

Actions Taken by the Securities and Exchange Commission

On July 27, 2010, Chairwoman Mary Shapiro stated that in accordance with the Dodd-Frank Act, the overarching goals are “to create a new, more effective regulatory structure, fill a host of regulatory gaps, bring greater public transparency and market accountability to the financial system and give investors important protections and greater input into corporate governance.”¹ In response, the following proposals or rules have been made since the enactment of the Dodd-Frank Act.

1. *Advisers to Hedge and Private Funds Must Register*

On July 21, 2010, pursuant to the Dodd-Frank Act, all advisers to private funds must register with and are subject to reporting requirements to the SEC if their assets are greater than \$150 million. This amendment goes into effect on July 21, 2011.

Advisers that had been exempt from registration must now register with the SEC. In addition, several states have enacted regulations requiring those fund advisers with less than \$150 million in assets to register with the state.

Notably, on April 8, 2011, the SEC Division of Investment Management issued a letter which provided in part, “given the time needed for advisers to register and come fully into compliance with the obligations applicable to them once they are registered...the Commission will *consider* extending the date by which these advisers must register and come into compliance with the obligations of a registered adviser until the first quarter of 2012” [emphasis added].² However, at this time, no official extensions have been officially granted.

¹ Available at: <http://sec.gov/spotlight/dodd-frank.shtml>.

² Available at: <http://www.sec.gov/rules/proposed/2010/ia-3110-letter-to-nasaa.pdf>.

2. Corporate Governance Issues - Executive Compensation Disclosure

Various provisions of the Dodd-Frank Act involve the governance of issuers. This includes requirements for advisory votes of shareholders about executive compensation and golden parachutes and additional disclosures related to compensation arrangements. Importantly, some of the Dodd-Frank Act provisions apply to proxy materials prepared in connection with the annual meetings of shareholders that take place after January 20, 2011.³

For example, on January 25, 2011, the SEC adopted rules governing “golden parachute” compensation arrangements, which now require shareholder approval every three years. For more information on the new say on pay requirements, please refer to <http://www.sec.gov/news/press/2011/2011-25.htm>.

3. Derivatives - 28 Rulemakings

Recognizing a gap in the U.S. financial regulation of OTC swaps, the Dodd-Frank Act called for 28 rulemakings to regulate derivatives. Most rulemakings are required to be completed within 360 days of enactment, or by July 15, 2011, which is soon approaching.

Up until the passing of the Dodd-Frank Act, the SEC was provided with anti-fraud authority over security-based swap agreements but was prohibited from imposing requirements, such as reporting or disclosures, to prevent fraud with respect to such agreements. In an effort to fill this regulatory gap, the Dodd-Frank Act provides the SEC with regulatory authority over “security-based swaps,” which are defined as swaps based on a single security or loan or a narrow-based group or index of securities or events relating to a single issuer or issuers of securities in a narrow-based security index.⁴ The CFTC will have regulatory authority over all other swaps.

On October 13, 2010, the SEC adopted interim rule (Rule 13Aa-2T) that requires certain swaps dealers and other parties to report any security-based swaps entered into prior to the July 21, 2010, whose terms has not expired as of the passage of the Dodd-Frank Act. For more information please visit: <http://www.sec.gov/news/press/2010/2010-191.htm>.

4. Asset-Backed Securities

In accordance with the Dodd-Frank Act’s passage, Asset Backed Securities (“ABS”) require issuers to provide heightened disclosures to assist investors with analyzing information about the bundled loans used to create the security investment. On January 20, 2011, the SEC voted to adopt specific rules regarding issuers’ responsibilities to disclose the history of the requests received and repurchases made related to outstanding ABS. In addition, the issuer is now required to review the assets underlying those securities.⁵

Sections 621 (relating to conflict of interest rules) and 941 (involving joint rules regarding risk retention) were required to be adopted by April 15, 2011. Other sections of the Dodd-Frank Act,

³ Available at: <http://sec.gov/spotlight/dodd-frank/corporategovernance.shtml>.

⁴ Available at: <http://sec.gov/spotlight/dodd-frank/derivatives.shtml>.

⁵ Available at: <http://www.sec.gov/news/press/2011/2011-18.htm>.

such as Section 943 (regarding representations and warranties) and 945 (regarding issuer review of assets) needed to be adopted by January 14, 2011. For more information on these requirements, please see <http://sec.gov/spotlight/dodd-frank/assetbackedsecurities.shtml>.

5. Whistleblower Program

Section 922 of the Dodd-Frank Act established a whistleblower program that requires the SEC to prescribe regulations to pay an award to eligible whistleblowers that voluntarily provide the Commission with original information about a violation of the federal securities laws that leads to the successful enforcement of a covered judicial or administrative action, or related action. In addition, the Act specifically prohibited retaliation by employers against whistleblowers in the event of discrimination following the issuance of a tip to the SEC.

On May 25, 2011, the SEC voted to approve the final rule for these Whistleblower Provisions, which, among other things, includes incentives for the whistleblower to go to compliance first to allow them to investigate the matter prior to going to the Commission.⁶ The implementation date is not yet known, but will become effective 60 days after they are submitted to Congress or published in the Federal Register.

6. Municipal Securities

Until the passage of the Dodd-Frank Act, the activities of municipal advisors were largely unregulated and municipal advisors were generally not required to register with the SEC or any other Federal, State or self-regulatory entity with respect to their municipal advisory activities.

Under Section 975, the Dodd-Frank Act imposes registration and other obligations, including fiduciary duties, upon **municipal advisors** (as that term is defined and subject to certain exemptions) who engage in certain activities with respect to "municipal entities," and became effective October 1, 2010.⁷

To comply, all municipal advisors must register with the SEC by completing Form MA (for Municipal Advisory firms) or Form MA-I (for natural person Municipal Advisors), which will be made publicly available. In addition, Dodd-Frank grants the Municipal Securities Rulemaking Board (MSRB) regulatory authority over municipal advisors, so municipal advisors will be required to comply with MSRB requirements as well.

What is Next

In the months ahead, expect to see new rules adopted related to reporting obligations on investment advisers related to the assessment of systemic risk, exemptions from registration for advisers to venture capital firms and to certain advisers to private funds, final definition of "family office" and reports by the SEC to Congress related to actions taken to address deficiencies identified by the SEC's Inspector General. CCLS will continue keeping you apprised as to these and other developments.

⁶ Available at: <http://sec.gov/rules/final/2011/34-64545.pdf>.

⁷ Available at: <http://www.sec.gov/spotlight/dodd-frank/municipalsecurities.shtml>.

Authors: Michelle L. Jacko, CEO and Nicole Miller, Compliance Analyst, Core Compliance & Legal Services (“CCLS”). CCLS works extensively with investment advisers, broker-dealers, investment companies, hedge funds, private equity firms and banks on regulatory compliance issues. For more information about this topic and other compliance consultation services, please contact us at (619) 278-0020, info@corecls.com or visit www.corecls.com.

This article is for information purposes and does not contain or convey legal or tax advice. The information herein should not be relied upon in regard to any particular facts or circumstances without first consulting with a lawyer and/or tax professional.